MACHINE LEARNING IN CREDIT RISK: MEASURING THE DILEMMA BETWEEN PREDICTION AND SUPERVISORY COST

2020

Andrés Alonso and José Manuel Carbó
MACHINE LEARNING IN CREDIT RISK: MEASURING THE DILEMMA
BETWEEN PREDICTION AND SUPERVISORY COST
MACHINE LEARNING IN CREDIT RISK: MEASURING THE DILEMMA BETWEEN PREDICTION AND SUPERVISORY COST (*)

Andrés Alonso and José Manuel Carbó
BANCO DE ESPAÑA

(*) The authors appreciate the comments received from Ana Fernández, Sergio Gorjón, José Manuel Marqués, Carlos Conesa, Juan Ayuso, Carolina Toloba and Arancha Gutiérrez, as well as the information shared by the Department of Supervision IV from the Central Bank and the suggestions and feedback received from colleagues attending at two internal webinars done to present this work.

The opinions and analyses on this paper are responsibility exclusively of the authors and, therefore, do not necessarily coincide with those from Banco de España or the Eurosystem.
The Working Paper Series seeks to disseminate original research in economics and finance. All papers have been anonymously refereed. By publishing these papers, the Banco de España aims to contribute to economic analysis and, in particular, to knowledge of the Spanish economy and its international environment.

The opinions and analyses in the Working Paper Series are the responsibility of the authors and, therefore, do not necessarily coincide with those of the Banco de España or the Eurosystem.

The Banco de España disseminates its main reports and most of its publications via the Internet at the following website: http://www.bde.es.

Reproduction for educational and non-commercial purposes is permitted provided that the source is acknowledged.

© BANCO DE ESPAÑA, Madrid, 2020

ISSN: 1579-8666 (on line)
New reports show that the financial sector is increasingly adopting machine learning (ML) tools to manage credit risk. In this environment, supervisors face the challenge of allowing credit institutions to benefit from technological progress and financial innovation, while at the same ensuring compatibility with regulatory requirements and that technological neutrality is observed. We propose a new framework for supervisors to measure the costs and benefits of evaluating ML models, aiming to shed more light on this technology’s alignment with the regulation. We follow three steps. First, we identify the benefits by reviewing the literature. We observe that ML delivers predictive gains of up to 20% in default classification compared with traditional statistical models. Second, we use the process for validating internal ratings-based (IRB) systems for regulatory capital to detect ML’s limitations in credit risk management. We identify up to 13 factors that might constitute a supervisory cost. Finally, we propose a methodology for evaluating these costs. For illustrative purposes, we compute the benefits by estimating the predictive gains of six ML models using a public database on credit default. We then calculate a supervisory cost function through a scorecard in which we assign weights to each factor for each ML model, based on how the model is used by the financial institution and the supervisor’s risk tolerance. From a supervisory standpoint, having a structured methodology for assessing ML models could increase transparency and remove an obstacle to innovation in the financial industry.

**Keywords:** artificial intelligence, machine learning, credit risk, interpretability, bias, IRB models.

**JEL classification:** C53, D81, G17.
Resumen

Informes recientes muestran la creciente adopción en el sector financiero de técnicas de aprendizaje automático o machine learning (ML) en la gestión del riesgo de crédito. En este entorno, los supervisores se encuentran ante el reto de permitir que se maximicen las oportunidades derivadas del progreso tecnológico y la innovación financiera, a la vez que se respeta la neutralidad tecnológica y la compatibilidad con la regulación. Proponemos un marco para medir los beneficios y los costes de usar ML en riesgo de crédito, siguiendo tres pasos. Primero, identificamos los beneficios a través de una revisión de la literatura económica, donde se observa que el ML proporciona mejoras de hasta el 20% en la capacidad de discriminación de impagos con respecto a modelos estadísticos tradicionales. Segundo, utilizamos el proceso de validación de sistemas de rating (IRB) para capital regulatorio a fin de detectar las limitaciones del ML en riesgo de crédito. Identificamos hasta trece factores que pueden suponer un coste supervisor. Finalmente, proponemos una metodología para evaluar estos costes. A modo ilustrativo, cuantificamos las mejoras en predicción mediante la estimación de seis modelos de ML usando una base de datos pública. Posteriormente construimos una función de coste supervisor asignando valores a través de un scorecard que pondera, para cada modelo, cada factor en función de la tolerancia al riesgo del supervisor y el uso que se le dé por parte de la entidad financiera. De esta manera se podría aumentar la transparencia, eliminando una barrera a la innovación en la industria financiera.

Palabras clave: inteligencia artificial, aprendizaje automático, riesgo de crédito, interpretabilidad, sesgos, modelos IRB.

Códigos JEL: C53, D81, G17.
Index

1. Introduction.................................................................................................................................................. 8

2. The use of ML in the financial industry to measure credit risk.......................................................... 10

3. How to measure the benefits of using ML models.................................................................................. 11

4. How to measure the supervisory cost of evaluating ML models............................................................ 13
   4.1. Internal ratings-based (IRB) system.................................................................................................... 14
   4.2. Compatibility of ML with the IRB system validation process............................................................. 14

5. Measuring the dilemma prediction vs supervisory cost........................................................................... 21
   5.1. Computing the benefits...................................................................................................................... 21
   5.2. The supervisory cost function........................................................................................................... 22
   5.3. Quantifying the dilemma................................................................................................................... 24

6. Conclusion.................................................................................................................................................... 25

Annex............................................................................................................................................................. 27
1. Introduction

The mathematical foundations for the development of artificial intelligence (AI) have been present since the 1950s, but its mainstream application has only been feasible recently thanks to the advances in computing power and data storage capacity, also known as the Big Data era.\footnote{The Big Data era is characterised first by the data being generated and processed at unprecedented speeds; second by the volume of data, the amount of data stored is huge, as it is estimated that 90% of all stored data has been created in just the last 5 years (see Marr 2018); and third, by the diversity of data formats, both structured (e.g. numerical tables) and unstructured (e.g. texts, images, videos, audio).} It is only since the 1980s that machine learning (ML) tools have become popular as a sub-category of AI focused on using statistical techniques that allow computers to learn and improve in a task relying solely on experience. Athens and Imbens (2018) define ML as a discipline devoted to the creation of algorithms to make predictions based on other variables, or to classify variables based on a subset of limited input data. It is clear how ML prioritises the pursuit of predictive power. It could be argued that this contrasts with the emphasis on structural modelling and the search for causal relationships that is predominant in the use of more traditional econometric tools (see Breiman 2001).\footnote{However, ML is also starting to be used to study causal inference; see Athey (2018).}

ML tools used both for prediction and classification purposes have multiple applications in the financial industry. Recent surveys show that credit institutions are gradually adopting more ML techniques in different areas of credit risk management, such as regulatory capital, provisions, credit scoring and monitoring (see IIF 2019, Bank of England 2019). While ML models seem to outperform traditional quantitative models on predictive capabilities\footnote{For a complete review of the literature please see Section 3.} from the supervisors’ perspective, they also pose new challenges, such as higher algorithmic complexity, as an inherent consequence of being a solution for more complex problems (e.g. non-linear relationships). Yet it is not just the algorithmic complexity that matters to the supervisors, more factors are interlinked. These are not always statistical in nature or involve quantitative modelling, but they do affect the supervisors’ role of ensuring the comparability, reliability and robustness of the results. Some of them, cited in the supervisory and regulatory literature (see European Banking Authority 2017, European Banking Authority 2020 and Dupont et al 2020) are interpretability, biases or discrimination, prediction stability, governance or changes in the technological risk profile due to exposure to cyber-risk, and dependence on external providers of technological infrastructure. Therefore, supervised credit institutions need to balance the advantages and disadvantages of ML tools applied to real business problems. How can we strike a balance? The existence of all these factors points to a dilemma which might be preventing these tools from further penetrating the financial industry in the field of credit risk, as suggested by the Institute of International Finance (IIF) (2019a). Supervisors face the challenge of allowing financial institutions and clients to maximize the opportunities stemming from technological progress and financial innovation, while observing the principles of technological neutrality, regulatory compliance and consumer protection.

To help with this challenge, in this paper we suggest a framework that supervisors may use to evaluate the dilemma between the costs and benefits of using ML in credit risk management,\footnote{In this paper we consider advanced ML models to be those non-parametric models that most commonly appear in the respective academic literature, in particular: random forest, XGBoost, and deep neural networks.} facilitating an informed decision about the models’ adequacy, so that more transparency can be given to this process vis-à-vis credit institutions, aiming to remove...
obstacles to innovation. This framework will consist of, first, computing the benefits (i.e. predictive power) and, second, building a cost function, which will be subject to the idiosyncrasies of each ML technique, the supervisor’s risk tolerance and how the institution is using the model.

We will follow three steps to set up this framework. First, we will document the benefits of predictive power comparing the performance of ML to a more traditional logistic regression (Logit) as a benchmark, by systematically reviewing the academic literature. We observe that using more advanced ML models may offer gains in classification power of up to 20% compared to Logit. However, the analysis suggests that as the algorithmic complexity increases, the gains in predictive performance are non-monotonic and very uneven, depending on the dataset and model used in each study.

