



EBA/GL/2018/03

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Final Report

Guidelines on the revised common procedures and methodologies
for the supervisory review and evaluation process (SREP) and
supervisory stress testing

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Executive summary

The comprehensive common EU supervisory review and evaluation process (SREP) framework was established in 2014 and has been applied in practice since 2016. While the framework remains robust and serves the purpose of ensuring the convergence of supervisory practices, certain changes are deemed necessary to reinforce the framework in the light of recent developments in the EU and international fora. Furthermore, revisions to the framework are necessary in order to reflect the EBA's findings from its ongoing monitoring and assessment of the convergence of supervisory practices.

In accordance with the EBA Pillar 2 Roadmap¹, in which the EBA's multi-stage approach to the updating of the EU SREP framework in 2017-2018 and beyond has been outlined, the EBA has developed and published for consultation the first revisions to the SREP framework. The revisions to the SREP Guidelines reflect the ongoing policy initiatives related to Pillar 2/SREP, which include, among other things, the introduction of Pillar 2 capital guidance (P2G), the integration of supervisory stress testing requirements and supervisory assessment of banks' stress testing from the EBA Consultation Paper on Guidelines on stress testing and supervisory stress testing², clarification of certain aspects of scoring, further details on the articulation of total SREP capital requirements (TSCR) and overall capital requirements (OCR), and various consistency checks with relevant EBA standards and guidelines that came into force after the publication of the original SREP Guidelines in 2014.

These revised guidelines, which now also cover supervisory stress testing, aim to achieve the convergence of the practices followed by competent authorities in supervisory stress testing across the EU. They provide guidance with a view to ensuring the convergence of supervisory stress testing in the context of SREP performed by competent authorities in accordance with Article 100 of Directive 2013/36/EU. These revised guidelines are issued partly to update the Committee of European Banking Supervisors (CEBS) Guidelines on stress testing³, which will be repealed and replaced by these guidelines, and partly on the basis of Article 100(2) of Directive 2013/36/EU to cover supervisory stress testing. It should be noted that supervisory stress testing is established in Article 100 of Directive 2013/36/EU as an obligation on competent authorities independent and distinct from the official sector Union-wide stress test required since 2010 by Article 22 of Regulation (EU) No 1093/2010.

Next steps

The revised guidelines will be translated into the official EU languages and published on the EBA website. These revisions will amend, where relevant, and supplement the existing SREP Guidelines,

¹ <https://www.eba.europa.eu/documents/10180/1814098/EBA+Pillar+2+roadmap.pdf>

² Consultation Paper: Draft Guidelines on stress testing and supervisory stress testing ([EBA/CP/2015/28](#)).

³ CEBS Guidelines on stress testing (GL32).

published on 19 December 2014, once they enter into force. The guidelines will apply from 1 January 2019 and should therefore be applied in the 2019 cycle of SREP and joint decisions on institution-specific prudential requirements. The EBA has updated in parallel its Guidelines on interest rate risk in the banking book (IRRBB)⁴ in the context of the supervisory review process and the Guidelines on institutions' stress testing⁵.

⁴ Guidelines on the management of interest rate risk arising from non-trading book activities (EBA/GL/2018/02).

⁵ Guidelines on institutions' stress testing (EBA/GL/2018/04).

Background and rationale

1. As part of the EBA's continued efforts to maintain the SREP Guidelines, published on 19 December 2014 and in force since January 2016, update them in accordance with EU and international standards and promote best supervisory practices as well as address issues identified in its ongoing work on the assessment of supervisory convergence, revisions to the SREP framework are considered essential.
2. Since the publication and first application of the SREP Guidelines, there have been a significant number of external developments affecting the SREP framework, which need to be reflected in the revised guidelines. In particular, these relate to the use of supervisory stress testing in SREP and the wider introduction of P2G in the 2016 EU-wide stress test⁶, the revision by the Basel Committee on Banking Supervision (BCBS) of its IRRBB framework⁷, which needs to be implemented in the EU legislation, and the clarification of the European framework for the application of the maximum distributable amount (MDA)⁸.
3. Furthermore, during the EBA's ongoing work on the monitoring and assessment of supervisory convergence, a number of significant observations⁹ have been noted with respect to the practical application of supervisory practices, and specific areas have been identified that need to be better reflected and explained in the SREP framework and factored into the revised SREP Guidelines.
4. To this end, the revisions to the existing SREP Guidelines aim to refine or introduce guidance on the following: (1) P2G and supervisory stress testing, (2) the supervisory assessment of institutions' stress testing, (3) the alignment of the supervisory assessment of IRRBB with the revised EBA Guidelines on IRRBB, (4) the scoring framework, (5) the interaction between SREP elements, (6) the articulation of TSCR and OCR and the communication of supervisory capital expectations to institutions, and (7) consistency with recently published legislation on internal governance.
5. Since an institution may face risks that are not covered or not fully covered by the minimum own funds requirements in accordance with Regulation (EU) No 575/2013 or the capital buffers specified in Directive 2013/36/EU, through assessment of the adequacy of the institution's own funds, competent authorities should determine the quantity and composition of additional own funds required to cover such risks (Pillar 2 capital requirements). Such requirements should be set out in a legally binding way and

⁶ [EBA clarifies use of 2016 EU-wide stress test results in the SREP process.](#)

⁷ <http://www.bis.org/bcbs/publ/d368.htm>

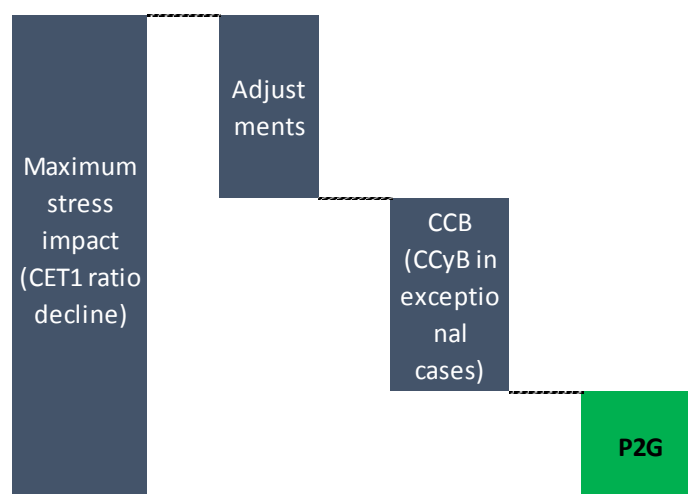
⁸ [Opinion of the European Banking Authority on the interaction of Pillar 1, Pillar 2 and combined buffer requirements and restrictions on distributions.](#)

⁹ [EBA report on the convergence of supervisory practices.](#)

institutions should be expected to meet them at all times. The guidelines establish minimum composition requirements for own funds requirements covering certain risk types, but competent authorities are not prohibited from applying stricter requirements to cover such risks if they believe them to be appropriate. However, they should not apply less strict requirements, as this would be perceived as non-compliant with Directive 2013/36/EU.

As part of the assessment of capital adequacy, competent authorities should also determine whether applicable own funds requirements can be met in stressed conditions. Where the quantitative outcomes of relevant stress tests suggest that an institution may not be able to meet the applicable own funds requirements in stressed conditions, or is excessively sensitive to the assumed scenarios, competent authorities should take appropriate supervisory measures to ensure that the institution is adequately capitalised. These include communicating expectations to institutions that they will have own funds over and above their overall capital requirements (OCR) and which are not subject to the restrictions on distributions provided for in Article 141 of Directive 2013/36/EU (Pillar 2 capital guidance – P2G). In particular, these guidelines outline how competent authorities should establish and set out P2G based on supervisory stress test results (see Figure 1 and Section 7.7). As P2G is positioned above the combined buffer requirement, a failure to meet P2G does not trigger the automatic restrictions on distributions provided for in Article 141 of Directive 2013/36/EU. In addition to the determination of TSCR and setting P2G, competent authorities should score the risk to the viability of the institution given the quantity and composition of own funds held.

Figure 1 – P2G calculations

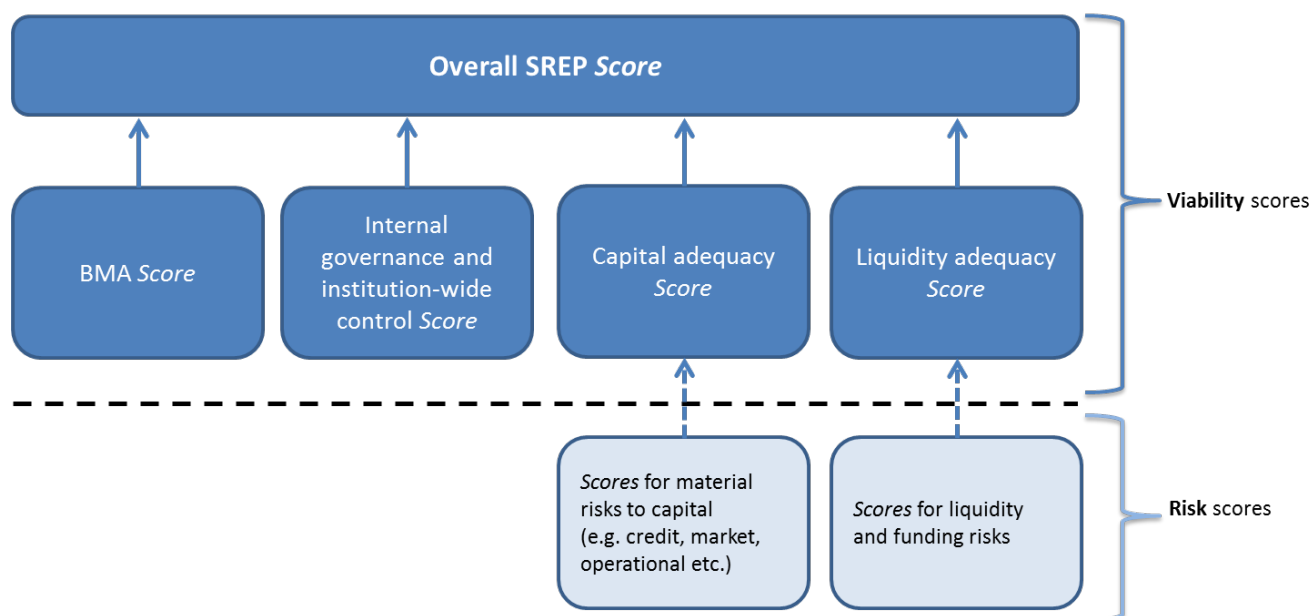


6. Furthermore, these revisions cover supervisory stress testing for SREP purposes in accordance with Article 100 of Directive 2013/36/EU and supervisory assessment of

institutions' own stress testing. Article 100(2) of Directive 2013/36/EU empowers the EBA to issue guidelines to ensure that common methodologies are used by competent authorities when conducting annual supervisory stress tests for SREP purposes.

