EBA European Banking Authority



# Guidelines on Stressed Value-At-Risk (Stressed VaR) and on the Incremental Default and Migration Risk Charge (IRC)

**16 May 2012**

The EBA published today two sets of Guidelines on Stressed Value-At-Risk (Stressed VaR) and on the Incremental Default and Migration Risk Charge (IRC) modelling approaches employed by credit institutions using the Internal Model Approach (IMA).

These Guidelines are seen as an important means of addressing weaknesses in the regulatory capital framework and in the risk management of financial institutions. Their objective is to contribute to a level playing field and to enhance convergence of supervisory practices across the EU.

National competent authorities are expected to implement the provisions set out in the Guidelines within six months after their publication. After that date, the competent authorities must ensure that institutions comply with the Guidelines effectively.

## Guidelines on Stressed Value-At-Risk (Stressed VaR)

These Guidelines include provisions on Stressed VaR modelling by credit institutions using the Internal Model Approach for the calculation of the required capital for market risk in the trading book.

The main provisions of the Guidelines relate to:
- The identification and the review of the stressed period;
- The Stressed VaR methodology;
- The Use test.

## Guidelines on the Incremental Default and Migration Risk Charge (IRC)

These Guidelines include provisions on the IRC modelling approaches employed by credit institutions using the Internal Model Approach ('IMA') for the calculation of the required capital for specific interest risk in the trading book. The incremental risk charge is intended to complement additional standards being applied to the value-at-risk (VaR) modelling framework in the trading book.

The main provisions of the Guidelines relate to:
- The scope of application; Individual modelling of all aspects of the IRC approach
- The interdependence between default and migration events;
- The profit and losses (P&L) valuation including how ratings changes impact on market prices and on the computation of P&L;
- The liquidity horizons;
- The validation and use test for IRC models.

## Notes for Editors

*1) According to the amendments of the Capital Requirements Directive by Directive 2010/76/EU (CRD IIV), entered into force on 31 December 2011, the EBA is tasked with monitoring the range of practices in the area of Stressed Value-at-Risk (Stressed VaR) and Incremental Default and Migration Risk Charge (IRC) in the trading book. The EBA shall draw up guidelines in order to ensure convergence of supervisory practices.*

*2) In accordance with Article 16(3) of the EBA Regulation, Guidelines set out the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how*

*Union law should be applied in a particular area. Competent authorities and financial market participants must make every effort to comply with the guidelines. Before the deadline indicated in the Guidelines, i.e 6 months from the date of publication, Competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance. The notifications shall be published on the EBA website.*

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