Second, we identify the costs for the supervisor in its task of assessing the adequacy of ML models used in credit risk management. To this end, we propose to capitalise on studying the compatibility of ML techniques with the validation process of internal ratings-based (IRB) models, as per the Basel general framework, for calculating the minimum regulatory capital requirements. Since the IRB approach requires that the risk factors estimated for regulatory capital purposes are aligned with any other internal use, we are able to suggest extending its use for evaluating ML models to more areas of credit risk management. Indeed, we find it an effective and transparent mechanism for explaining the concerns arising from the supervisors’ perspective. As it incorporates statistical requirements, technological aspects and market conduct issues, the IRB approach becomes a powerful tool, setting up an ideal environment to identify the key limitations of using ML in credit risk. In particular, we find 13 factors that may be included as inputs in the supervisory cost function.

Third, we propose a methodology to evaluate the dilemma between benefits gained and costs incurred by the supervisor when evaluating ML models. We will consider the most common ML models mentioned in the academic literature focusing on credit risk and default prediction. These include the lasso penalized logistic regression, decision tree, random forest, XGBoost and deep neural network. To account for the benefits, we will strictly measure at micro or institution level the gains in classification power, expressed in relative terms to a standard Logit model, while excluding from this study how to integrate potential spillovers at macroprudential level, for instance, into financial inclusion and/or discrimination. We estimate all six ML models using the same dataset on loan defaults, specifically one publicly available at Kaggle.com. The output of our cost function will consist of an index value that will serve to rank the supervisory costs of each ML model based on the weights given to 13 different factors identified previously alongside the IRB approach. This index will be a weighted average calculated using a scorecard that each supervisor will need to adjust based on its risk tolerance and how each credit institution may be using the ML model.

The paper is composed as follows: in Section 2 we document the use of ML in credit risk in the financial industry. In Section 3 we present the meta-analysis of the literature and we document the advantages observed in the use of ML. In Section 4 we review the IRB system under the Basel framework and we identify the potential limitations of using ML in credit risk management by using a traffic light system. In Section 5 we estimate each model’s costs and benefits, based on its idiosyncrasies, subject to the risk tolerance of the supervisor and the different uses of the ML model. Section 6 contains our conclusion.
2. The use of ML in the financial industry to measure credit risk

According to the IIF (2019a), the most common use of ML in the financial industry is in the field of credit scoring. In this regard, credit institutions seem to have shifted their preferred use from regulatory purposes, such as capital calculation, stress testing and even provisions, to business-related solutions such as decisions on granting new credit, monitoring outstanding loans and refinancing non-performing exposures, and early-warning systems. In fact, this survey reveals that 37% of the 60 international institutions consulted have fully operational ML models dedicated to automating credit scoring processes. It is interesting that one of the reasons mentioned by institutions to abandon the use of this technology for regulatory capital is that “regulatory requirements do not always align with the direct application of ML models, due to the fact that regulatory models have to be simple, while ML models might be more complex (although not impossible) to interpret and explain”. The scale of the challenge of aligning these techniques with the prudential regulation becomes clear with the reported reduction in the use of ML for calculating regulatory capital, which fell from 20% in 2018 to 10% in 2019. A recent study (see European Banking Authority, 2020) reports a similar figure, with close to 10% of European institutions currently using ML models for capital purposes. This last report points to the need to have more historical evidence available on the behaviour of these models in different economic environments, such as a recession, in order to check whether or not pro-cyclical effects exist. It shall be ensured that the default probabilities used to estimate ratings have a long time horizon, in addition to guaranteeing the consistency, transparency and comparability across different credit institutions’ estimations.

In any case, an increase is observed in the overall number of institutions with ML models in production or in pilot projects, including this type of technology in their innovation agenda and business strategy (see IIF 2019a). The rise in adoption is also evident across a broad range of geographies.

It is reported that those institutions that use this kind of model for several purposes usually achieve high-technology standards in general, while those making limited use of these models have a more uneven level of technological development at firm level. Although ML is used in the modelling of different underlying credit exposures, the truth is that the majority of institutions report using them for retail credit. Usually this might happen because this is the segment where better quality data are more abundant. In fact, the biggest growth in annual terms has been in the SME sector (see IIF 2019a).

It might be highlighted that the use of this technology in the financial industry is not restricted to banking institutions. Other types of institution, such as insurance companies or asset managers have started to implement this type of model, as reported in a joint survey by the UK financial authorities (Bank of England 2019a). Here again, most of the banking institutions who responded to this survey answered that they already use ML, mainly for lending (i.e. credit scoring and pricing). Similarly, at European level the use of ML and big data is gaining traction in the Fintech industry based on studies conducted by the European Banking Authority (EBA) (2017c and 2018) and Eccles et al (2020).

It definitely seems as though we are in an early adoption phase of AI/ML technology in the provision of financial services, and especially in credit risk management. However, at present the use of simpler models is predominant in the market because institutions

---

5 These results are in line with the survey conducted at European level by the EBA (2020).

6 See the Basel framework, Article 36.29 on the horizon of ratings.
prioritise the ease of interpretability and explainability of results over the potential gains on predictive power (see EBA 2020). Finally, the growth rates observed in the number of institutions studying their feasibility in the market show their clear interest in this innovation. Yet the question remains, how do we define the suitability of ML models in order to satisfy supervisors' needs?

3. How to measure the benefits of using ML models

The availability of high quality granular databases with long time series poses a challenge to the research on credit risk management, but it is necessary to conclude on the costs and benefits of using ML tools. Bearing this in mind, we have reviewed updated academic literature on credit default prediction comparing the predictive power of ML models with traditional quantitative ones. In particular, we chose papers that use as a benchmark a logistic regression or Logit. This will help us understand the performance of the ML models in predictive power terms as their algorithmic complexity increases.

In all the papers analysed the target variable to predict is the probability of default (PD) of loans (mortgages, retail exposures, corporate loans, or a mixture thereof). In order to assess robustly the results obtained from different models and samples, we have compared classification power using the Area Under the Curve – Receiver Operating Characteristic (AUC-ROC) metric, out-of-sample. The ROC curves show the relationship between the true positive rate (TPR) and the false positive rate (FPR) for all possible thresholds of classification. The area that stays below the ROC curve measures the predictive power of the classifier, as shown in Graph 1.

Graph 1. ROC Curve and AUC

\[
TPR = \frac{TP}{TP + FN} \\
FPR = \frac{FP}{FP + TN}
\]

7 In Butaru et al (2016) predictive power is measured with the Recall, which represents the percentage of defaulted loans correctly predicted as such. In the case of Cheng and Xiang (2017), predictive power is measured by means of the Kolmogorov-Smirnov statistic, a metric similar to AUC-ROC that measures the degree of separation between the distributions of positives (default) and negatives (non-default).

8 For an optimal selection of a credit scoring model that maximizes the expected profit of the credit institution in the new lending business, more emphasis should be placed on the vertical axis of the ROC curve, as the opportunity cost of a false positive (not granting a loan to a performing counterparty) will presumably have a smaller impact on the profit than the importance of getting a true positive right (not granting a loan to a non-performing counterparty). Therefore, different techniques could be used rather than just focusing on AUC-ROC. Nonetheless, in this paper we aim to compare models applied to different fields of credit risk management, not only credit scoring, therefore we decided to use AUC-ROC as the most complete metric.
The following Figure 1 presents in an orderly manner all the papers included in our literature review. On the horizontal axis we divide the papers based on the ML technique used and the a priori algorithmic complexity. On the vertical axis we measure the gain in predictive power relative to the discriminatory power obtained using a Logit model on the same sample. While as mentioned above the sample sizes and the nature of the underlying exposures and model designs differ between studies, they all highlight that the more advanced ML techniques (e.g. random forest and deep neural networks) predict better than traditional statistical models. The predictive gains are very heterogeneous, reaching up to 20% and not behaving monotonically as we advance towards more algorithmically complex models.

**Figure 1. The dilemma between prediction and algorithmic complexity**

- Dimensionality reduction (PCA) and regularization (LASSO, Ridge, etc)  
- Trees, Random Forest and XGBoost  
- Deep Neural Networks  
- Reinforcement Learning, Convolutional Neural Networks, and Ensemble Methods

**SOURCE:** Devised by the authors.

From a business perspective, the ability to better classify debtors might result directly in profit gains, as well as savings, but as importantly it will be a key component of a sound credit risk management strategy. At micro level, it will influence the institution’s risk appetite, aiming to maximise its market share. Yet there are also potential impacts at macro level, e.g. increasing financial inclusion of underserved population segments thanks to, for instance, the possibility of using ML models together with massive amounts of information, such as alternative data like the digital footprint of prospective clients, affording new individuals with little to no financial history the possibility of accessing new credit (Barlett 2015).

