# Clear and fair rules for the use of machine learning in Internal Rating Based models

Position paper – Executive summary

## February 2022

**The European Savings and Retail Banking Group (ESBG) welcomes the initiative of the European Banking Authority (EBA) to discuss the implications of the use of machine learning (ML) in the internal rating based (IRB) models for credit risk. We encourage the EBA to build a clear and fair supervisory scheme that goes further and allows compliance with the proposed principles to be measured, and that finds the balance between the advantages and the new risks that machine learning brings.**

## Extend the scope of machine learning

The possibility of using ML techniques in the IRB models' context represents a significant improvement in the predictive power of these ML models compared to traditional IRB models. This improvement implies a significant enhancement in the performance of the models which has a direct impact on the income statements, solvency and on the future performance of the financial entities. Hence, it is important that the financial sector can also make use of this technology and make the most of the many advantages it offers, not only for a IRB models use, but also any other area (e.g. process optimization, cash management, etc.).

## Strike balance between complexity and explicability

As the EBA report points out, as a counterpart to the significant improvement in the prediction of IRB models, the use of ML models in this context may also lead to a certain increase in the complexity of its interpretability and explicability. That is why it will be key to find a balance between these two extremes.

## Do not over-regulate

We welcome the initiative to develop principle-based recommendations for ML models in IRB context. However, we think it is important not to over-regulate weak artificial intelligence (AI) so it would prevent the private sector from developing their own AI applications, leaving the digital market to other countries.

## Maintain a level playing field

In order to guarantee a level-playing field in the market, the principle "same activity, same risk, same regulation" needs to be applied, ensuring fair competition since these methodologies entail a significant improvement in the performance of the models which has a direct impact on the income statements, solvency and on the future performance of the entities.

## Clear supervisory framework

The recommendations that will be developed should build a clear and fair supervisory framework, which includes some detail on compliance with the recommendations, to promote legal certainty for the financial entities using ML models in the IRB context.

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