7. The newly added supervisory stress testing section focuses on different forms of supervisory stress testing and objectives, their use for SREP purposes, aspects related to organisation, resources and communication, and possible methodologies. In particular, the supervisory stress testing section complements Section 7.7 by further clarifying and operationalising procedures for dealing with instances where the results of stress tests would suggest that an institution will not be able to meet its applicable capital requirements.
8. Article 107 of Directive 2013/36/EU also mandates the EBA to monitor and assess the convergence of supervisory practices, with particular emphasis on SREP practices and methodologies. Such convergence monitoring and assessment activities should also lead to the EBA keeping the SREP Guidelines updated; therefore, the EBA's findings from its convergence monitoring and assessment are also reflected in these revisions.
9. To help in facilitating communication among the competent authorities and colleges of supervisors, fostering comparability and a level playing field between institutions, as well as to prioritise supervisory resources and measures, further clarifications have been included with regard to the assessment of SREP elements. Competent authorities should assign a score between 1 (low risk) and 4 (high risk) to reflect the 'supervisory view' for each element-specific title of the guidelines. These revisions further clarify the two types of scores introduced in the initial version of the SREP Guidelines: (1) risk scores to be applied to individual risks to capital, liquidity and funding that indicate the likelihood that a risk will have a significant prudential impact on the institution (e.g. potential loss) and (2) viability scores to be applied to the four SREP elements and the overall SREP score that indicate the magnitude of the risk to the institution's viability stemming from the SREP element assessed.

Figure 2 – Overview of the scoring framework



10. Considering that since the publication of the SREP Guidelines in 2014 the EBA has issued two sets of guidelines explaining how SREP outcomes can be used for the purposes of early intervention and recovery and resolution (Guidelines on triggers for use of early intervention measures (EBA/GL2015/03¹⁰) and Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail (EBA/GL/2015/07¹¹)), as well as the progress made on enhancing the framework for the assessment of institutions' recovery plans in the EBA Supervisory Handbook, it was important to clarify the interaction between SREP and the supervisory processes covered in the abovementioned guidelines and the Supervisory Handbook.

Interaction between SREP and other supervisory processes, in particular the assessment of recovery plans

11. Competent authorities should reflect in SREP assessments available information and outcomes from all other supervisory activities, including on-site inspections, approvals of internal models, fit and proper and other authorisation approvals, the assessment of recovery plans, market conduct and consumer protection activities, anti-money laundering and countering terrorist financing activities, etc. Likewise, the findings from the assessments of SREP elements should inform other supervisory processes. Such integration of supervisory activities and use of findings from various activities to inform each other

¹⁰ EBA Guidelines on triggers for use of early intervention measures pursuant to Article 27(4) of Directive 2014/59/EU (EBA/GL/2015/03).

¹¹ Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU (EBA/GL/2015/07).

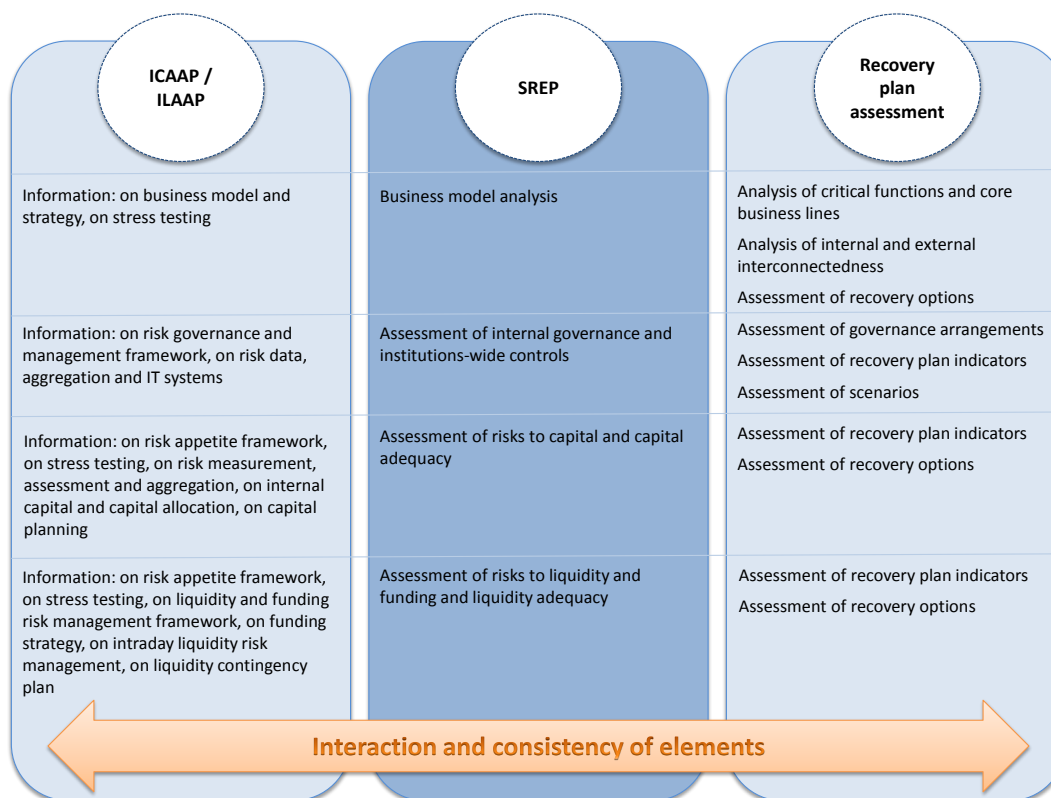
allows for truly integrated analysis and supervision of institutions, enhancing the overall supervisory view of institutions, their viability and their risks, as well as maximising synergies in various (sometimes overlapping) areas of the assessments.

12. An important example of such synergies and complementarity of analyses is the interaction between SREP and the assessment of recovery plans: the outcomes of the assessment of recovery plans feed into the SREP assessment of institutions' internal governance and institution-wide controls, and information from the recovery plans themselves support supervisors in their business model analyses and assessment of internal governance and controls as an additional source of information. Conversely, findings from the assessment of SREP elements, including the assessment of internal governance and institution-wide controls, the business model analysis, the capital and liquidity adequacy assessment, including the setting of additional capital and liquidity requirements, should feed into the assessment of recovery plans.
13. Such interaction between the SREP and recovery plan assessments also aligns with the principle that an institution's own recovery planning activities should be embedded in its risk management framework. Furthermore, competent authorities should expect from institutions that such integration be noticeable also in relation to internal capital adequacy assessment process (ICAAP)/internal liquidity adequacy assessment process (ILAAP) and various aspects of recovery planning, in particular governance arrangements, recovery plan indicators, the analysis of recovery options, and scenario testing used in recovery planning (see Figure 3 for more details).
14. With respect to stress testing, it should be noted that, although the ICAAP/ILAAP stress testing and scenario testing in recovery plans have different objectives, this does not preclude that some elements of the stress tests, especially the methodologies and models, may be the same. In particular, should institutions when identifying their 'severe but plausible' scenarios for ICAAP and ILAAP stress testing¹² already meet the requirements for the recovery planning scenario testing¹³, in particular in terms of severity and choice of scenarios, they can use such scenarios as one element of the scenario testing for recovery planning. On the supervisory assessment side, competent authorities should use the outcomes of assessments of institutions' stress testing programmes and capabilities under SREP to help in their assessment of scenario testing when assessing recovery plans.

¹² [EBA Guidelines on institutions' stress testing](#).

¹³ [EBA Guidelines on scenarios to be used in recovery plans \(EBA/GL/2014/06\)](#).

Figure 3 – Interaction between the elements of ICAAP/ILAAP, SREP and recovery plan assessment

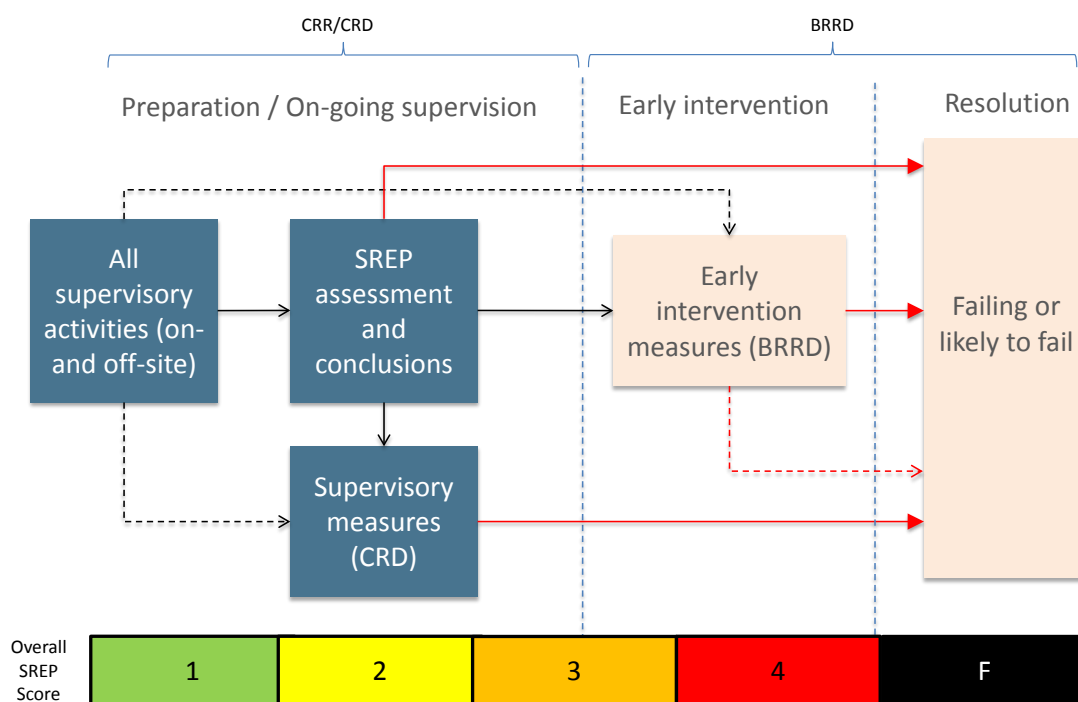


Link between SREP and early intervention and resolution

15. The assessment through SREP of the viability of an institution and its ability to meet the requirements of Regulation (EU) No 575/2013 and Directive 2013/36/EU allows for the use of the outcomes of the SREP assessment in setting triggers for early intervention measures, as set out in Article 27 of Directive 2014/59/EU. It also allows for the determination of whether an institution can be considered to be failing or likely to fail pursuant to Article 32 of Directive 2014/59/EU, which activates the formal interaction procedure with resolution authorities as set out in Article 32 of Directive 2014/59/EU, based on the outcomes of the SREP assessment, when such a determination is made by a competent authority. This link between SREP and the application of early intervention measures and the determination of whether an institution is failing or likely to fail is based on the viability focus of the overall SREP assessment and the assessment of individual SREP elements as expressed by viability scores, and on the assumption that the outcomes of all supervisory activities are taken into account in the SREP assessments, as explained above.
16. In particular (as illustrated by Figure 4), the outcomes of the SREP assessments may lead competent authorities to take supervisory measures or decide on the application of early intervention measures when the overall SREP score acts as a trigger for the decision on

whether to apply early intervention measures (an overall SREP score of ‘4’ or a combination of an overall SREP score of 3 and SREP elements scores of 4). In certain cases (explained in the EBA Guidelines on triggers for use of early intervention measures¹⁴), competent authorities may also decide on the application of early intervention measures based on the immediate findings from supervisory activities or significant events, without the need to update the SREP assessments. Furthermore, should a competent authority, as part of SREP, assess an institution as not viable (as expressed in an overall SREP score of ‘F’), competent authorities would consider that institution to be failing or likely to fail. The inability of an institution to comply with previous supervisory and/or early intervention measures may indicate that that particular measure has been exhausted, and this may form part of the competent authority’s grounds for considering the institution failing or likely to fail.