---

9 We rank the models by the perceived complexity of the algorithms involved in a standard configuration of each model. First, we distinguish between parametric and non-parametric models. Among the non-parametric models, we consider that deep learning models are more complex than tree-based ones, since the number of parameters to estimate is higher and their interpretability is more complex, requiring the use of additional techniques. Finally, we consider reinforcement learning and convolutional nets as the most complex models, since the former needs a complicated state/action/reward architecture, while the latter entails a time dimension and thus an extra layer of complexity with respect to deep neural networks. Metrics like the VC dimension (see Vapnik-Chervonenkis 1971) could be used to account for the capacity of the algorithms, when a particular architecture is taken into account. However, for comparison reasons we solely aimed to illustrate the changes in the “structural” algorithmic complexity, in terms of ability to adapt to non-linear, highly dimensional problems. Therefore, changes to this rank could be considered depending on the set of parameters and hyper-parameters considered in each model.
In Section 4.3 we review the current academic debate on ML and financial inclusion, linked to the discussion on biases. On the other hand, negative spillovers have also been reported in several studies if the credit scoring models are over-reliant on digital data which could discriminate against other individuals that lack or decide not to share this sort of personal data (Bazarbash 2019, Jagtiani and Lemieux 2019). Another example is the case of using ML for an optimal segmentation of clients based on behavioural data that could result in a person being categorised into a group for reasons other than their repayment capacity, such as their observed loyalty to the institution or their price elasticity to cross-selling strategies (European Supervisory Authorities 2016).

In our study we will focus on the benefits and costs at microprudential level, aiming to account only for the institution’s potential predictive gains and the supervisory costs, while leaving for further research how to integrate the net effect of potential financial stability spillovers on the computation of the benefits of using ML in credit risk management. Ultimately, from the literature review we conclude that there are potential significant predictive gains for institutions, leading us to further investigate, in the following section, the definition of the costs associated with the use of ML techniques from a supervisor’s perspective.

4. How to measure the supervisory cost of evaluating ML models

As mentioned above, the use of statistical models in financial services is very widespread (Fernández 2019), from regulatory capital to credit scoring, monitoring of outstanding loans and the calculation of optimal provisions for non-performing exposures. Also, from a prudential standpoint, there are different angles or areas involved in the microsupervision of predictive models used by credit institutions, mainly referring to the models’ statistical requirements, assessment of the technological risk profile and market conduct issues. While regulatory fragmentation in this regard adds value and allows for fully fledged coverage of the potential risks derived from using predictive models, it is also an obstacle to isolating the factors that determine whether or not a new quantitative tool is compatible with the regulatory and supervisory framework. There are papers in the literature that try to explain which factors matter to the supervisors when evaluating ML models or AI (see for instance Dupont et al 2020 for a comprehensive summary). However, we are yet to address the challenge of how to rank and weight each of these factors, assessing the overall impact for the supervisor, which at the moment suffers from being considered an obstacle to further innovation (IIF 2019b, Bank of England 2019, European Banking Authority 2020). In this paper we establish a methodology that will allow supervisors to understand how to weight each factor depending on the model used. In order to do this, we harness on the validation of IRB systems to identify and classify all the factors that might constitute a cost for the supervisors. Although the IRB approach is restricted to the calculation of minimum capital requirements, it has an impact beyond this use, as the risk factors estimated using IRB models must be aligned with those used internally for any other purpose.11

In Section 4.1 we explain what the IRB system is. In Section 4.2 we show how these rating systems are validated and the compatibility with the use of ML, identifying the factors (we

---

10 In Section 4.3. we review the current academic debate on ML and financial inclusion, linked to the discussion on biases.

11 Article CRE36.60 of the Basel general framework requires that models under the IRB approach be used in the management of the institution’s business, requiring alignment between IRB systems and the risk factors used internally in any other field, such as credit scoring, internal risk management or corporate governance.
discover 13) that could represent a cost for the supervisor. We then classify them into three different categories: statistics, technology and market conduct.

4.1. Internal ratings-based (IRB) system

Banking regulation requires credit institutions to keep a minimum balance of own funds to absorb unexpected losses. In order to determine this amount, institutions may use either a set of standardised formulas or statistical models to assess internally its risk profile (European Central Bank 2019b), also known as internal ratings-based (IRB) systems. These systems must satisfy a series of prudential requirements, which must be approved by the competent financial supervisor. The IRB system is not the only way that institutions can calculate the regulatory capital requirements, but it is indeed one of the most used approaches, in particular, in its basic form, where in general only PD is an input to be estimated by the institution (Trucharte et al 2015). To put the wide use of the IRB approach into context, we can check the survey conducted by the EBA (2017b) on IRB modelling practices. From the total of 102 responding institutions, there were 1,493 models reported for the purpose of estimating the PD in their internal systems. Nonetheless, it shall be noted that among the reported institutions, some mentioned using the quantitative models in a very wide range of fields, while others mentioned using the model for only one purpose. Similarly, some reported having only one model, while others submitted up to a hundred of them to the study.

Credit institutions have historically used statistical tools like multivariate analysis or logistic regressions, such as Logit or Probit, to perform the quantitative estimations under the IRB system (Bank for International Settlements 2001). Indeed, the notable success of these techniques in terms of efficiency and predictive performance has been documented (Banco de España 2016). However, as seen in Section 3, new ML techniques could offer benefits in terms of predictive gains with respect to Logit (even lasso penalized, as we will see later) at the cost of being more complex. This innovation might have a significant impact on the financial industry, even at macro level, as its market-level adoption would determine the calculation of risk-weighted assets (RWA) and their variability.12

4.2. Compatibility of ML with the IRB system validation process

Credit institutions are responsible for evaluating the performance of IRB systems. However, there are explicit requirements in the Basel framework, and its transposed regulation, about how this process should be undertaken (Bank for International Settlements 2005). In this regard, the supervisor’s tasks include ensuring that models are correctly validated. When using the foundation IRB approach, as a general rule institutions will only have to estimate PD, while the remaining risk components, such as loss given default (LGD), will be

---

12 This a major concern for the regulators and supervisors. Ensuring consistency at international level (see Arroyo et al 2012), was one of the objectives of the Targeted Review of Internal Models (TRIM) performed by the European Central Bank (ECB). In spite of the limitations observed, the conclusion reached is that these models play an important role in the efficient management of capital by institutions. The review of this approach, through the IRB roadmap, is expected to be concluded by 2020 (see European Banking Authority, 2019a).
All the remaining risk factors (i.e. LGD, maturity adjustments and credit conversion factors) are defined in the regulation, depending on the type of underlying credit exposure. This part of the validation is pre-determined by the regulation. Once the statistical model’s design has been approved, and the estimation is aligned with the supervisor’s requirements, the result will be entered into an economic model for computing regulatory capital. This part of the validation is primarily quantitative. In tandem, IRB systems also involve issues like data privacy and quality, internal reporting, governance and how to solve problems while operating normally. The importance of these issues will depend on the purpose of the model (e.g. credit scoring or pricing, apart from the main use, i.e. regulatory capital calculation). This part of the validation is mostly qualitative, and is more dependent on the supervisor’s expertise and skills.

In this section we study the compatibility of the use of ML models with the IRB validation scheme. This way we can identify the potential benefits and costs for the supervisor stemming from use of ML in credit risk. In Figure 2 we use a traffic light system to understand the degree of compatibility. Green denotes those aspects for which the use of ML is a good fit or even an improvement with respect to traditional statistical techniques.

Amber indicates the aspects where there is still uncertainty, and red marks the aspects for which there may be a limitation in the use of ML, and therefore the need for further adaptation. These assessments are explained below. We finish by listing the factors that we consider would make up the standard cost function for a supervisor evaluating ML models, discovering a total of 13 factors.

**Figure 2. Components of the validation of IRB systems and their compatibility with ML**

13 All the remaining risk factors (i.e. LGD, maturity adjustments and credit conversion factors) are defined in the regulation, depending on the type of underlying credit exposure.

14 See the annex for further details, Figure 3 in the Annex.
The benefits: first classify, then calibrate

From the IRB validation process we learn the two inputs that must be satisfied so that any statistical model passes the supervisory test from a model design perspective (left-hand side in Figure 2). First, it needs to classify debtors correctly as per their estimated credit risk; it will then be well-calibrated, i.e. represent realistically the observed default rate in each risk group. As we mentioned at the beginning of the paper, from the literature review we observed that the use of ML models can result in gains in discriminatory power of up to 20% in terms of AUC-ROC with respect to traditional statistical techniques, although these improvements are very heterogeneous across the different articles reviewed, and the improvements differ as the algorithmic complexity dimension changes (see Figure 1). In any case, it is a significant improvement, so it is awarded a green light in the traffic light assessment.

