Supervisory Review of Qualitative Approaches, Overlays and Adjustments
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Supervisory Views from CCAR 2017

- Some good news
  - Using qualitative approaches and overlays is acceptable, provided they are done well
  - Certain firms are developing successful processes to develop qualitative approaches and independently review them
  - Also seeing some firms with sound processes for applying overlays/adjustments and reviewing those, too
  - Pleased to see different approaches applied

- But still some issues
  - Some firms are still not yet meeting supervisory expectations
  - Consistent application across the firm remains a challenge
  - In some cases, issues have persisted for several CCARs
Developing Qualitative Approaches

- Supervisors have identified issues with the development and application of qualitative approaches, including:
  - Poor quality and rigor
  - Inadequate transparency, support, documentation
  - Used to “arbitrage” around standards for models
  - Inappropriate application to new/different areas

- More recently, some firms have made strides
  - Internal standards for quality/rigor of qualitative approaches
  - Standards and controls for qualitative and quantitative approaches are similarly stringent
  - Justification offered for use of qualitative approach
  - First-line confirmation that approach is fit for purpose
  - First-line monitoring of output from qualitative approaches
  - Assumptions of approach very clearly outlined, justified
Reviewing Qualitative Approaches

- Supervisors have also observed some shortcomings with independent review of qualitative approaches, including:
  - Not subject to any review at all – or review much less rigorous
  - No consistent internal standards for independent review
  - Embedded quantitative elements not reviewed
  - Poor evaluation of assumptions used

- Some firms have improved review practices
  - Clear, consistent internal standards & use of review templates
  - Pairing of quantitative experts and business experts for full evaluation of the approach
  - Some firms include qualitative approaches within MRM
  - Others develop a separate second-line group
  - Heightened quality and consistency of second-line reviews
  - Second-line monitoring of qualitative approach output over time
Applying Overlays/Adjustments

- Overlays not always well developed or properly reviewed
  - Made “on the fly” or at last minute, with no independent review
  - Poor transparency for overlays/adjustments (esp. model-internal adjustments)
  - Broad overlay applied (across models or portfolios) as a “catch-all” buffer
  - Little support for overlays – how did they arrive at this number?
  - Overlays do not address underlying model issues/limitations
  - Automatic assumption that overlays are conservative
  - Some overlays dressed up as “in-model adjustments”
  - Excessive use of overlays across the firm or over time
Better practices for overlays observed recently

- Clear internal standards for application of all overlays
- Roles and responsibilities for overlays explicit
- Overlays/adjustments fully supported and documented
- Overlays targeted to specific areas to address specific issues with primary/underlying approaches
- Overlays subject to proper independent review, including quantitative & qualitative aspects
- More frequent or sizable overlays subject to higher-level sign-off
- Firm looks at full set of overlays applied, across models & portfolios