Figure 4 – Link between ongoing supervision, early intervention and a ‘failing or likely to fail’ determination



17. Consequently, these guidelines should be read together with the EBA Guidelines on triggers for use of early intervention measures and the EBA Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail¹⁵.

¹⁴ EBA Guidelines on triggers for use of early intervention measures ([EBA/GL/2015/03](#)).

¹⁵ EBA Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail ([EBA/GL/2015/07](#)).

Link between SREP and supervisory stress testing

18. Since the issue of the EBA Guidelines on institutions' stress testing, there have been a number of developments in stress testing with regard to its methodologies and use. The financial crisis and the several negative events in the financial sector since 2010 have provided significant lessons in relation to stress testing practices. Several important conclusions were drawn from the 2013 EBA peer review on the implementation of the stress testing guidelines, one of the aims of which was to compare the implementation of related provisions by competent authorities¹⁶. In particular, the results of the peer review suggested that competent authorities often focused on the largest institutions in their respective jurisdictions, and devoted far less attention to other institutions. Moreover, many of the competent authorities have shown evidence of substantial work on top-down stress testing, from both micro- and macroprudential perspectives.
19. These guidelines are designed to identify the relevant building blocks required for an effective supervisory stress testing programme, from simple sensitivity analysis on single risk factors or portfolios to complex macroeconomic scenario stress testing on an institution-wide basis.
20. The supervisory stress testing section focuses on different forms of supervisory stress testing and objectives, their use for SREP purposes, aspects related to organisation, resources and communication, and possible methodologies. In particular, the supervisory stress testing section complements Section 7.7 by further clarifying and operationalising procedures for dealing with instances where the results of stress tests would suggest that an institution will not be able to meet its applicable capital requirements.

¹⁶ [Report on the peer review of the EBA Stress Testing Guidelines \(GL 32\)](#).

EBA/GL/2018/03

Revised Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing, amending EBA/GL/2014/13 of 19 December 2014

1. Compliance and reporting obligations

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010¹⁷. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set out the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting requirements

3. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA that they comply or intend to comply with these guidelines, or otherwise give reasons for non-compliance, by ([01.04.2019]). In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to compliance@eba.europa.eu with the reference 'EBA/GL/2018/03'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to the EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3).

¹⁷ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

2. Subject matter and implementation

Subject matter

5. These guidelines amend the Guidelines on common procedures and methodologies for the supervisory review and evaluation process of 19 December 2014 (EBA/GL/2014/13, hereinafter referred to as ‘the Guidelines’).
6. Provisions of the Guidelines that are not amended by these guidelines remain in force and continue to apply.

Date of application

7. These guidelines apply from 01.01.2019

3. Amendments to the Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP)

- (1). The phrase 'and supervisory stress testing' is added to the title of the Guidelines.
- (2). At the end of paragraph 1 of the Guidelines, the following sentence is added:

'In addition, these guidelines aim to provide common methodologies to be used by competent authorities when conducting supervisory stress tests in the context of their SREP as referred to in Article 100(2) of Directive 2013/36/EU.'
- (3). The following sentence is added as paragraph 2 of the Guidelines:

'These guidelines do not set methodologies for the stress tests conducted by the EBA in cooperation with other competent authorities in accordance with Article 22 of Regulation (EU) No 1093/2010; however, they do describe the range of stress tests and help to set the appropriate context for the consideration of future EBA stress tests as one part of the suite of supervisory stress tests.'
- (4). Paragraph 3 of the Guidelines is amended as follows:
 - a. The following is inserted before the first phrase:

'Unless otherwise specified, terms used and defined in Regulation (EU) No 575/2013, Directive 2013/36/EU, Directive 2014/59/EU or the EBA Guidelines on institutions' stress testing have the same meaning in the guidelines.'
 - b. After the definition of 'capital buffer requirements', the following definition is inserted:

"Consolidating institution" means an institution that is required to abide by the prudential requirements on the basis of the consolidated situation in accordance with Part 1, Title 2, Chapter 2 of Regulation (EU) No 575/2013.'
 - c. The definition of 'information and communication (ICT) risk' is replaced with the following:

"Information and communication technology (ICT) risk" means risk of loss due to breach of confidentiality, failure of integrity of systems and data, inappropriateness or unavailability of systems and data, or inability to change IT within a reasonable time and costs when the environment or business requirements change (i.e. agility).'
 - d. After the definition of 'overall SREP score', the following two definitions are inserted:

- i. “Pillar 2 guidance (P2G)” means the level and quality of own funds the institution is expected to hold in excess of its OCR, determined in accordance with the criteria specified in these guidelines.’
 - ii. “Pillar 2 requirements (P2R)” or “additional own funds requirements” means the additional own funds requirements imposed in accordance with Article 104(1)(a) of Directive 2013/36/EU.’
 - e. After the definition of ‘risk appetite’, the following definition is inserted:

“Risk score” means the numerical expression summarising the supervisory assessment of an individual risk to capital, liquidity and funding representing the likelihood that a risk will have a significant prudential impact on the institution (e.g. potential loss) after considering risk management and controls and before consideration of the institution’s ability to mitigate the risk through available capital or liquidity resources.’
 - f. After the definition of ‘unhedged borrowers’, the following definition is inserted:

“Viability score” means the numerical expression summarising the supervisory assessment of an SREP element and representing an indication of the risk to the institution’s viability stemming from the SREP element assessed.’
- (5). In paragraph 9 of the Guidelines, the phrase ‘which are also summarised in Figure 1’ is deleted and Figure 1 is removed.
- (6). Paragraph 26 of the Guidelines is replaced with:

‘Competent authorities should assign risk and viability scores to summarise the outcomes of the assessment of various risk categories and elements in the SREP framework. The following paragraphs describe the general approach to scoring that is further detailed in the element-specific titles.’
- (7). The following paragraphs are inserted after paragraph 26 of the Guidelines:

‘26a. Competent authorities should assign risk scores to individual risks to capital in accordance with the criteria specified in Title 6, and scores to risks to liquidity and funding in accordance with the criteria specified in Title 8. These scores represent the likelihood that a risk will have a significant prudential impact on the institution (e.g. potential loss), before consideration of the institution’s ability to mitigate the risk through available capital or liquidity resources.

26b. Competent authorities should separately assign scores to summarise the level of risk posed to the viability of the institution based on the outcomes of the assessment of the four SREP elements:

 - i. business model and strategy, in accordance with the criteria specified in Title 4;
 - ii. internal governance and institution-wide controls, in accordance with the criteria specified in Title 5;
 - iii. capital adequacy, in accordance with the criteria specified in Title 7; and
 - iv. liquidity adequacy, in accordance with the criteria specified in Title 9.

26c. For capital adequacy and liquidity adequacy, these scores represent the supervisory view of the capacity of the institution's capital and liquidity resources to mitigate/cover individual risks to capital and liquidity and funding, as set out in Titles 6 and 8, and/or other elements for which additional own funds have been determined as set out in Title 7.

26d. Competent authorities should also assign an overall SREP score in accordance with the criteria specified in Title 10. This score should be assigned based on supervisory judgement and represents the supervisory view of the overall viability of the institution on the basis of the aggregate view of the threats to viability from the four SREP elements (business model and strategy, internal governance and institution-wide controls, capital adequacy, and liquidity adequacy), taking into account the outcomes of the assessment of individual risks to capital, liquidity and funding.'

(8). The first sentence of paragraph 28 of the Guidelines is replaced with:

'In the assessment of the individual SREP elements, competent authorities should use a range of scores – 1 (low risk), 2 (medium-low risk), 3 (medium-high risk) and 4 (high risk) – reflecting the supervisory view based on the relevant scoring tables in each element-specific title.'

(9). Paragraph 29 of the Guidelines is replaced with:

'In their implementation of the guidelines, competent authorities may introduce aggregation methodologies for aggregating individual risks to capital and liquidity and funding scores. Competent authorities may also introduce more granular scoring for their internal purposes, such as planning of resources, provided that the overall scoring framework set out in these guidelines is respected.'

(10). After paragraph 29 of the Guidelines, the following subtitle is added:

'2.2.1 Risk scores'.

(11). Paragraph 30 of the Guidelines is replaced with:

'Competent authorities should ensure that through the scoring of individual risks to capital, liquidity and funding they provide an indication of the potential prudential impact of a risk to the institution (e.g. potential loss) after considering the quality of risk controls to mitigate this impact (i.e. residual risk) but before considering capital or liquidity resources.'

(12). The following paragraphs are inserted after paragraph 30 of the Guidelines:

'36. Competent authorities should determine the risk score predominantly through an assessment of inherent risk, but they should also reflect considerations about risk management and controls. In particular, the adequacy of management and controls may increase or – in some cases – reduce the risk of significant prudential impact (i.e. considerations relating to inherent risk may under- or overestimate the level of risk

depending on the adequacy of management and controls). The assessment of inherent risk and the adequacy of management and controls should be made with reference to the considerations specified in Tables 4 to 7 and 9 and 10.'

'37. In implementing these guidelines, competent authorities may use different methods to decide on individual risk scores. Inherent risk levels and the quality of risk management and controls may be scored separately (resulting in an intermediate and a final score) or in aggregate.'

(13). Before paragraph 31 of the Guidelines, the following subtitle is added:

'2.2.2. Viability scores'.

(14). Paragraph 31 of the Guidelines is replaced with the following:

'Competent authorities should ensure that the scoring of the business model, internal governance and institution-wide controls, capital adequacy and liquidity adequacy achieves the following objectives:

- i. providing an indication of the risks to the institution's viability stemming from the SREP elements assessed, given their individual assessments as set out in Titles 4, 5, 7 and 9;
- ii. indicating the likelihood that supervisory measures may need to be taken to address concerns in accordance with the criteria specified in Title 10¹⁸;
- iii. acting as a trigger for the decision on whether to apply early intervention measures¹⁹ in accordance with the EBA Guidelines on triggers for use of early intervention measures; and
- iv. helping with the prioritisation and planning of supervisory resources and the setting of priorities in the supervisory examination programme (SEP).'

(15). After paragraph 31 of the Guidelines the following subtitle is added:

'2.2.3 Overall SREP scores'.