On the other hand, the calibration of a model in credit risk management is a more complex task than discrimination from a statistical point of view. This is because institutions’ credit portfolios do not usually have a large number of defaults, so the frequency of the prediction variable is usually low. This leads us to assess this input with an amber light in Figure 2. While some ML models can offer gains over traditional methods in terms of calibration and accuracy of probabilities of default, these gains will depend on the probability threshold chosen to determine the realisation of the event to be predicted (from what probability of default is a client deemed likely to fail?). The selection of one threshold or another results in the classic dilemma between false positives (Type 1 error) and false negatives (Type 2 error). A common solution is to select the optimal threshold that balances both error types, but this could introduce imprecise predictions (Butaru et al, 2016). Indeed, as we mentioned above, in credit scoring in particular more weight is usually given to true positives in order to maximise the expected benefit. Calibration could also have implications, for example, if we want to use these models in pricing policies, where accurately predicting the absolute value of the probability of default is necessary to correctly quantify the interest rate spread charged to clients.

The costs: a tale of statistics, technology and market conduct

Statistics

Next, we identify a series of factors that could affect the model’s estimation and are commonly associated with the use of ML, such as the presence of hyper-parameters (3), the need to process the input data (feature engineering) (5) or the complexity of performing backtesting when dynamic calibration is required, for instance, (4) in reinforced learning models, since it would not be feasible to “freeze” the model and evaluate its performance outside the sample, as proposed in Basel. Likewise, the concern about over-fitting (2) is always present in the use of ML as it offers high flexibility.

Regarding stability (1), we consider that the use of ML is still uncertain, thus the amber light. A pending task is to better evaluate the stability of these classifications (European Banking

---

15 See McKinsey (2019).
16 In the calculation of capital add-on for market risk, errors are counted on a daily basis, and depending on whether they amount to one threshold or another, they are counted as green, yellow, or red. This data is abundant and can be used to improve the models. Furthermore, in credit risk, the scarcity of defaults means that a time series usually contains only up to ten annual data points, such that the confidence in the credit risk estimates is significantly lower than in the market risk estimates. To correct this weakness, there is the possibility of counting the errors based on the rating migrations observed for the debtors, since there will be a higher frequency of observed data. In any case, if a bias is identified in the quantification of risk, it must always be adjusted, beyond the estimation’s own margin of error, by establishing a margin of conservatism.
Authority 2017a), avoiding the pro-cyclicality of the estimates and following the possible migrations observed between ratings, so that the robustness of the model throughout an economic cycle can be demonstrated.

Technology

One of the areas associated with algorithmic complexity is the technological requirements necessary for its implementation and maintenance in production while operating normally. A variable that can approximate this cost is the time that the ML model needs to be computed and its consequent environmental impact, i.e. carbon footprint (7) derived from its electricity consumption (see Alonso and Marqués 2019). Another factor that should be considered is the increasing dependence on services provided by third-party providers such as cloud computing or those related to fast data processing through the use of GPUs or TPUs (Financial Stability Board 2019)\(^\text{17}\) (8) and the potential change in exposure to cyber-risk (9). The integration of these services with legacy technology is one of the main challenges for institutions and is presented as one of the most important obstacles when putting ML models into production (see IIF 2019a). In fact, some institutions are exploring the use of cloud computing providers to avoid such challenges and make use of new data sources, which is in turn of particular relevance to financial authorities, due to its potential further impact on data privacy.\(^\text{18}\)

**Market conduct: be transparent, behave well, and explain yourself**

Likewise, data quality and in particular all privacy-related matters (10) are additional aspects to be taken into account by institutions when applying ML. According to the EBA (2020), one of ML’s main limitations concerns data quality. It is mentioned that institutions use their own structured data as the main source of information in predictive models, prioritising compliance with privacy regulations and the availability of highly reliable data. It follows that in the context of lending there is no widespread use of alternative data sources (e.g. information from social networks), while advanced data analytics are used to some extent. To consider all these issues, the system of governance and monitoring of ML models acquires particular relevance, including aspects such as transparency in the programming of algorithms (6), as well as the auditability (11) of models and their use by different users within the institutions, from the management team to the analysts (see McKinsey 2019).

Finally, there are two areas, interpretability (12) and control of biases (13) whose importance transcends statistical or technological evaluation, influencing legal and ethical considerations with repercussions for client and consumer protection. Therefore, from a supervisory point of view, these aspects belong mostly to the field of market conduct. Perhaps these two additional factors represent ML’s most important new developments with respect to traditional statistical models.

**Interpretability**

In accordance with Article 22 of the General Data Protection Regulation (GDPR), “the data subject shall have the right not to be subject to a decision based solely on automated

---

\(^{17}\) The graphics processing unit (GPU) has an advantage over the central processing unit (CPU) when training complex ML models because of its distinct architecture. While the CPU is made up of a small number of complex cores that work sequentially, the GPU is made up of many simple, small cores that are designed to work on multiple tasks simultaneously. The ability to perform multiple calculations in tandem makes the GPU a very efficient tool for using ML. Likewise, the Tensor Processing Unit (TPU) is an application-specific integrated circuit, AI accelerator, developed by Google specifically for machine learning.

\(^{18}\) See European Banking Authority (2017c).
processing, including profiling, which produces legal effects concerning him or her or similarly significantly affects him or her. Several observations arise from this legal provision. First, the intervention of a human being is necessary in every phase of the lending process.\(^{19}\)

This is in line with the validation of IRB systems, which indicates that these ratings cannot be based exclusively on a statistical model, and there must always be human judgement in the estimation of risk factors (see Bank for International Settlements 2005, European Banking Authority 2017). Additionally, as stated by the European Commission (2019), the results of an ML model need to be interpretable for all the people participating in the process, including clients, since the decision that entails the extension, rejection or refinancing of a loan can have a significant economic impact on people’s lives, which implies a series of ethical and moral assumptions whose fulfilment is desirable. For this reason, the European Commission’s Ethics Guidelines for Trustworthy AI (2019) cites the principle of explicability of algorithms as one of the critical elements: “[…] This means that processes need to be transparent, the capabilities and purpose of AI systems openly communicated, and decisions – to the extent possible – explainable to those directly and indirectly affected […]”.

In the field of credit risk management, this means that a financial institution should be able to communicate to clients in an understandable way those elements of their profiles that determine the decision to grant or refinance credit.\(^{20}\) Otherwise, consumers would not be able to properly challenge a decision on their loan application.\(^{21}\) Again, following the European Commission (2019): “[…] the degree to which explicability is needed is highly dependent on the context and the severity of the consequences if that output is erroneous or otherwise inaccurate […]”. Therefore, when speaking of interpretability we must think about the impact of the explicability of the results.\(^{22}\) This is a central issue in the field of credit compared to other uses for which AI and ML can be implemented when providing financial services. For instance, according to the European Commission (2019): “[…] little ethical concern may flow from inaccurate shopping recommendations generated by an AI system, in contrast to AI systems that evaluate whether an individual convicted of a criminal offence should be released on parole”.\(^{23}\) That explains the red light assessment in Figure 2. However, this remains a promising field for further work, also known as Interpretable ML, in which academics are making significant headway, especially with global and local

\(^{19}\) In European Commission (2019) various alternatives are cited, such as the so-called human-in-the-loop mechanism. Indeed, there have already been unsuccessful experiences of full automation in different sectors of the economy that highlight the importance of having expert judgement at some point in the decision-making process. Reese (2016) explains the case of the automated assistant “Tay” and its failure to interact via Twitter; (The Guardian 2018) highlights the example of Tesla and the delays derived from the full automation of the assembly chain. Another example was the closure by Adidas of its “speedfactories” in Germany and the USA in 2019, two completely robotic footwear manufacturing plants, which failed to improve the efficiency of the production chain, highly dependent on the location of the suppliers (CNN 2019).

\(^{20}\) The EBA (2017c) cites an example in which an online credit provider claims that it uses up to 20,000 explanatory variables per individual in its credit granting algorithm. This makes it more difficult for the institution to explain to customers the reasons why they are denied credit.

\(^{21}\) In 2019, Goldman Sachs was accused of gender discrimination in the automated establishment of limits on credit cards marketed by Apple, allegedly due to differences in the limit granted to each of the members of a marriage whose tax return is filed jointly.

\(^{22}\) In EBA (2020) explicability is defined as a general concept, which encompasses interpretability. In this regard, a model is explainable when it allows humans to understand how the result has been obtained or what factors have determined such result. In this sense, the model is explainable when the mechanisms that drive its results are intrinsically interpretable, or when there are additional techniques that facilitate such interpretation of the results.

\(^{23}\) See MIT (2019).
interpretable techniques such as Shapley Additive Values (for a richer insight into the developments of these techniques see Dickerson et al, 2020).

**Biases**

To understand the importance of bias control in the use of ML models, we can refer again to the European Commission (2019), which defines the principle of equality as: “a commitment to ensuring equal and just distribution of both benefits and costs, and ensuring that individuals and groups are free from unfair bias, discrimination and stigmatisation”.

