

MEMO

**DANISH FINANCIAL
SUPERVISORY AUTHORITY**

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Banking Division 1
J.no. 521-0004

Internal Audit's role in connection to the implementation of significant changes in the IRB approach

According to article 191 in the CRR-regulation¹ internal audit "... or another comparable independent auditing unit shall review at least annually the institution's rating systems and its operations, including the operations of the credit function and the estimation of PDs, LGDs, ELs and conversion factors. Areas of review shall include adherence to all applicable requirements."

Furthermore, it follows from article 143 in the CRR that institutions shall obtain the prior permission of the competent authorities for material changes to a rating system and material changes to the range of application of a rating system. The conditions for these material changes are specified in a technical standard².

Article 8 in the technical standard specifies the requirements for documentation in relation to applications for material changes. It follows that applications must include "reports of the institutions' independent review or validation".

The Danish FSA would like to emphasize that the FSA generally expects that internal audit reviews material changes to a rating system. The review should consider all relevant requirements in the CRR-regulation. In addition, the FSA expects to receive a report on internal audit's review in relation to applications for material changes. Furthermore, the FSA expects that the institutions validate all material changes prior to implementation, cf. the memo "Validation of changes to the IRB Approach prior to implementation".

¹ REGULATION (EU) No 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

² COMMISSION DELEGATED REGULATION (EU) No 529/2014 of 12 March 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach.

The abovementioned is in accordance with the FSA's current practice as well as the practice of the other Nordic supervisory authorities.