(16). Paragraph 32 of the Guidelines is replaced with the following:

'Competent authorities should ensure that the overall SREP score assigned on the basis of the aggregate view of the threats from the four SREP elements achieves the following objectives:

- i. providing an indication of the institution's overall viability;
- ii. and whether the institution is 'failing or likely to fail' within the meaning of Article 32 of Directive 2014/59/EU;
- iii. indicating the likelihood that supervisory measures may need to be taken to address concerns in accordance with the criteria specified in Title 10;

¹⁸ Irrespective of the score for capital adequacy, additional own funds requirements should be imposed as specified in Title 7 and Title 10.3.

¹⁹ EBA Guidelines on triggers for use of early intervention measures ([EBA/GL/2015/03](#)).

- iv. acting as a trigger for the decision on whether to apply early intervention measures in accordance with the EBA Guidelines on triggers for use of early intervention measures; and
- v. helping with the prioritisation and planning of supervisory resources and the setting of priorities in the SEP.'

(17). In paragraph 33 of the Guidelines, the word 'overall' is capitalised.

(18). In paragraph 37 of the Guidelines, 'senior management' is defined as 'as defined in paragraph 3(9) of Directive 2013/36/EU', and the word 'particularly' is replaced with 'particularly'.

(19). In paragraph 80 of the Guidelines, the word 'viability' is added before the word 'score'.

(20). Table 2 of the Guidelines is amended as follows:

- a. In the first row, the words 'no discernible' are replaced with 'low level of'.
- b. In the second row, the word 'medium-' is added before 'low'.
- c. In the third row, the word '-high' is added after 'medium'.

(21). Title 5 of the Guidelines is replaced with the following:

Title 5. Assessing internal governance and institution-wide controls

5.1 General considerations

88. Competent authorities should assess whether or not an institution's internal governance arrangements are adequate for and commensurate with the institution's risk profile, business model, nature, size and complexity. They should identify the extent to which the institution complies with the applicable EU requirements regarding sound internal governance arrangements. Competent authorities should evaluate in particular whether or not the internal governance arrangements ensure the sound management of risks and include appropriate internal controls. Competent authorities should establish if there are material risks posed by poor internal governance arrangements and their potential effect on the sustainability of the institution.
89. For SREP, the assessment of internal governance and institution-wide controls should include an assessment of the following areas:
- a. the overall internal governance framework;
 - b. the composition, organisation and functioning of the management body and, where established, its committees;
 - c. corporate and risk culture;
 - d. remuneration policies and practices;
 - e. the internal control framework, which should include a clear organisational structure and well-functioning independent internal risk management, compliance and audit functions;
 - f. the risk management framework, including ICAAP, ILAAP and new product approval processes;
 - g. administrative and accounting procedures;
 - h. outsourcing arrangements;
 - i. information systems and business continuity; and

j. the consistency and credibility of recovery planning.

90. The assessment of internal governance should inform the assessment of risk management and controls as specified in Titles 6 and 8, as well as the assessment of ICAAP and ILAAP in the SREP capital assessment (Title 7) and the SREP liquidity assessment (Title 9). Likewise, a risk-by-risk analysis of ICAAP calculations/capital estimates reviewed under Title 7, and any deficiencies identified thereby, should inform the assessment of the overall ICAAP framework assessed under this title.

5.2 Overall internal governance framework

91. In line with the EBA Guidelines on internal governance, the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders, and the EBA Guidelines on disclosure requirements²⁰, the assessment of the internal governance framework by competent authorities should include an assessment of whether the institution demonstrates at least that:
- a. the duties of the management body are clearly defined, distinguishing between the duties of the management (executive) function and of the supervisory (non-executive) function, and that appropriate governance arrangements have been implemented;
 - b. a robust and transparent organisational structure with clearly defined responsibilities, including those of the management body and its committees, has been set up;
 - c. the management body has set and ensured the implementation of a business and a risk strategy, including the setting of the institution's risk appetite, on an individual and a consolidated basis with the appropriate involvement of the management body in its supervisory function;
 - d. risk policies and their implementation, including communication and training, are appropriate;
 - e. a selection and suitability assessment process for key function holders has been implemented;
 - f. an adequate and effective internal governance and internal control framework has been implemented that includes a clear organisational structure and well-functioning independent internal risk management, compliance and audit

²⁰ EBA Guidelines on internal governance ([EBA/GL/2017/11](#)), Joint ESMA and [EBA Guidelines on the assessment of the suitability of members of the management body and key function holders \(EBA/GL/2017/12\)](#) and [EBA Guidelines on disclosure requirements under Part Eight of Regulation \(EU\) No 575/2013 \(EBA/GL/2016/11\)](#).

- functions that have sufficient authority, stature and resources to perform their functions;
- g. a remuneration policy and remuneration practices that are in line with the remuneration principles set out in Articles 92 to 95 of Directive 2013/36/EU and the EBA Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU²² have been implemented²²;
 - h. arrangements aimed at ensuring the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards, have been implemented;
 - i. an outsourcing policy and strategy that consider the impact of outsourcing on the institution's business and the risks it faces have been implemented²³;
 - j. the internal governance framework is set, overseen and regularly assessed by the management body; and
 - k. the internal governance framework is transparent to stakeholders, including shareholders.

5.3 Organisation and functioning of the management body

92. In accordance with Articles 74 and 91(12) of Directive 2013/36/EU and with the EBA Guidelines on internal governance and the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders, competent authorities should assess whether:
- a. arrangements aimed at ensuring that the individual and collective suitability of the management body and the individual suitability of key function holders are implemented and carried out effectively upon appointment, when material changes happen (e.g. those having an impact on the conditions assessed in the context of the initial fit and proper assessment) and on an ongoing basis, including notification to the relevant competent authorities²⁴;
 - b. the composition and succession planning of the management body are appropriate and the number of members of the body adequate;

²² EBA Guidelines on sound remuneration policies ([EBA/GL/2015/22](#)).

²³ [CEBS Guidelines on outsourcing](#), published 14.12.2006; the CEBS guidelines are due to be updated and replaced by EBA Guidelines on Outsourcing.

²⁴ See also the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders ([ESMA/2016/1529](#)).

- c. diversity has been taken into account when recruiting members of the management body;
- d. effective interaction exists between the management and the supervisory functions of the management body;
- e. the management body in its management function appropriately directs the business and in its supervisory function oversees and monitors management decision-making and actions;
- f. members act with independence of mind;
- g. there is sufficient time commitment by the members of the management body to perform their functions;
- h. the limitation on the number of directorships for significant institutions as set out in Article 91(3) of Directive 2013/36/EU is complied with;
- i. appropriate internal governance practices and procedures are in place for the management body and its committees, where established; and
- j. the management body, in its management function and in its supervisory function, and the risk committee, where established, have appropriate access to information on the risk situation of the institution.

5.4 Corporate and risk culture

- 93. Competent authorities should assess whether the institution has an appropriate and transparent corporate structure that is 'fit for purpose' and a sound corporate and risk culture that is comprehensive and proportionate to the nature, scale and complexity of the risks inherent within the business model and the institution's activities and consistent with the institution's risk appetite.
- 94. In line with the EBA Guidelines on internal governance, competent authorities should assess whether:
 - a. the management body knows and understands the legal, organisational and operational structure of the institution ('know your structure') and ensures that it is consistent with its approved business and risk strategies and risk appetite;
 - b. institutions have not set up opaque or unnecessarily complex structures that have no clear economic rationale or legal purpose, and when setting up structures the management body understands them, their purpose and the particular risks associated with them and ensures that the internal control functions are appropriately involved;

- c. institutions have developed an integrated and institution-wide risk culture, based on a full understanding and holistic view of the risks they face and how they are managed, taking into account the institution's risk appetite;
- d. the institution's ethical corporate and risk culture creates an environment of effective challenge in which decision-making processes promote a range of views (e.g. by including independent members in the management body committees);
- e. institutions have implemented independent whistleblowing processes and procedures;
- f. institutions appropriately manage conflicts of interest at an institutional level and have established a conflict of interest policy for staff to manage conflicts between the personal interests of the staff and the interest of the institution; and
- g. there is clear, strong and effective communication of strategies, corporate values, the code of conduct, risk and other policies to all relevant staff, and the risk culture is applied across all levels of the institution.

5.5 Remuneration policies and practices

95. Competent authorities should assess whether the institution has a remuneration policy and practices, as specified in Articles 92 to 95 of Directive 2013/36/EU, for staff whose professional activities have a material impact on the institution's risk profile and appropriate remuneration policies for all staff members. In line with the EBA Guidelines on internal governance and the EBA Guidelines on sound remuneration policies²⁵, competent authorities should assess whether:
- a. the remuneration policy is consistent with the institution's business and risk strategies, corporate culture and values, the long-term interests of the institution and the measures taken to avoid conflicts of interest, does not encourage excessive risk taking and is maintained, approved and overseen by the management body;
 - b. staff whose professional activities have a material impact on the institution's risk profile (identified staff) are appropriately identified and Regulation (EU) No 604/2014 is properly applied, in particular with regard to:
 - i. the application of the qualitative and quantitative criteria for the identification of staff; and

²⁵ EBA Guidelines on sound remuneration policies and disclosures ([EBA/GL/2015/22](#)).

- ii. the provisions on exclusion of staff who are identified only under the quantitative criteria specified in Article 4 of Regulation (EU) No 604/2014;
- c. the combination of variable and fixed remuneration is appropriate, the provisions on the limitation of the variable remuneration component to 100% of the fixed remuneration component (200% with shareholders' approval) are complied with and variable remuneration is not paid through vehicles or methods that facilitate non-compliance with Directive 2013/36/EU or Regulation (EU) No 575/2013; and
- d. variable remuneration for identified staff is based on performance, the requirements on deferral, retention, pay-out in instruments and the application of malus and clawback are respected and the institution does not use vehicles or practices to circumvent remuneration requirements.

5.6 Internal control framework

96. Competent authorities should assess whether the institution has an appropriate internal control framework. This assessment should include, at least, whether:
- a. the institution has adequate written internal control policies in place and has implemented an internal control framework within the business units and within independent control functions;
 - b. there is a clear decision-making process with a clear allocation of responsibilities for implementation of the internal control framework and its components;
 - c. there is an adequate segregation of duties with regard to conflicting activities;
 - d. all independent control functions are effective and have sufficient resources, authority and stature to fulfil their mission, as well as direct access to the management body, including in its supervisory function;
 - e. the internal control framework is implemented in all areas of the institution, with business and support units being responsible in the first instance for establishing and maintaining adequate internal controls and risk management procedures;
 - f. there is exchange of the necessary information in a manner that ensures that the management body, business lines and internal units, including each internal control function, are able to carry out their duties;
 - g. the institution has a new product approval policy (NPAP) and process, including a process for material changes, with a clearly specified role for the independent

- risk management and compliance functions, approved by the management body;
- h. the institution has the capacity to produce risk reports, uses them for management purposes and such risk reports are:
 - i. accurate, comprehensive, clear and useful; and
 - ii. produced and communicated to the relevant parties with the appropriate frequency; and
 - i. audit recommendations are subject to a formal follow-up procedure by the appropriate levels of management to ensure and report on their effective and timely resolution.