There are several potential sources of biases (see IIF 2019c). One example is the sample bias, which occurs if ML algorithms are trained with historical data that bear or hide existing biases. In that case the impact of automating decisions based on that data could amplify those biases.\(^{24}\) Another possibility is bias by association. Under Article 22.4 of the GDPR: “Decisions […] shall not be based on special categories of personal data referred to in Article 9 […] as race or ethnicity, restricting its use to situations exceptional, such as express consent […].” Thus, the use of information on sensitive categories in classification algorithms shall be limited in order not to incur in possible discrimination. Furthermore, if we leave in our model other features that are correlated to these sensitive categories, it is possible that the ML model would continue to discriminate. For example, imagine a case in which postcodes are used to predict probabilities of default, and there are postcodes with a strong racial mark-up. Then it is possible that the combination of postcode together with other variables allows the algorithm to discriminate equally according to race, even if it does not appear as an explanatory variable. The third type of bias is algorithmic bias. This occurs when models rely more on certain variables when making a prediction or classification. For example, decision trees or random forests might be biased in favour of categorical variables with more values. McKinsey (2019) cites the case of an entity that developed a decision tree model for the prevention of money laundering, and found that the model favoured the variable “occupation” due to the large number of admissible categories, while it did not attach as much weight to variables with greater explanatory power such as “country”. Something similar happens in the credit field if the models attach greater weight to variables with long time series. This can put borrowers without a long credit history but with an equally adequate financial profile at a disadvantage (see Deng et al 2011 and Bazarbash 2019).

In sum, we have used the IRB system to list the factors that allow us to understand the benefits of using ML models, as well as the factors that define the supervisory cost function. In Table 1 we group these factors into three categories: (i) statistics, (ii) technology, and (iii) market conduct.

**It all depends on the purpose of the model**

Finally, we must reinforce the fact that the cost-benefit assessment will be depend on the model’s use. For instance, accuracy may be a very important input to pass the supervisory test on regulatory capital, yet classification power will be a priority for creating a credit scoring rule. Similarly, the control of biases will be less important in the computation of regulatory capital, but a very sensitive issue in credit scoring.

We also assign traffic lights depending on the perceived improvement that ML may entail as per the literature review in each of these uses. We group them in four possible categories: credit scoring, computation of prices for credit operations (pricing), calculation of provisions,

\(^{24}\) This bias occurs when the sample data does not represent the population well. This can be due to many reasons, such as historical inertia, prejudices in the people who collect the data, etc. For a summary of the causes of data bias in ML problems, see Mehrabi (2019).
and calculation of minimum capital requirements (regulatory capital). In this regard, one of the uses where ML models could have a greater impact is calculating the optimal level of provisions (see IIF 2019a), which includes setting up early-warning systems in refinancing operations. In this field, financial institutions enjoy greater flexibility when using statistical models than in other fields like regulatory capital, although they must still comply with the regulations and principles of prudence and fair presentation. In fact, provisions could be contemplated as an accounting concept governed by the International Accounting Standard Board (IASB). Specifically, IFRS 9.B5.5.42 requires “the estimate of expected credit losses from credit exposures to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes [...] this may not need to be a complex analysis”. Similarly, it is established that the information used to compute provisions can only be qualitative, although occasionally the use of statistical models or rating systems will be required to incorporate quantitative information (B5.5.18). Moreover, granting new credit or credit scoring is a field in which the use of ML could have a great impact, due to the availability of massive amounts of data that could enrich the value provided by more flexible and scalable models (see IIF 2019b). But precisely because of its importance, credit scoring is a field that is subject to special regulation, including a set of market conduct rules. This is also the case with the field of regulatory capital (see IIF 2019a), since it too could benefit from the use of big data and ML, but it is subject to strict regulation.

To this end, we disregard the potential use of ML techniques to build a master model by the supervisor to assist with the benchmarking task.

See Annex 9 from Circular 04/2017, November 27th, Banco de España.

The EBA (2019b) guidelines on loan origination and monitoring determines that when technological innovation is used to grant credit, institutions must, inter alia, (1) manage the risks derived from the use of this technology; (2) evaluate the potential bias that can be introduced into the decision-making process; (3) be able to explain the result ensuring their robustness, traceability, auditability and resilience; (4) document the correct use of the tool; and (5) ensure that the entire management team and analysts understand how it works. Based on the principle of proportionality, the national competent authorities will require documentation on the credit scoring models, and their level of understanding within the entity, both by managers and employees, as well as the technical capacity for their maintenance. Likewise, given the relevance of the use of this technology in the Fintech sector, the ECB (2018) incorporates the evaluation of structural aspects of the governance of the credit granting process, as well as the credit evaluation methodologies and the management of the data. In fact, the use of AI (including ML) for credit scoring is one of the practical cases recently discussed by the Single Supervisory Mechanism (SSM) with the Fintech industry in one of its latest dialogues (May 2019).

Table 1. Summary of factors that determine the benefits and supervisory cost functions, based on each possible use of the ML model

<table>
<thead>
<tr>
<th>Benefits Function</th>
<th>Supervisory Costs Function</th>
<th>Model Uses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discriminatory power</td>
<td>(1) Stability</td>
<td>Credit scoring</td>
</tr>
<tr>
<td>Accuracy</td>
<td>(2) Over-fitting</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(3) Hyper-parameters</td>
<td>Pricing</td>
</tr>
<tr>
<td></td>
<td>(4) Dynamic Calibration</td>
<td>Provisioning</td>
</tr>
<tr>
<td></td>
<td>(5) Feature Engineering</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(6) Transparency</td>
<td>Supervisory Model</td>
</tr>
<tr>
<td></td>
<td>(7) Carbon Footprint</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(8) Third-party providers</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(9) Cyber Risk</td>
<td></td>
</tr>
<tr>
<td>Technology</td>
<td>(10) Privacy</td>
<td></td>
</tr>
<tr>
<td>Conduct</td>
<td>(11) Auditability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(12) Interpretability</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(13) Biases</td>
<td></td>
</tr>
</tbody>
</table>

---

25 To this end, we disregard the potential use of ML techniques to build a master model by the supervisor to assist with the benchmarking task.

26 See Annex 9 from Circular 04/2017, November 27th, Banco de España.

27 The EBA (2019b) guidelines on loan origination and monitoring determines that when technological innovation is used to grant credit, institutions must, inter alia, (1) manage the risks derived from the use of this technology; (2) evaluate the potential bias that can be introduced into the decision-making process; (3) be able to explain the result ensuring their robustness, traceability, auditability and resilience; (4) document the correct use of the tool; and (5) ensure that the entire management team and analysts understand how it works. Based on the principle of proportionality, the national competent authorities will require documentation on the credit scoring models, and their level of understanding within the entity, both by managers and employees, as well as the technical capacity for their maintenance. Likewise, given the relevance of the use of this technology in the Fintech sector, the ECB (2018) incorporates the evaluation of structural aspects of the governance of the credit granting process, as well as the credit evaluation methodologies and the management of the data. In fact, the use of AI (including ML) for credit scoring is one of the practical cases recently discussed by the Single Supervisory Mechanism (SSM) with the Fintech industry in one of its latest dialogues (May 2019).
5. Measuring the dilemma prediction vs supervisory cost

5.1. Computing the benefits

We have previously discussed that the main benefit of using ML instead of a simpler logistic model in credit risk management is its better performance, especially, in terms of discrimination. Most of the articles compiled in the literature review in Section 3 report that ML models represent an improvement in terms of predictive performance with respect to Logit in terms of AUC-ROC. This improvement can vary from values of 0% to slightly higher than 20%. This range of results could be explained by the fact that each study uses different techniques and datasets. In order to compare more clearly between ML models, in this section we propose to check the discriminatory power of different ML models using the same database. Specifically, we use a database available for free at Kaggle.com, called “Give me some credit”. It contains data on 120,000 granted loans. For each loan there is a binary variable that indicates whether the loan has defaulted or not. In addition, 11 characteristics are known for each loan: the age of the borrowers, debt ratio, number of existing loans, monthly income, number of open credit lines, number of revolving credit accounts, number of real estate loans, number of dependents, and the number of times the borrower has been 30, 60, and 90 days past due. To capture non-linear relationships, we include the square of these characteristics as additional variables, until we have a total of 22 explanatory variables. We measure the discriminatory power through the AUC-ROC, and the models that we will use are the ones that appear most frequently in the academic literature on credit risk: penalised logistic regression via Lasso, decision tree, random forest, XGBoost, and deep neural network. We compare the results of these models in terms of AUC-ROC with those obtained with a logistic regression (Logit). The hyper-parameters of the models have been chosen with cross-validation, and we have performed 100 simulations with different training and test samples (split 80% and 20%, respectively).

The results can be found in Table 2, where we show the increase in AUC-ROC of each model with respect to the one achieved by a Logit. XGBoost is the model with the largest gain in terms of prediction, around 5%, followed by the random forest with 4% and deep neural networks with 1.7%. Decision trees and Lasso have 0.4% and 0.2% gains on average compared to Logit. This ranking based on AUC-ROC gains is in line with the results from the literature reviewed in Figure 1, where the models with the highest prediction gains are XGBoost and random forest, and deep neural networks do not necessarily predict

---

28 In Spain, for example, the data in the Central Credit Register (CCR) could be used as a benchmark. As indicated in its report, this would allow “the banking regulator to build its own credit risk models with which to compare and validate those presented by the institutions”.

29 The ML models have been estimated with Python and open access libraries such as Sklearn and Keras.

30 For a deeper insight into the functioning of these predictive models, please see World Bank (2019) “Credit Scoring Approaches Guidelines”.

