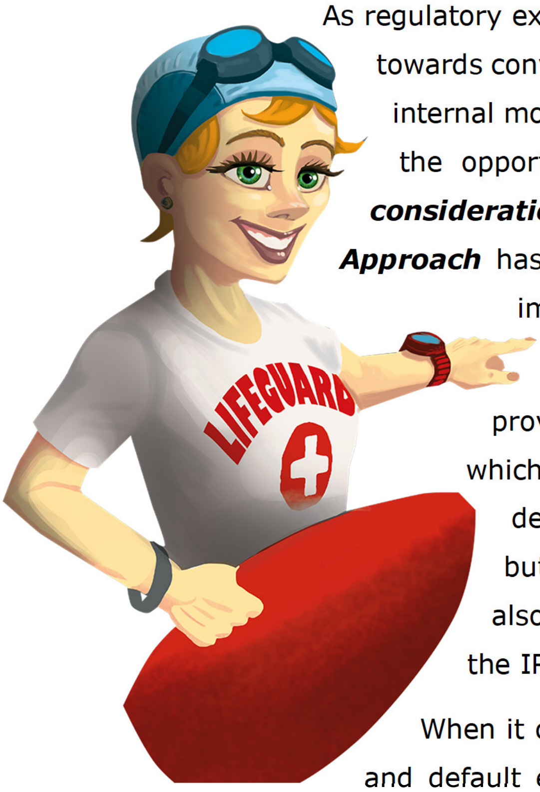
## Why not join a Pool Party?
## Modelling Low Default Portfolios

By the time the Basel II framework got implemented back in 2007, internal models started becoming increasingly more important to banks. Basel II requires banks to hold a certain amount of capital to compensate for unexpected credit losses, this amount can be calculated by using internal models. Being a source of competitive advantage in early years, internal models were shaken by the financial crisis and since then they have been a main focus for supervisory bodies across Europe. In the more recent past, ground-breaking changes to the internal model landscape in Europe have been triggered by inter alia, the TRIM exercise, EBA's "Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures" as well as the final Basel III reforms.




As regulatory expectations continuously increase, costs are set to rise and the trend towards convergence between banks seems to be unstoppable. The ECB guide to internal models (October 2019) is offering a way out of this dilemma, by taking the opportunity to use rating models developed from ***pooled data into consideration***. Relatively unknown throughout Europe, this so called ***Pool Approach*** has existed in Germany for over 15 years and has been performing impeccably for several of the largest German IRB banks.

If you take a look behind the scenes, the highly specialised service provider ***RSU Rating Service Unit*** is responsible for pooling all data which is contributed by participating institutions. RSU also manages model development and a part of model validation based on this cooperative but anonymised wholesale ***Data Pool***. IT operations and changes are also included – and most importantly – supporting its clients in defending the IRB models towards regulators.

When it comes to modelling low default portfolios, the lack of historical data and default experience strikes banks as the most troubling issue. This fact is especially true concerning wholesale portfolios such as large corporates, banks, project finance or commercial real estate. By joining a ***Pool Approach***, banks contribute their data to a continuously growing ***Data Pool,*** which reflects the basis for the corresponding IRB-models. The service provider, in this case ***RSU Rating Service Unit***, develops and runs several IRB-approved models based on this cooperative ***Data Pool***. As a result of data pooling, the dataset available for modelling low default portfolios is significantly larger than the individual datasets available to the institutions sharing this approach. This broad database of historical and even more important default data, provides the modelling teams at ***RSU Rating Service Unit*** with a solid base for differentiated models. A limited amount of data leads to a more general modelling approach, often fitting several asset classes into one model, whereas having access to an extensive amount of data allows for greater sophistication and more accurate modelling. Additionally, when it comes to defending models towards supervisors and auditors, improved statistical options are immensely supportive. Another very important aspect, which is quite obvious, is the fact that having access to a certain amount of good quality data can lead to high stability of internal models.

Joining a ***Pool Approach*** comes with a specific division of labor. ***RSU Rating Service Unit*** assumes responsibility for central modelling, extensive parts of model validation and all central IT tasks. The institutions take care of their part of the model validation as well as all internal processes and contribute wherever may be necessary and specified.

The ***Pool Approach clearly provides results of exceptional modelling quality***, accompanied by economies of scale leading to a cost efficient alternative to outsourcing modelling activities for sub-portfolios as well as for core businesses. Conclusively, risk control units at institutions are relieved from having to implement new time consuming regulatory standards as previously mentioned and are thus able to focus on their core business.

If you would like to join our Pool Party, please contact: infos@rsu-rating.de

*RSU Rating Service Unit GmbH is the leading provider of internal rating systems for wholesale banking in Germany. These systems are based on a unique and continuously growing data pool, which we use to develop and validate our rating models.*
*We also work on other solutions for measuring and assessing credit risk. As a full service provider we handle the IT implementation and operation of our systems for banks, insurance companies, and other financial institutions in both the public and private sector. Currently more than 7,000 users in Germany and abroad work with our systems.*
*RSU originated from a joint project of eight German Landesbanken and DekaBank and has been operating as a separate company since December 2003.*