2.6.1 Internal audit function

97. In line with the EBA Guidelines on internal governance, competent authorities should assess whether the institution has established an effective independent internal audit function that:
- a. is set up in accordance with national and international professional standards;
 - b. has its purpose, authority and responsibility defined in a mandate that recognises professional standards and that is approved by the management body;
 - c. has adequate resources and stature to perform its tasks;
 - d. has its organisational independence and the internal auditors' objectivity protected, including by an appropriate segregation of duties, having an independent head with sufficient stature and direct access and reporting lines to the management body;
 - e. assesses the appropriateness of the institution's governance framework, including whether existing policies and procedures remain adequate and comply with legal and regulatory requirements, with decisions of the management body and with the risk appetite and strategy of the institution;
 - f. assesses whether procedures are correctly and effectively implemented (e.g. compliance with conduct requirements of transactions, compliance of the level of risk effectively incurred with the risk appetite and limits, etc.);
 - g. assesses the adequacy, quality and effectiveness of the controls performed and the reporting done by the business units and the internal risk management and compliance functions;

- h. adequately covers all areas in a risk-based audit plan, including ICAAP, ILAAP and NPAP; and
- i. determines if the institution adheres to internal policies and relevant EU and national implementing legislation and addresses any deviations from either.

5.7 Risk management framework

98. Competent authorities should assess whether the institution has established an appropriate risk management framework and risk management processes. Competent authorities should review, at least:
- a. whether the risk strategy, risk appetite and risk management framework are appropriate and implemented on an individual and a consolidated basis;
 - b. the ICAAP and ILAAP frameworks;
 - c. stress testing capabilities and results;
 - d. whether the institution has established an independent risk management function covering the whole institution, which is actively involved in drawing up the institution's risk strategy and all material risk management decisions, and which provides the management body and business units with all relevant risk-related information;
 - e. whether the institution has a head of the risk management function with sufficient expertise, independence and seniority, and, where necessary, direct access to the management body in its supervisory function;
 - f. whether the independent risk management function ensures that the institution's risk measurement, assessment and monitoring processes are appropriate; and
 - g. whether the institution has put in place policies and procedures to identify, measure, monitor, mitigate and report risk and associated risk concentrations and whether these are in line with the institution's risk limits and risk appetite or are approved by the management body.

2.7.1 Risk appetite framework and strategy

99. When assessing the risk management framework, competent authorities should consider the extent to which it is embedded in, and how it influences, the overall strategy of the institution. Competent authorities should, in particular, assess if there are appropriate and consistent links between the business strategy, the risk

strategy, risk appetite and risk management framework, and the capital and liquidity management frameworks.

100. When reviewing the risk strategy, risk appetite and risk management framework of an institution, competent authorities should assess whether:
 - a. the responsibility of the management body in respect of the risk strategy, risk appetite and risk management framework is exercised in practice by providing appropriate direction and oversight;
 - b. the risk strategy and risk appetite consider all material risks to which the institution is exposed and contain risk limits, tolerances and thresholds;
 - c. the risk strategy and risk appetite are consistent and implemented;
 - d. the risk appetite framework is forward-looking, in line with the strategic planning horizon set out in the business strategy and regularly reviewed;
 - e. the risk strategy and appetite appropriately consider the risk tolerance and financial resources of the institution (i.e. the risk appetite should be consistent with supervisory own funds and liquidity requirements and other supervisory measures and requirements); and
 - f. the risk strategy and risk appetite statement are documented in writing and there is evidence that they have been communicated to the staff of the institution.

2.7.2 ICAAP and ILAAP frameworks

101. Competent authorities should periodically review institutions' ICAAP and ILAAP based on the information collected from the institutions in accordance with the EBA Guidelines on ICAAP and ILAAP information collected for SREP purposes²⁶ and determine their (1) soundness, (2) effectiveness and (3) comprehensiveness according to the criteria specified in this section. Competent authorities should also assess how ICAAP and ILAAP are integrated into overall risk management and strategic management practices, including capital and liquidity planning.
102. These assessments should contribute to the determination of additional own funds requirements and the assessment of capital adequacy as outlined in Title 7, as well as to the evaluation of liquidity adequacy as outlined in Title 9.

²⁶ EBA Guidelines on ICAAP and ILAAP information collected for SREP purposes ([EBA/GL/2016/10](#)).

Soundness of the ICAAP and ILAAP

103. To evaluate the soundness of the ICAAP and ILAAP, competent authorities should consider whether the policies, processes, inputs and models constituting the ICAAP and ILAAP are proportionate to the nature, scale and complexity of the activities of the institution. To do so, competent authorities should assess the appropriateness of the ICAAP and ILAAP for assessing and maintaining an adequate level of internal capital and liquidity to cover risks to which the institution is or might be exposed and to make business decisions (e.g. in relation to allocating capital under the business plan), including under stressed conditions in line with the EBA Guidelines on institutions' stress testing²⁷.
104. In the assessment of the soundness of the ICAAP and ILAAP, competent authorities should consider, where relevant:
- a. whether methodologies and assumptions applied by institutions are appropriate and consistent across risks, are grounded in solid empirical input data, use robustly calibrated parameters and are applied equally for risk measurement and capital and liquidity management;
 - b. whether the confidence level is consistent with the risk appetite and whether the internal diversification assumptions reflect the business model and the risk strategies;
 - c. whether the definition and composition of available internal capital or liquidity resources considered by the institution for the ICAAP and ILAAP are consistent with the risks measured by the institution and are eligible for the calculation of own funds and liquidity buffers; and
 - d. whether the distribution/allocation of available internal capital and liquidity resources among business lines or legal entities properly reflects the risk to which each of them is or may be exposed, and properly takes into account any legal or operational constraints on the transferability of these resources.

Effectiveness of the ICAAP and ILAAP

105. When assessing the effectiveness of the ICAAP and ILAAP, competent authorities should examine their use in the decision-making and management processes at all levels in the institution (e.g. limit setting, performance measurement, etc.). Competent authorities should assess how the institution uses the ICAAP and ILAAP in its risk, capital and liquidity management (use test). The assessment should consider the interconnections and interrelated functioning of the ICAAP and ILAAP with the risk appetite framework, risk management, and liquidity and capital

²⁷ [EBA Guidelines on institutions' stress testing](#).

management, including forward-looking funding strategies, and whether they are appropriate for the business model and complexity of the institution.

106. To this end, competent authorities should assess whether the institution has policies, procedures and tools to facilitate:
 - a. clear identification of the functions and/or management committees responsible for the different elements of the ICAAP and ILAAP (e.g. modelling and quantification, internal auditing and validation, monitoring and reporting, issue escalation, etc.);
 - b. capital and liquidity planning: the calculation of capital and liquidity resources on a forward-looking basis (including in assumed stress scenarios) in connection with the overall strategy or significant transactions;
 - c. the allocation and monitoring of capital and liquidity resources among business lines and risk types (e.g. risk limits defined for business lines, entities or individual risks are consistent with the objective of ensuring the overall adequacy of the institution's internal capital and liquidity resources);
 - d. the regular and prompt reporting of capital and liquidity adequacy to senior management and to the management body (in particular, the frequency of reporting should be adequate with respect to risks and business-volume development, existing internal buffers and the internal decision-making process, to allow the institution's management to put in place remedial actions before capital or liquidity adequacy is jeopardised); and
 - e. senior management or management body awareness and action where the business strategy and/or significant individual transactions may be inconsistent with the ICAAP and available internal capital (e.g. senior-management approval of a significant transaction where the transaction is likely to have a material impact on available internal capital) or with the ILAAP and available internal liquidity resources.
107. Competent authorities should assess whether the management body demonstrates appropriate commitment to and knowledge of the ICAAP and ILAAP and their outcomes. In particular, they should assess whether the management body approves the ICAAP and ILAAP frameworks and outcomes and, where relevant, the outcomes of internal validation of the ICAAP and ILAAP.
108. Competent authorities should assess the extent to which the ICAAP and ILAAP are forward-looking in nature. Competent authorities should do this by assessing the consistency of the ICAAP and ILAAP with capital and liquidity plans and strategic plans.

Comprehensiveness of the ICAAP and ILAAP

109. Competent authorities should assess the ICAAP's and ILAAP's coverage of business lines, legal entities and risks to which the institution is or might be exposed, and the ICAAP's and ILAAP's compliance with legal requirements. In particular, they should assess:
- a. whether the ICAAP and ILAAP are implemented homogeneously and proportionately for all the relevant institution's business lines and legal entities with respect to risk identification and assessment;
 - b. whether the ICAAP and ILAAP cover all material risks regardless of whether the risk arises from entities not subject to consolidation (special-purpose vehicles (SPVs), special-purpose entities (SPEs)); and
 - c. where any entity has different internal governance arrangements or processes from the other entities of the group, whether these deviations are justified (e.g. the adoption of advanced models by only part of the group may be justified by a lack of sufficient data to estimate parameters for some business lines or legal entities, provided that these business lines or legal entities do not represent a source of risk concentration for the rest of the portfolio).

2.7.3 Assessment of institutions' stress testing

110. Competent authorities should review and assess institutions' stress testing programmes and their compliance with the requirements of the EBA Guidelines on institutions' stress testing in particular in relation to the assessment of stress testing programmes, governance arrangements, data infrastructure, use of stress testing in ICAAP and ILAAP, and management actions as referred to in Title 4 of those guidelines.
111. Competent authorities should perform a qualitative assessment of stress testing programmes, as well as a quantitative assessment of the results of stress tests. Competent authorities should consider the outcomes of qualitative and quantitative assessments together with the results of supervisory stress tests (see Title 12) for the purposes assessing an institution's capital and liquidity adequacy and determining the appropriate supervisory response to the deficiencies identified.
112. Furthermore, supervisory assessments of institutions' stress testing programmes, and the outcomes of various stress tests performed by an institution as part of its stress testing programme, could inform the assessment of various SREP elements and, in particular:

- a. The identification of possible vulnerabilities or weaknesses in risk management and controls on individual risk areas. These should be used as an additional source of information to be taken into account by the competent authorities when assessing individual risks to capital as referred to in Title 6 of these Guidelines, or risks to liquidity and funding as referred to in Title 8 of these Guidelines. For example, sensitivity analyses and scenario analyses performed by an institution can be used to assess the sensitivity and adequacy of the models used and the quantification of the individual risks.
- b. The identification of possible deficiencies in overall governance arrangements or institution-wide controls. These should be considered by competent authorities as an additional source of information for the purposes of the SREP assessment of internal governance and institution-wide controls. Furthermore the results of an institution's stress tests can be used in assessing the institution's capital planning, and in particular its time dimension.
- c. The quantification of specific quantitative liquidity requirements in the context of the assessment of liquidity adequacy, especially where a competent authority has not developed specific supervisory benchmarks for liquidity requirements, or does not apply liquidity supervisory stress testing.