31 We have trained a neural network with three hidden layers, of 300, 200 and 100 nodes. Results do not change significantly when changing the neural network’s architecture.

32 The average AUC-ROC for Logit is around 80%
better than other algorithms. Since our dataset lacks a time dimension, it has not been possible to calculate the benefit of using reinforcement learning algorithms or convolutional neural networks.\footnote{Unlike supervised algorithms, reinforcement learning algorithms receive an assessment for each given response, and learn based on the reward or punishment they receive for hit or miss, so the time dimension of loans would be an essential variable for reinforcement learning. Instead, we extrapolated in Section 5.3 the prediction gains for reinforcement learning as a function of the gains from Deep Learning (deep neural network).}

Although this particular ranking among ML models may change when using other databases, our exercise provides a quantification of the prediction gains that will assist us in our challenge to measure the shape of the dilemma between costs and benefits. We thus intend to facilitate the supervisor’s task of making an informed decision about how to balance both dimensions, while being transparent to supervised institutions in this exercise, so that they can incorporate this into their expectations, aiming to smooth the innovation process of introducing ML and AI technology into the financial sector.

### Table 2. Results of the estimated AUC-ROC using the Give Me Some Credit dataset.

<table>
<thead>
<tr>
<th></th>
<th>Logit (%)</th>
<th>Lasso (%)</th>
<th>Tree (%)</th>
<th>Random forest (%)</th>
<th>XGBoost (%)</th>
<th>Deep learning (%)</th>
<th>RL &amp; ensemble methods (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUC</td>
<td>80</td>
<td>80.2</td>
<td>80.4</td>
<td>84.2</td>
<td>85.3</td>
<td>81.7</td>
<td>81.7</td>
</tr>
<tr>
<td>AUC 95% interval</td>
<td>79.3</td>
<td>79.6</td>
<td>79.7</td>
<td>83.7</td>
<td>84.8</td>
<td>81.0</td>
<td>81.0</td>
</tr>
<tr>
<td>AUC (Difference with Logit)</td>
<td>—</td>
<td>0.2</td>
<td>0.4</td>
<td>4.2</td>
<td>5.3</td>
<td>1.7</td>
<td>1.7</td>
</tr>
</tbody>
</table>

#### 5.2. The supervisory cost function

In Section 4.2 we identified 13 factors that influence the compatibility of ML techniques with the validation of statistical models based on the IRB approach. In this section we are going to propose a methodology to measure the supervisory cost of each of the six aforementioned ML models, which will depend on these 13 factors, based on the supervisor’s risk tolerance and the ML model’s purpose. To quantify the supervisory cost, we propose performing a scorecard in two phases. First, for each of the 13 identified factors, we order the ML models according to their relative risk. In our case, by using six different models, we suggest establishing an ordinal numbering ranging from 1 to 6, where 6 is the highest level of risk perceived by the supervisor in the case of approving the model. This first phase will require a structural assessment of each ML technique,\footnote{It can be carried out by a professional analyst or technician with a quantitative profile, such as an ML engineer, data scientist, or advanced analytics expert.} regardless of the model’s use, in order to rank the models based on technical issues intrinsic to each model. In Table 3 we present a proposal for valuing the six ML models across all 13 factors.\footnote{As we mentioned above, we can order the 13 factors identified above through the IRB scheme into three "supervisory" blocks, such as (i) statistics, (ii) technology and (iii) market conduct.}

Once we have ranked the ML models for each factor, the second phase of the scorecard begins, where the supervisor weights the importance of each factor according to the use...
Table 3. Scorecard Phase 1: “The algorithmic black-box”

<table>
<thead>
<tr>
<th>Statistics</th>
<th>Lasso</th>
<th>Tree</th>
<th>Random Forest</th>
<th>XGBoost</th>
<th>Deep Learning</th>
<th>RL &amp; Ensemble Methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stability</td>
<td>1.0</td>
<td>3.0</td>
<td>2.0</td>
<td>2.0</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>(N^\text{th}) (Hyper) parameters</td>
<td>1.0</td>
<td>2.0</td>
<td>3.0</td>
<td>4.0</td>
<td>5.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Oven-fitting</td>
<td>1.0</td>
<td>3.0</td>
<td>2.0</td>
<td>3.0</td>
<td>5.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Feature engineering</td>
<td>1.0</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Dynamic calibration</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>1.0</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Technology</th>
<th>Lasso</th>
<th>Tree</th>
<th>Random Forest</th>
<th>XGBoost</th>
<th>Deep Learning</th>
<th>RL &amp; Ensemble Methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transparency</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Carbon Footprint</td>
<td>1.0</td>
<td>1.0</td>
<td>3.0</td>
<td>2.0</td>
<td>5.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Third-party providers dependencies</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>3.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Cyber-attacks</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Conduct</th>
<th>Lasso</th>
<th>Tree</th>
<th>Random Forest</th>
<th>XGBoost</th>
<th>Deep Learning</th>
<th>RL &amp; Ensemble Methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Privacy</td>
<td>1.0</td>
<td>1.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Auditability</td>
<td>1.0</td>
<td>1.0</td>
<td>3.0</td>
<td>4.0</td>
<td>5.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Interpretability</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
<td>2.0</td>
<td>3.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Biases</td>
<td>1.0</td>
<td>3.0</td>
<td>4.0</td>
<td>4.0</td>
<td>5.0</td>
<td>5.0</td>
</tr>
</tbody>
</table>

given to the model.\(^{36}\) The factors will be weighted by assigning weights between 0% and 100% to each factor depending on the scenario or use of the model to be assessed, as well as the supervisor’s own risk tolerance. The composition of both quantifications will thus allow us to obtain a global metric of the supervisory cost for each ML model, as shown in Table 4. We can define the supervisory cost of model \(i\) for use \(j\), as follows:

\[ C_{i,j} = \sum_{m=1}^{M} W_{m,j} X_m \]

Table 4. Scorecard Phase 2: The supervisor’s preferences

<table>
<thead>
<tr>
<th>Statistics</th>
<th>Weight of (model use)</th>
<th>Lasso</th>
<th>Tree</th>
<th>Random Forest</th>
<th>XGBoost</th>
<th>Deep Learning</th>
<th>RL &amp; Ensemble Methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stability</td>
<td>10.0%</td>
<td>1.0</td>
<td>3.0</td>
<td>2.0</td>
<td>2.0</td>
<td>4.0</td>
<td>4.0</td>
</tr>
<tr>
<td>(N^\text{th}) (Hyper) parameters</td>
<td>10.0%</td>
<td>1.0</td>
<td>2.0</td>
<td>3.0</td>
<td>4.0</td>
<td>5.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Oven-fitting</td>
<td>10.0%</td>
<td>1.0</td>
<td>3.0</td>
<td>2.0</td>
<td>3.0</td>
<td>5.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Feature engineering</td>
<td>10.0%</td>
<td>1.0</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Dynamic calibration</td>
<td>10.0%</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>1.0</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Technology</th>
<th>Weight of (model use)</th>
<th>Lasso</th>
<th>Tree</th>
<th>Random Forest</th>
<th>XGBoost</th>
<th>Deep Learning</th>
<th>RL &amp; Ensemble Methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transparency</td>
<td>5.0%</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Carbon Footprint</td>
<td>5.0%</td>
<td>1.0</td>
<td>1.0</td>
<td>3.0</td>
<td>2.0</td>
<td>5.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Third-party providers dependencies</td>
<td>10.0%</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>3.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Cyber-attacks</td>
<td>10.0%</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Conduct</th>
<th>Weight of (model use)</th>
<th>Lasso</th>
<th>Tree</th>
<th>Random Forest</th>
<th>XGBoost</th>
<th>Deep Learning</th>
<th>RL &amp; Ensemble Methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Privacy</td>
<td>0.0%</td>
<td>1.0</td>
<td>1.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Auditability</td>
<td>10.0%</td>
<td>1.0</td>
<td>1.0</td>
<td>3.0</td>
<td>4.0</td>
<td>5.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Interpretability</td>
<td>10.0%</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
<td>2.0</td>
<td>3.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Biases</td>
<td>0.0%</td>
<td>1.0</td>
<td>3.0</td>
<td>4.0</td>
<td>4.0</td>
<td>5.0</td>
<td>5.0</td>
</tr>
</tbody>
</table>

Supervisory cost of the model | 100% | 0.90 | 1.30 | 1.60 | 1.85 | 3.30 | 3.90 |

\(^{36}\) For example, biases will matter more if the purpose of the model is to grant credit, but less if the purpose is the computation of provisions.
The construction of the supervisory cost is a multidisciplinary task, which aims to quantify supervisors’ preferences in order to comply with the regulation. While expert knowledge of statistics and technology is required in the first phase to open the algorithmic black-box, an in-depth understanding of financial supervision will be key in the second phase to break down the supervisor’s preferences or needs. Our scorecard offers a methodology to build this supervisory cost function. It also allows the supervisor to provide the credit institutions with an assessment of the ML models in a standardised format. This way the dialogue with the industry can be enriched and transparency increased.