Qualitative assessment of institutions' stress testing programmes

113. To facilitate the qualitative assessment, competent authorities should require institutions to submit information regarding the organisation of their stress testing programme in relation to all the aspects specified above. The information submitted by institutions should cover data architecture and IT infrastructure, governance arrangements, methodologies, scenarios, key assumptions, results and planned management actions.
114. Competent authorities should consider all relevant sources of information about stress testing programmes and methodologies, including institutions' own internal assessments and validation or reviews undertaken by independent control functions, as well as information and estimations provided by third parties, where available.
115. Competent authorities should also engage in dialogue with the management body and senior management of institutions in relation to major macroeconomic and financial market vulnerabilities, as well as institution-specific threats to institutions' ongoing business, to assess how institutions manage their stress testing programmes.
116. When assessing stress testing programmes, and the results of stress tests, competent authorities should pay specific attention to the appropriateness of the

selection of the relevant scenarios, and the underlying assumptions and methodologies, as well as of the use of stress test results in institutions' risk and strategic management. In particular, competent authorities should assess:

- a. the extent to which stress testing is embedded in an institution's risk management framework;
 - b. the involvement of senior management and of the management body in the stress testing programme;
 - c. the integration of stress testing and its outcomes into decision-making throughout the institution; and
 - d. the institution's ability and the infrastructure available, including with regard to data, to implement the stress testing programme in individual business lines and entities and across the group, where relevant.
117. When assessing stress testing programmes, the results of stress tests and proposed management actions, competent authorities should consider both idiosyncratic and system-wide perspectives. In particular, management actions should be primarily assessed from an internal perspective with regard to their plausibility, considering the specificities of an individual institution. Competent authorities should also consider management actions from a system-wide perspective, as other institutions are likely to consider similar actions, which in a system-wide context may be implausible.
118. When assessing management actions with an effect on an institution's capital or general financial position, competent authorities should consider the timelines for the implementation of the action. In particular, management actions should be completed and implemented during the time horizon of the stress test. Competent authorities may also consider, where relevant, management actions that will be completed later than the time horizon of the stress test.
119. Competent authorities should take into account the effectiveness of institutions' stress testing programmes in identifying relevant business vulnerabilities and take this into consideration when assessing institutions' business model viability and sustainability of their strategies (see Title 4).
120. When assessing stress testing programmes and their results in the case of cross-border groups, competent authorities should consider the transferability of capital and liquidity between the legal entities or business units during stressed conditions, as well as the functioning of any established intra-group financial support arrangements, taking into account the funding difficulties that might be expected in stressed conditions.

Quantitative assessment of institutions' stress tests done for ICAAP and ILAAP purposes

121. Competent authorities, in addition to carrying out the qualitative assessment specified above, should assess and challenge the choice and use of scenarios and assumptions, their severity and their relevance to the business model of the institution, as well as the results of such stress tests, in particular with regard to stress tests performed for ICAAP and ILAAP purposes (see also Section 5.7.2).
122. Competent authorities should ensure that in a stress scenario used for ICAAP purposes the capital ratio is negatively affected as a result of, for example, credit rating migrations, a reduction in net interest margins or trading losses. Competent authorities should have access to the details of the institution's main assumptions and risk drivers and should challenge these, also based on supervisory stress tests, as specified in Title 12 of these guidelines.
123. In their reviews of stress tests for ICAAP and ILAAP purposes, competent authorities should carry out a combined assessment of the impact of stress test outcomes on capital and liquidity needs, as well as on other relevant regulatory requirements. To that end, competent authorities should assess whether the institution is able to maintain the applicable TSCR at all times in an adverse scenario, and if it has identified a set of management actions to address any potential breaches of TSCR.
124. Competent authorities should duly challenge the scenarios, assumptions and methodologies used by an institution. When challenging scenarios, assumptions and the outcomes of institutions' stress tests done for ICAAP and ILAAP purposes, competent authorities should use, where appropriate, the outcomes, scenarios and assumptions from supervisory stress tests, including relevant regional stress test exercises done by various authorities, such as the EBA, the IMF and the ESCB/ESRB, as well the qualitative assessment as specified above, to determine the extent to which the institution's stress testing programme and its outcomes can be relied on.
125. If competent authorities identify deficiencies in the design of the scenarios or assumptions used by institutions, they may require institutions to re-run their stress tests, or some specific parts of the stress testing programme, using modified assumptions provided by the competent authorities, or specific prescribed scenarios (e.g. the anchor scenarios defined in the EBA Guidelines on institutions' stress testing).
126. Competent authorities should also consider the impact of stress tests on an institution's leverage ratio, as well as its eligible liabilities held for the purposes of minimum requirements for eligible liabilities (MREL) as referred to in Directive 2014/59/EU.

127. In the assessment of stress test results, competent authorities should also consider all known future regulatory changes affecting institutions within the scope and time horizon of the stress test exercise. Likewise, competent authorities should also consider all known changes in future capital requirements (e.g. fully loaded assessments) when assessing stress test results and business model viability.

2.7.4 New products and significant changes

128. Competent authorities should assess whether the institution has in place a well-documented NPAP, approved by the management body, that addresses the development of new markets, products and services, and significant changes to existing ones, as well as exceptional transactions.
129. Competent authorities should assess whether the internal risk management function and compliance function are appropriately involved in approving new products or significant changes to existing products, processes and systems.

5.8 Information systems and business continuity

130. In line with the EBA Guidelines on internal governance, competent authorities should assess whether the institution has effective and reliable information and communication systems and whether these systems fully support risk data aggregation capabilities at normal times as well as during times of stress. In particular, competent authorities should assess whether the institution is at least able to:
- a. generate accurate and reliable risk data for business units and the entire institution;
 - b. capture and aggregate all material risk data across the institution;
 - c. generate aggregate and up-to-date risk data in a timely manner; and
 - d. generate aggregate risk data to meet a broad range of on-demand requests from the management body or competent authorities.
131. Competent authorities should assess whether the institution has established effective business continuity management with tested contingency and business continuity plans, as well as disaster recovery plans, for all its critical functions and resources, and whether those plans can credibly recover these.

5.9 Recovery planning

132. To assess internal governance and institution-wide controls, competent authorities should consider any findings and deficiencies identified in the assessment of recovery plans and recovery planning arrangements conducted in accordance with Articles 6 and 8 of Directive 2014/59/EU.
133. Similarly, findings from the assessment of SREP elements, including internal governance and institution-wide control arrangements, should inform the assessment of recovery plans.

5.10 Application at the consolidated level and implications for group entities

134. At the consolidated level, in addition to the elements covered in the sections above, competent authorities should assess whether:
 - a. the management body of the consolidating institution understands both the organisation of the group and the roles of its different entities, and the links and relationships among them;
 - b. the organisational and legal structure of the group – where relevant – is clear and transparent, and suitable for the size and the complexity of the business and operations;
 - c. the institution has established an effective group-wide management information and reporting system applicable to all business units and legal entities, and this information is available to the management body of the institution's parent undertaking on a timely basis;
 - d. the management body of the consolidating institution has established consistent group-wide strategies, including a group-wide risk strategy and appetite framework;
 - e. group risk management covers all material risks regardless of whether the risk arises from entities not subject to consolidation (including SPVs, SPEs and property firms) and establishes a comprehensive view on all risks;
 - f. the institution carries out regular stress testing covering all material risks and entities in accordance with the EBA Guidelines on institutions' stress testing; and
 - g. the group-wide internal audit function is independent, has a group-wide risk-based auditing plan, is appropriately staffed and resourced, has appropriate

stature and has a direct reporting line to the management body of the consolidating institution.

135. When conducting the assessment of internal governance and institution-wide controls at subsidiary level, in addition to the elements listed in this title, competent authorities should assess whether group-wide policies and procedures are implemented consistently at subsidiary level and whether group entities have taken steps to ensure that their operations are compliant with all applicable laws and regulations.

5.11 Summary of findings and scoring

136. Following the above assessments, competent authorities should form a view on the adequacy of the institution's internal governance arrangements and institution-wide controls. This view should be reflected in a summary of findings, accompanied by a viability score based on the considerations specified in Table 3.

Table 3. Supervisory considerations for assigning a score for internal governance and institution-wide controls

| Score | Supervisory view | Considerations |
|-------|---|--|
| 1 | Deficiencies in internal governance and institution-wide control arrangements pose a low level of risk to the viability of the institution. | <ul style="list-style-type: none"> • The institution has a robust and transparent organisational structure with clear responsibilities and separation of risk taking from risk management and control functions. • There is a sound corporate culture, management of conflicts of interest and whistleblowing processes. • The composition and functioning of the management body are appropriate. • The time commitment of members of the management body is appropriate and, where relevant, they comply with the limitation on the number of directorships. • The institution has adopted a diversity policy that fosters a diverse board composition and complies with the targets set. |

| Score | Supervisory view | Considerations |
|-------|--|--|
| | | <ul style="list-style-type: none"> • The remuneration policy is in line with the institution’s risk strategy and long-term interests. • The risk management framework and risk management processes, including the ICAAP, ILAAP, NPAP, stress testing framework, capital planning and liquidity planning, are appropriate. • The internal control framework and internal controls are appropriate. • The internal risk management, compliance and audit functions are independent and have sufficient resources, and the internal audit function operates effectively in accordance with established international standards and requirements. • Information systems and business continuity arrangements are appropriate. • The recovery plan is credible and recovery planning arrangements are appropriate. |
| 2 | Deficiencies in internal governance and institution-wide control arrangements pose a medium-low level of risk to the viability of the institution. | <ul style="list-style-type: none"> • The institution has a largely robust and transparent organisational structure with clear responsibilities and separation of risk taking from risk management and control functions. • There is a largely sound corporate culture, management of conflicts of interest and whistleblowing processes. • The composition and functioning of the management body are largely appropriate. • The time commitment of members of the management body is largely appropriate, and, where relevant, they |

| Score | Supervisory view | Considerations |
|-------|--|--|
| | | <p>comply with the limitation on the number of directorships.</p> <ul style="list-style-type: none"> • The institution has adopted a diversity policy that fosters a diverse board composition, and largely complies with the targets set or has implemented appropriate measures to achieve the targets defined in the policy. • The remuneration policy is largely in line with the institution’s risk strategy and long-term interests. • The risk management framework and risk management processes, including the ICAAP, ILAAP, NPAP, stress testing framework, capital planning and liquidity planning, are largely appropriate. • The internal control framework and internal controls are largely appropriate. • The internal risk management, compliance and audit functions are independent and their operations are largely effective. • Information systems and business continuity arrangements are largely appropriate. • The recovery plan is largely credible. The recovery planning arrangements are largely appropriate. |
| 3 | <p>Deficiencies in internal governance and institution-wide control arrangements pose a medium-high level of risk to the viability of the institution.</p> | <ul style="list-style-type: none"> • The institution’s organisational structure and responsibilities are not fully transparent and risk taking is not fully separated from risk management and control functions. • There are doubts about the appropriateness of the corporate culture, management of conflicts of interest and/or whistleblowing processes. |

| Score | Supervisory view | Considerations |
|-------|------------------|---|
| | | <ul style="list-style-type: none"> • There are doubts about the appropriateness of the composition and functioning of the management body. • There are doubts about the appropriate time commitment of members of the management body and, where relevant, they do not comply with the limitation on the number of directorships. • The institution has not adopted a diversity policy or has not put measures in place to achieve an appropriate level of diversity. • There are concerns that the remuneration policy may conflict with the institution’s risk strategy and long-term interests. • There are doubts about the appropriateness of the risk management framework and risk management processes, including the ICAAP, ILAAP, NPAP, stress testing framework, capital planning and/or liquidity planning. • There are doubts about the appropriateness of the internal control framework and internal controls. • There are doubts about the independence and effective operation of the internal risk management, compliance and audit functions. • There are doubts about the appropriateness of information systems and business continuity arrangements. • The recovery plan was assessed as potentially having material deficiencies and/or having material impediments to its implementation, and supervisory concerns have not been fully addressed. There are doubts about the |

| Score | Supervisory view | Considerations |
|-------|---|---|
| | | <p>appropriateness of arrangements for recovery planning.</p> |
| 4 | <p>Deficiencies in internal governance and institution-wide control arrangements pose a high level of risk to the viability of the institution.</p> | <ul style="list-style-type: none"> • The institution’s organisational structure and responsibilities are not transparent and risk taking is not separated from risk management and control functions. • The corporate culture, management of conflicts of interest and/or whistleblowing processes are inappropriate. • The composition and functioning of the management body are inappropriate. • The time commitment of members of the management body is insufficient and, where relevant, they do not comply with the limitation on the number of directorships. • The institution has not adopted a diversity policy, the management body is not diverse and the institution has not put measures in place to aim for an appropriate level of diversity. • The remuneration policy conflicts with the institution’s risk strategy and long-term interests. • The risk management framework and the risk management processes, including the ICAAP, ILAAP, NPAP, stress testing framework, capital planning and/or liquidity planning, are inappropriate. • The internal risk management, compliance and/or audit functions are not independent and/or the internal audit function is not operating in accordance with established international standards and requirements; operations are not effective. |

| Score | Supervisory view | Considerations |
|-------|------------------|---|
| | | <ul style="list-style-type: none"> • The internal control framework and internal controls are inappropriate. • The information systems and business continuity arrangements are inappropriate. • The recovery plan was assessed as having material deficiencies and/or having material impediments to its implementation and supervisory concerns have not been fully addressed. The recovery planning arrangements are inappropriate. |

(22). Paragraph 129 is replaced with the following:

‘The outcome of the assessment of each material risk should be reflected in a summary of findings that provides an explanation of the main risk drivers, and a risk score, as specified in the following sections.’

(23). Paragraphs 130 and 131 are deleted.

(24). In paragraph 196, the word ‘risk’ is added before the words ‘score based’.

(25). Table 4 is replaced with the following:

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations for adequate management & controls |
|------------|---|--|--|
| 1 | There is a low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies non-material risk/very low risk. • Exposure to complex products and transactions is not material/very low. • The level of credit concentration risk is not material/very low. • The level of forborne and non-performing exposures is not material/very low. • The credit risk posed by performing exposures is not material/very low. • The level of coverage of provisions and of credit valuation adjustments is very high. | <ul style="list-style-type: none"> • There is consistency between the institution’s credit-risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for credit risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. • Credit-risk measurement, monitoring and reporting systems are appropriate. |

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations for adequate management & controls |
|------------|--|--|--|
| | | <ul style="list-style-type: none"> • The level of coverage and quality of guarantees and collateral are very high. | <ul style="list-style-type: none"> • Internal limits and the control framework for credit risk are sound. |
| 2 | <p>There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.</p> | <ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies low to medium risk. • Exposure to complex products and transactions is low to medium. • The level of credit concentration risk is low to medium. • The level of forborne and non-performing exposures is low to medium. • The credit risk posed by performing exposures is low to medium. • The level of coverage of provisions and of credit valuation adjustments is high. • The level of coverage and quality of guarantees and collateral are high. | <ul style="list-style-type: none"> • Limits allowing the credit risk to be mitigated or limited are in line with the institution's credit risk management strategy and risk appetite. |
| 3 | <p>There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.</p> | <ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies medium to high risk. • Exposure to complex products and transactions is medium to high. • The level of credit concentration risk is medium to high. • The level of forborne and non-performing exposures is medium to high. • The credit risk posed by performing exposures is medium to high and subject to further deterioration under stressed conditions. • The level of coverage of provisions and of credit valuation adjustments is medium. • The level of coverage and quality of guarantees and collateral are medium. | |

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations for adequate management & controls |
|------------|--|---|---|
| 4 | There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies high risk. • Exposure to complex products and transactions is high. • The level of credit concentration risk is high. • The level of forborne and non-performing exposures is high. • The credit risk posed by performing exposures is high. • The level of coverage of provisions and of credit valuation adjustments is low. • The level of coverage and quality of guarantees and collateral are low. | |

(26). In paragraph 231, the word ‘risk’ is added before the words ‘score based’.

(27). Table 5 is replaced with the following:

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|--|--|---|
| 1 | There is a low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • The nature and composition of market risk exposures imply not material/very low risk. • The institution’s exposures to market risk are non-complex. • The level of market risk concentration is not material/very low. • The institution’s market risk exposures generate non-volatile returns. | <ul style="list-style-type: none"> • There is consistency between the institution’s market risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for market risk is robust, with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. |
| 2 | There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • The nature and composition of market risk exposures imply low to medium risk. • The complexity of the institution’s market risk exposures is low to medium. • The level of market risk concentration is low to medium. | <ul style="list-style-type: none"> • Market risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the control framework for market risk are sound and |

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|---|---|--|
| | | <ul style="list-style-type: none"> The institution's market risk exposures generate returns that have a low to medium degree of volatility. | in line with the institution's risk management strategy and risk appetite. |
| 3 | There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> The nature and composition of market risk exposures imply medium to high risk. The complexity of the institution's market risk exposures is medium to high. The level of market risk concentration is medium to high. The institution's exposures to market risk generate returns that have a medium to high degree of volatility. | |
| 4 | There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> The nature and composition of market risk exposures imply high risk. The complexity of the institution's market risk exposures is high. The level of market risk concentration is high. The institution's exposures to market risk generate returns that have a high degree of volatility. | |

(28). In paragraph 287, the word 'risk' is added before the words 'score based'.

(29). Table 6 is replaced with the following:

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|---|---|---|
| 1 | There is a low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> The institution's operational risk exposures are limited to a few high-frequency/low-severity impact categories. The significance of the institution's exposure to operational risk is not material/very low, as shown by scenario analysis and compared with the losses of peers. | <ul style="list-style-type: none"> There is consistency between the institution's operational risk policy and strategy and its overall strategy and risk appetite. The organisational framework for operational risk is robust, with clear responsibilities and a clear separation of tasks |

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|--|--|--|
| | | <ul style="list-style-type: none"> The level of losses experienced by the institution in recent years has been not material/very low, or has decreased from a higher level. | <p>between risk takers and management and control functions.</p> <ul style="list-style-type: none"> Operational risk measurement, monitoring and reporting systems are appropriate. |
| 2 | <p>There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.</p> | <ul style="list-style-type: none"> The institution's operational risk exposures are mainly in high-frequency/low-severity impact categories. The significance of the institution's exposure to operational risk is low to medium, as shown by scenario analysis and compared with the losses of peers. The level of losses experienced by the institution in recent years has been low to medium, or is expected to increase from a lower historic level or decrease from a higher historic level. | <ul style="list-style-type: none"> The control framework for operational risk is sound. |
| 3 | <p>There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.</p> | <ul style="list-style-type: none"> The institution's operational risk exposures extend to some low-frequency/high-severity impact categories. The significance of the institution's exposure to operational risk is medium to high, as shown by scenario analysis and compared with the losses of peers. The level of losses experienced by the institution in recent years has been medium to high, or is expected to increase from a lower historic level or decrease from a higher historic level. | |
| 4 | <p>There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.</p> | <ul style="list-style-type: none"> The institution's operational risk exposures extend to all main categories. The significance of the institution's exposure to operational risk is high and increasing, as shown by scenario | |

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|------------------|--|--|
| | | analysis and compared with the losses of peers. <ul style="list-style-type: none"> • The level of losses experienced by the institution over the last few years has been high, or risk has significantly increased. | |

(30). Section 6.5 is replaced with the following:

6.5 Assessment of interest rate risk arising from non-trading book activities

6.5.1 General considerations

310. Competent authorities should assess interest rate risk arising from interest rate sensitive positions from non-trading on- and off-balance-sheet activities (commonly referred to as interest rate risk in the non-trading book, or IRRBB), including hedges for these positions, irrespective of their recognition and measurement, and irrespective of the recognition and measurement of losses and gains, for accounting purposes (note that credit spread risk arising from some non-trading book positions is covered in the section on market risk).
311. Competent authorities should consider the following sub-categories when assessing IRRBB:
- a. Gap risk – risk resulting from the term structure of interest rate sensitive instruments that arises from differences in the timing of their rate changes, covering changes to the term structure of interest rates occurring consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk).
 - b. Basis risk – risk arising from the impact of relative changes in interest rates on interest rate sensitive instruments that have similar tenors but are priced using different interest rate indices. It arises from the imperfect correlation in the adjustment of the rates earned and paid on different interest rate sensitive instruments with otherwise similar rate change characteristics.
 - c. Option risk – risk arising from options (embedded and explicit), whereby the institution or its customer can alter the level and timing of their cash flows, namely the risk arising from interest rate sensitive instruments where the holder will almost certainly exercise the option if it is in their financial interest to do so (embedded or explicit automatic options) and the risk arising from flexibility embedded implicitly or within the terms of interest rate sensitive instruments,

such that changes in interest rates may affect a change in the behaviour of the client (embedded behavioural option risk).

312. Competent authorities should take into account whether the guidance established in the EBA Guidelines on the management of interest rate risk arising from non-trading book activities (EBA Guidelines on IRRBB)²⁸ issued in accordance with Article 98(5) of Directive 2013/36/EU are implemented prudently by the institution. This applies particularly to the calculation of the supervisory outlier test specified in Article 98(5) of this Directive and any other supervisory outlier test, as well as to the institution's internal interest rate risk identification, measurement, monitoring and control procedures.

6.5.2 Assessment of inherent IRRBB

313. Through the assessment of the inherent level of IRRBB, competent authorities should determine the main drivers of the institution's IRRBB exposure and evaluate the potential prudential impact of this risk on the institution. The assessment of inherent IRRBB should be structured around the following main steps:
- a. preliminary assessment;
 - b. assessment of the nature and composition of the institution's interest rate risk profile; and
 - c. assessment of the outcome of the supervisory outlier tests and supervisory stress tests, as well as the institution's interest rate shock scenarios and interest rate stress scenarios.