5.3. Quantifying the dilemma

In Section 5.1 we measured the gains in predictive power from using six ML models (see Table 2), and in Section 5.2 we created a supervisory cost function of using those ML models (see Table 4) that depends on 13 factors and is subject to the risk tolerance (weights included in Figure 4 in the Annex) and the purpose of the ML model. Now we can compare both costs and benefits, by plotting both estimations and aiming to show the shape of this trade-off depending on how the model is used.

Graph 2. Dilemma prediction vs cost, by model use.

In Graph 2 we compare the costs and benefits by displaying, for each of the four possible ML model uses, the supervisory cost (horizontal axis) and the benefit in terms of AUC with respect to Logit (vertical axis) of each of the six ML models: lasso, tree, random forest, XGBoost, deep learning, reinforcement learning and other methods.

In regulatory capital, we find XGBoost to be the most efficient model in terms of balance between costs and benefits at a lower level of relative supervisory cost compared to the

---

37 There have been previous attempts to identify the factors that influence the supervisory process of ML models, such as Dupont et al (2020). While they list the most relevant factors (such as stability, technological cost, calibration, etc.), they do not provide rules to understand them under the supervisory framework, or a way of quantifying them in terms the cost to evaluate the models.
other uses. Specifically, the perceived cost for the XGBoost model applied for regulatory capital has a score of 1.85, while for pricing the XGBoost’s score is 2.80, considerably extending the distance compared to Logit. This is because pricing is a scenario where greater flexibility is required, but more restrictions exist around interpretability and biases when setting the price of new loans. Similarly, for regulatory capital the distance between a deep neural network and XGBoost in terms of cost is greater due to the weight given to the statistical requirements that would favour simpler models which might be more stable. In general, distances observed in our exercise between the cost of the models and their benefits coincide with the level of implementation observed in the industry (see IIF 2019a). The uses of more advanced models such as deep neural networks are a better match for fields such as the credit scoring and pricing where there is a lower relative cost in statistical terms, despite restrictions in terms of market conduct. In this regard, the most advanced models would be perceived in these fields as more expensive, but given their higher performance in terms of predictive gains, they would be more attractive to financial institutions.

Overall, XGBoost would be the most efficient model in our dataset, regardless of how it is used by the credit institutions and based on the subjective risk tolerance used for illustrative purposes in this exercise. However, the absolute level of the cost differs across uses. Furthermore, the relative cost level across uses will differ sometimes, with the dilemma displaying different shapes as, in our case, for regulatory capital a neural network is 2.05 cost units away from the most efficient model while it is only 1.6 units away in the pricing scenario.

This shows the potential for this methodology to discern the important factors inside the “algorithmic black box”, and connect them in a realistic manner with the supervisor’s preferences in order to obtain a transparent result that is easier to communicate to the banking industry.

6. Conclusion

According to recent surveys, financial institutions are at very different stages of ML implementation in the field of credit risk management. These range from the calculation of regulatory capital to credit scoring or estimating provisions. In this environment, financial authorities face the challenge of allowing financial institutions and clients to maximize the opportunities derived from progress and innovation, while observing the principle of technological neutrality, regulatory compliance and consumer protection. To better address this challenge, in this paper we have presented a framework to measure the benefit and the supervisory cost of evaluating ML models in credit risk. This framework is based on estimating the benefit and building a cost function that will depend on the ML model, the intended use, and the supervisor’s risk tolerance.

The main benefit of using ML is the improvement in the risk discrimination, a conclusion drawn from a review of the academic literature, where we observed gains in discriminatory power of up to 20% in terms of AUC-ROC when compared to more traditional quantitative methods like Logit. Although this gain is heterogeneous, the literature to date suggests that the most complex models are not necessarily the ones that present the greatest improvement in prediction, which in many cases is also linked to the use of new massive sources of information that can be incorporated into these models. In any case, progress in terms of discriminatory power comes at a cost. The supervisor must make significant
efforts to evaluate these models and ensure the estimates’ consistency, transparency and comparability.

To understand the challenges that financial institutions and supervisors must face when implementing an ML model, we have to capitalise on the IRB system validation process. While using the IRB approach is limited to regulatory capital, it has an impact on the model’s other uses, and also incorporates statistical, technological and market conduct aspects related to the institutions. Consequently, IRB is an ideal environment to tackle our problem. We have listed 13 factors to consider in the evaluation of ML models, and their importance depends on how they are used (pricing, credit scoring, regulatory capital, provisions), and the supervisor’s risk tolerance. We illustrate the proposed methodology by performing an exercise using a real database and assigning values to the 13 cost factors. The results of this exercise point in the same direction as the literature. We find that the improvements in terms of discriminatory power do not necessarily increase as algorithm complexity increases. Moreover, the shape of the cost-benefit dilemma differs depending on the use of the model.

In short, the evolution of ML in the credit sector must take into account the supervisory internal model valuation process. It should also be in line with the explanatory needs of the results, something that the academic literature is promoting with important developments in the field of interpretable ML. In this regard, financial authorities, such as the Basel Committee, are working on understanding these dilemmas in order to establish a framework for the appropriate use of this technology in the provision of financial services.

For further research, the challenge remains to better measure the benefits of employing ML models using bigger datasets. A sensitivity analysis could be performed in order to discern whether predictive improvements are due to the availability of larger amounts of data or the architecture of the models (extending the results from Huang et al 2020). Also, how to integrate macroprudential considerations into this assessment could be the cornerstone of any policy decision in this connection.
In estimating the PD, the IRB approach requires its statistical performance to be assessed in two steps. First, the model will have to correctly identify the risk in terms of classification power, and second, the model ought to be correctly calibrated to properly quantify the risk. In order to classify debtors in different risk buckets using metrics such as the cumulative accuracy profile (CAP) or the ROC-AUC (see BIS 2005 and EBA 2017) is suggested. Once the debtors have been classified, the estimated probability of default of each rating class or bucket must be accurate and realistically represent the risk profile of the debtors included in each group. This process is called calibration. In order to assess how well it is calibrated we must check that the difference between the probability of default and the observed default rate is not much greater than zero.

In validating the estimates of the statistical models, the IRB approach has two main mechanisms: backtesting and benchmarking. From a time standpoint, the validation must pass backtesting that will count the models’ error rate when evaluated out-of-sample. This means that the model deployed into production will need to pass this test, which will be performed using statistical techniques to compare the estimates obtained with new realised observations. Similarly, to compare on a cross-sectional dimension, benchmarking or comparing the estimates with those obtained by other comparable institutions and/or the estimates from external data providers (e.g. credit rating agencies) in addition to the results from a potential master model prepared by the supervisor is suggested.

---

Risk buckets must be sufficiently heterogeneous across buckets, but each bucket must be uniform.

It is important to mention that in the case of credit risk supervision, backtesting is only performed on the model’s inputs (e.g. PD), because the “economic model” is given by the regulator’s formulae to compute risk-weighted assets (RWA). This contrasts with the backtesting carried out in market risk supervision, where the reliability of the model itself is tested (either the Value-at-Risk or Extreme VαR), by comparing the estimated losses in the investment portfolio versus the actual ones incurred by the institution in the market.
Figure 4 Weights used in estimating the shape of the dilemma prediction vs supervisory cost, depending on model use.

SOURCE: Devised by the authors.
References


European Banking Authority (2016). “RTS on the specification of the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use the IRB Approach in accordance with Articles 144(2), 173(3) and 180(3)(b) of Regulation (EU) No 575/2013”.


MIT (2019) “AI is sending people to jail—and getting it wrong”. MIT Technology Review.


<table>
<thead>
<tr>
<th>Year</th>
<th>Title</th>
<th>Authors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1930</td>
<td>Mapping China’s time-varying house price landscape.</td>
<td>MICHAEL FUNKE, DANILO LEIVA-LEON and ANDREW TSANG</td>
</tr>
<tr>
<td>1931</td>
<td>Beyond the LTV ratio: new macroprudential lessons from Spain.</td>
<td>JORGE E. GALÁN and MATÍAS LAMAS</td>
</tr>
<tr>
<td>1932</td>
<td>Staying dry on Spanish wine: the rejection of the 1905 Spanish-Italian trade agreement.</td>
<td>JACOPO TIMINI</td>
</tr>
<tr>
<td>1933</td>
<td>Domestic and foreign investment in advanced economies. The role of industry integration.</td>
<td>TERESA SASTRE and LAURA HERAS RECUEIRO</td>
</tr>
<tr>
<td>1934</td>
<td>Exchange rate shocks and inflation comovement in the euro area.</td>
<td>DANILO LEIVA-LEON, JAIME MARTÍNEZ-MARTÍN and EVA ORTEGA</td>
</tr>
<tr>
<td>1935</td>
<td>Child labor under cash and in-kind transfers: evidence from rural Mexico.</td>
<td>FEDERICO TAGLIATI</td>
</tr>
<tr>
<td>1936</td>
<td>External adjustment with a common currency: the case of the euro area.</td>
<td>ALBERTO FUERTES</td>
</tr>
<tr>
<td>1937</td>
<td>Economic growth, institutional quality and financial development in middle-income countries.</td>
<td>LAURA HERAS RECUEIRO and ROBERTO PASCUAL GONZÁLEZ</td>
</tr>
<tr>
<td>1938</td>
<td>International Bank Lending Channel of Monetary Policy.</td>
<td>SILVIA ALBRIZIO, SANGYUP CHOI, DAVIDE FURCERI and CHANSIK YOON</td>
</tr>
<tr>
<td>1939</td>
<td>Outsourcing and public expenditure: an aggregate perspective with regional data.</td>
<td>MAR DELGADO-TÉLLEZ, ENRIQUE MORAL-BENITO and JAVIER J. PÉREZ</td>
</tr>
<tr>
<td>1940</td>
<td>Heterogeneous spillovers of housing credit policy.</td>
<td>MYROSLAV PIDKUYKO</td>
</tr>
<tr>
<td>1941</td>
<td>Modelling regional housing prices in Spain.</td>
<td>LAURA ÁLVAREZ ROMÁN and MIGUEL GARCÍA-POSADA GÓMEZ</td>
</tr>
<tr>
<td>1942</td>
<td>The Global Financial Cycle and US monetary policy in an interconnected world.</td>
<td>STEPHANE DEES and ALESSANDRO GALESI</td>
</tr>
<tr>
<td>1943</td>
<td>Taxation and the life cycle of firms.</td>
<td>ANDRÉS EROSA and BEATRIZ GONZÁLEZ</td>
</tr>
<tr>
<td>1944</td>
<td>Dynamic effects of persistent shocks.</td>
<td>MARÍO ALLOZA, JESÚS GONZALO and CARLOS SANZ</td>
</tr>
<tr>
<td>1945</td>
<td>The gender gap in bank credit access.</td>
<td>PABLO DE ANDRÉS, RICARDO GIMENO and RUTH MATEOS DE CABO</td>
</tr>
<tr>
<td>1946</td>
<td>The SHERLOC: an EWS-based index of vulnerability for emerging economies.</td>
<td>IRMA ALONSO and LUIS MOLINA</td>
</tr>
<tr>
<td>1947</td>
<td>From Fixed-event to Fixed-horizon Density Forecasts: Obtaining Measures of Multi-horizon Uncertainty from Survey Density Forecasts.</td>
<td>GERGELY GANICS, BARBARA ROSSI and TATEVIK SEKHPOSYAN</td>
</tr>
<tr>
<td>1948</td>
<td>Bayesian VAR Forecasts, Survey Information and Structural Change in the Euro Area.</td>
<td>GERGELY GANICS and FLORENS ODENDAHL</td>
</tr>
<tr>
<td>2001</td>
<td>Debit sustainability and fiscal space in a heterogeneous Monetary Union: normal times vs the zero lower bound.</td>
<td>JAVIER ANDRÉS, PABLO BURRIEL and WENYI SHEN</td>
</tr>
<tr>
<td>2002</td>
<td>¿Cómo afecta la complejidad de la regulación a la demografía empresarial? Evidence para España.</td>
<td>JUAN S. MORA-SANGUINETTI and RICARDO PÉREZ-VALLS</td>
</tr>
<tr>
<td>2003</td>
<td>Measuring the procyclicality of impairment accounting regimes: a comparison between IFRS 9 and US GAAP.</td>
<td>ALEJANDRO BUESA, FRANCISCO JAVIER POBALACIÓN GARCÍA and JAVIER TARANCÓN</td>
</tr>
<tr>
<td>2004</td>
<td>From secular stagnation to robocalypse? Implications of demographic and technological changes.</td>
<td>HENRIQUE S. BASSO and JUAN F. JIMENO</td>
</tr>
<tr>
<td>2005</td>
<td>Dollar borrowing, firm-characteristics, and FX-hedged funding opportunities.</td>
<td>LEONARDO GAMBACCORTA, SERGIO MAYORDOMO and JOSÉ MARÍA SERENA</td>
</tr>
<tr>
<td>2006</td>
<td>Strategic interactions and price dynamics in the global oil market.</td>
<td>IRMA ALONSO ÁLVAREZ, VIRGINIA DI NINO and FABRIZIO VENDITTI</td>
</tr>
<tr>
<td>2007</td>
<td>The benefits are at the tail: uncovering the impact of macroprudential policy on growth-at-risk.</td>
<td>JORGE E. GALÁN</td>
</tr>
<tr>
<td>2008</td>
<td>Foreign direct investment and the equity home bias puzzle.</td>
<td>SVEN BLANK, MATHIAS HOFFMANN and MORITZ A. ROTH</td>
</tr>
<tr>
<td>2009</td>
<td>Trade agreements and Latin American trade (creation and diversion) and welfare.</td>
<td>AYMAR EL DAHRAWY SANCHEZ-ALBORNOZ and JACOPO TIMINI</td>
</tr>
<tr>
<td>2010</td>
<td>Eurozone prices: a tale of convergence and divergence.</td>
<td>ALFREDO GARCÍA-HIERNALUX, MARÍA T. GONZÁLEZ-PÉREZ and DAVID E. GUERRERO</td>
</tr>
<tr>
<td>2011</td>
<td>Sentiment analysis of the Spanish Financial Stability Report. (There is a Spanish version of this edition with the same number).</td>
<td>ANGEL MAN MOEYNO BERNAL and CARLOS GONZÁLEZ PEDRAZ</td>
</tr>
<tr>
<td>2012</td>
<td>External imbalances and recoveries.</td>
<td>MARIAM CAMAÑERO, MARÍA DOLORES GADEA-RIAS, ANA GÓMEZ-LOSCOS and CECILIO TAMARIT</td>
</tr>
</tbody>
</table>
2014 RODRIGO BARBONE GONZALEZ, DMITRY KHAMETSHIN, JOSÉ-LUIS PEYDRIÓ and ANDREA POLO: Hedger of last resort: evidence from Brazilian FX interventions, local credit, and global financial cycles.
2016 JAVIER ANDRÉS, ÓSCAR ARCE, JESÚS FERNÁNDEZ-VILLAVERDE and SAMUEL HURTADO: Deciphering the macroeconomic effects of internal devaluations in a monetary union.
2017 FERNANDO LÓPEZ-VICENTE, JACOPO TIMINI and NICOLA CORTINOVIS: Do trade agreements with labor provisions matter for emerging and developing economies’ exports?
2018 EDDIE GERBA and DANIEL LEIVA-LEON: Macro-financial interactions in a changing world.
2019 JAIME MARTÍNEZ-MARTÍN and ELENA RUSTICELLI: Keeping track of global trade in real time.
2020 VICTORIA IVASHINA, LUC LAEVEN and ENRIQUE MORAL-BENITO: Loan types and the bank lending channel.
2021 SERGIO MAYORDOMO, NICOLA PAVANINI and EMANUELE TARANTINO: The impact of alternative forms of bank consolidation on credit supply and financial stability.
2022 ALEX ARMAND, PEDRO CARNEIRO, FEDERICO TAGLIATI and YIMING XIA: Can subsidized employment tackle long-term unemployment? Experimental evidence from North Macedonia.
2023 JACOPO TIMINI and FRANCESCA VIANI: A highway across the Atlantic? Trade and welfare effects of the EU-Mercosur agreement.
2024 CORINNA GHIRELLI, JAVIER J. PÉREZ and ALBERTO URTASUN: Economic policy uncertainty in Latin America: measurement using Spanish newspapers and economic spillovers.
2025 MAR DELGADO-TÉLLEZ, ESTHER GORDO, IVÁN KATARYJNIK and JAVIER J. PÉREZ: The decline in public investment: “social dominance” or too-rigid fiscal rules?
2026 ELVIRA PRADES-ILLANES and PATROCINIO TELLO-CASAS: Spanish regions in Global Value Chains: How important? How different?
2027 PABLO ÁGUIAR, CORINNA GHIRELLI, MATÍAS PACCE and ALBERTO URTASUN: Can news help measure economic sentiment? An application in COVID-19 times.
2028 EDUARDO GUTIÉRREZ, ENRIQUE MORAL-BENITO, DANIEL OTO-PERALÍAS and ROBERTO RAMOS: The spatial distribution of population in Spain: an anomaly in European perspective.
2029 PABLO BURRIEL, CRISTINA CHECHERITA-WESTPHAL, PASCAL JACQUINOT, MATTHIAS SCHÖN and NIKOLAI STÄHLER: Economic consequences of high public debt: evidence from three large scale DSGE models.
2030 BEATRIZ GONZALEZ: Macroeconomics, Firm Dynamics and IPOs.
2031 BRINDUSA ANGHEL, NÚRIA RODRÍGUEZ-PLANAS and ANNA SANZ-DE-GALDEANO: Gender Equality and the Math Gender Gap.
2032 ANDRÉS ALONSO and JOSÉ MANUEL CARBÓ: Machine learning in credit risk: measuring the dilemma between prediction and supervisory cost.