Preliminary assessment

314. To determine the scope of the IRRBB assessment, competent authorities should first identify the sources of IRRBB to which the institution is or might be exposed. To do so, competent authorities should leverage the knowledge gained from ICAAP and ILAAP information collected for SREP purposes, from reporting established on IRRBB, from the assessment of other SREP elements, from the comparison of the institution's position with those of its peers and from any other supervisory activities.
315. As a minimum, competent authorities should consider:
- a. the institution's governance of interest rate risk, including its main IRRBB strategy and its risk appetite in relation to IRRBB;

²⁸ EBA-GL-2018-02. Guidelines are available online: <http://www.eba.europa.eu/regulation-and-policy/supervisory-review/guidelines-on-technical-aspects-of-the-management-of-interest-rate-risk-arising-from-non-trading-activities-under-the-supervisory-review-process>

- b. the impact of the supervisory outlier test specified in Article 98(5) of Directive 2013/36/EU, and any other supervisory outlier test, taking into account the EBA guidelines issued in accordance with that Article, on the institution's economic value as a proportion of its regulatory own funds, or Tier 1 (T1) funds;
 - c. the impact on earnings and economic value from a change in interest rates according to the methodology used by the institution; and
 - d. the internal capital – where relevant – allocated to IRRBB, both in total and as a proportion of the institution's total internal capital according to its ICAAP, including the historical trend and forecasts, if available.
316. In their preliminary assessment, competent authorities should also consider significant changes in the institution's exposures to IRRBB. As a minimum, they should assess the following aspects:
- a. significant changes in the institution's overall IRRBB strategy, risk appetite, policy or limit sizes;
 - b. the potential impact on the institution's risk profile of those changes;
 - c. major changes in the institution's modelling, customer behaviour or use of interest rate derivatives; and
 - d. major market trends.

Nature and composition of the institution's interest rate risk profile

317. Competent authorities should form a clear view on how changes in interest rates can have an adverse impact on an institution's earnings and economic value (the present value of expected cash flows) to gain both a short-term and a longer-term view on the possible threat to capital adequacy.
318. For this purpose, competent authorities should analyse and form a clear view on the structure of the institution's assets, liabilities and off-balance-sheet exposures. In particular:
- a. the different positions in the non-trading book, their maturities or repricing dates, and behavioural assumptions (e.g. assumptions regarding products with uncertain maturity) in relation to these positions;
 - b. the institution's interest cash flows, if available;
 - c. the proportion of products with uncertain maturity, and products with explicit and/or embedded options, paying particular attention to products with embedded customer optionality; and

- d. the hedging strategy of the institution and the amount and use of derivatives (hedging versus speculation).
319. To better determine the complexity and the interest rate risk profile of the institution, competent authorities should also understand the main features of the institution's assets, liabilities and off-balance-sheet exposures, in particular:
- a. loan portfolio (e.g. volume of loans with no maturity, volume of loans with pre-payment options, volume of floating-rate loans with caps and floors, share of floating rate loan contracts that prevent repricing at negative rates, etc.);
 - b. bond portfolio (e.g. volume of investments with options, possible concentrations);
 - c. non-performing exposures;
 - d. deposit accounts (e.g. sensitivity of the institution's deposit base to changes in interest rates including core deposits, possible concentrations);
 - e. derivatives (e.g. complexity of the derivatives used either for hedging or for speculative purposes, considerations relating to sold or bought interest rate options, impact of derivatives on the duration of non-trading book positions); and
 - f. nature of IRRBB embedded in fair value instruments, including less liquid instruments such as Level 3 assets and liabilities.
320. When analysing the impact on the institution's earnings, competent authorities should consider the institution's different sources of income and expenses and their relative weights to total revenues. They should be aware of how much the institution's returns depend on interest rate sensitive positions, and they should determine how different changes in interest rates would affect the institution's net interest income, as well as determining the effects of changes in the market value of instruments – depending on accounting treatment – either shown in the profit and loss (P&L) account or directly in equity (e.g. via other comprehensive income).
321. When analysing the impact on the institution's economic value and earnings, competent authorities should first consider the results of the supervisory outlier test specified in Article 98(5) of Directive 2013/36/EU, and any other supervisory outlier test, to get an initial benchmark against which to compare how interest rate changes would affect the institution. To ensure compliance, competent authorities should take into account the EBA guidelines issued in accordance with that Article. When performing this assessment, competent authorities should pay particular attention to the sensitivity of cash flows to repricing, in terms of both timing and amount, to changes in the underlying key assumptions (particularly for customer accounts without specific repricing dates, customer accounts with embedded customer optionality and/or equity capital).

322. Competent authorities should seek to understand the impact of those assumptions and then isolate the economic value and earnings risks arising from the institution's behavioural adjustments.
323. Competent authorities should pay attention to the sensitivity of cash flows to changes in the valuation of fair value instruments, including interest rate derivatives in connection to interest rate changes (e.g. impact of mark-to-market changes in fair value instruments on P&L, hedge account effectiveness).
324. In addition to using the supervisory outlier test specified in Article 98(5) of Directive 2013/36/EU, and any other supervisory outlier test, competent authorities should consider using their own designated shock scenarios (e.g. larger or smaller, for all or some currencies, allowing for non-parallel shifts in rates, considering basis risk, etc.). When deciding the level at which to set these additional shock scenarios, competent authorities should take into account factors such as the general level of interest rates, the shape of the yield curve and any relevant national characteristics of their financial systems. The institution's internal systems should therefore be flexible enough to compute its sensitivity to any shock that is prescribed by the competent authority.
325. In their quantitative assessment, competent authorities should also consider the results of the institution's internal methodologies for measuring IRRBB, where appropriate. Through the analysis of these methodologies, competent authorities should gain a deeper understanding of the main risk factors underlying the institution's IRRBB profile.
326. Competent authorities should assess whether those institutions operating in different currencies perform an analysis of the interest rate risk in each currency in which they have a significant position. Competent authorities should also assess the approaches that these institutions use for the purpose of aggregating the results of economic value and earnings measures in individual currencies.
327. When analysing the results of both the impact of the supervisory outlier tests and the institution's internal methodologies, competent authorities should consider 'point in time' figures as well as historical trends. These rates should be compared to peers and considered in the context of the global market situation.

Shock scenarios and stress testing

328. Competent authorities should assess and take into account the results of the interest rate shock scenarios and stress tests (in addition to those of the supervisory outlier tests) performed by the institution as part of its ongoing internal management process. In this context, competent authorities should be aware of the institution's main sources of IRRBB.

329. If, when the outcome of the institution's shock scenarios and stress tests is reviewed, particular accumulations of repricing/maturity at different points on the curve are revealed or suspected, competent authorities may need to carry out additional analyses.

6.5.3 Assessment of IRRBB management and controls (both risk management and compliance, and internal audit control functions)

330. To achieve a comprehensive understanding of the institution's interest rate risk profile in the non-trading book, competent authorities should review the governance and framework underlying its interest rate exposures.
331. Competent authorities should assess the following elements:
- a. IRRBB strategy and appetite (as distinct elements or as part of the broader market risk strategy and appetite);
 - b. organisational framework and responsibilities;
 - c. policies and procedures;
 - d. risk identification, measurement including internal models, monitoring and reporting; and
 - e. internal control framework.

IRRBB strategy and appetite

332. Competent authorities should assess whether the institution has a sound, clearly formulated and documented IRRBB strategy, approved by the management body. For this assessment, competent authorities should take into account:
- a. whether the management body clearly expresses the IRRBB strategy and appetite and the process for the review thereof (e.g. in the event of an overall review of risk strategy, or concerns about profitability or capital adequacy), and whether senior management properly implements the IRRBB strategy approved by the management body, ensuring that the institution's activities are consistent with the established strategy, written procedures are drawn up and implemented, and responsibilities are clearly and properly assigned;
 - b. whether the institution's IRRBB strategy properly reflects the institution's appetite for IRRBB and whether it is consistent with the overall risk appetite;
 - c. whether the institution's IRRBB strategy and appetite are appropriate for the institution considering:

- its business model;
 - its overall risk strategy and appetite;
 - its market environment and role in the financial system; and
 - its capital adequacy;
- d. whether the institution's IRRBB strategy broadly covers all the activities of the institution where IRRBB is significant;
- e. whether the institution's IRRBB strategy takes into account the cyclical aspects of the economy and the resulting shifts in the composition of IRRBB activities; and
- f. whether the institution has an appropriate framework in place to ensure that the IRRBB strategy is effectively communicated to relevant staff.

Organisational framework and responsibilities

333. Competent authorities should assess whether the institution has an appropriate organisational framework and clearly assigned responsibilities for IRRBB management, measurement, monitoring and control functions with adequate human and technical resources. They should take into account whether:
- a. there are clear lines of responsibility for the overall management of IRRBB, and for taking, monitoring, controlling and reporting IRRBB;
 - b. the IRRBB management and control area is subject to independent review and is clearly identified in the organisation and functionally and hierarchically independent of the business area; and
 - c. the staff dealing with interest rate risk (both in the business area and in the management and control areas) have appropriate skills and experience.

Policies and procedures

334. Competent authorities should assess whether the institution has clearly defined policies and procedures for the management of IRRBB that are consistent with its IRRBB strategy and appetite. They should take into account whether:
- a. the management body approves the policies for managing, measuring and controlling IRRBB and discusses and reviews them regularly in line with risk strategies;
 - b. senior management is responsible for developing policies and procedures and ensuring adequate implementation of the management body's decisions;

- c. IRRBB policies are compliant with relevant regulations and adequate for the nature and complexity of the institution's activities, enabling a clear understanding of the inherent IRRBB;
- d. such policies are clearly formalised and communicated and applied consistently across the institution;
- e. these policies are applied consistently across banking groups and allow proper management of IRRBB;
- f. IRRBB policies define the procedures for new product development, major hedging or risk management initiatives and such policies have been approved by the management body or its appropriate delegated committee. In particular, competent authorities should ensure that:
 - new products and new major hedging and risk management initiatives are subject to adequate procedures and controls before being introduced or undertaken; and
 - the institution has undertaken an analysis of their possible impact in its overall risk profile.

Risk identification, measurement including internal models, monitoring and reporting

335. Competent authorities should assess whether the institution has an appropriate framework for identifying, understanding, measuring and monitoring IRRBB, in line with the level, complexity and riskiness of non-trading book positions and the institution's size and complexity. The assessment should encompass internal models, such as those related to customer behaviour (e.g. models of deposit stability and loan early repayment). They should consider the following.
- a. Whether the information systems and measurement techniques enable management to measure the inherent IRRBB in all its material on- and off-balance-sheet exposures (where relevant at group level), including internal hedges, in the non-trading book portfolio.
 - b. Whether the institution has adequate staff and methodologies to measure IRRBB (in accordance with the requirements of the EBA Guidelines on the management of interest rate risk arising from non-trading activities (EBA Guidelines on IRRBB)), taking into account the size, form and complexity of their interest rate risk exposure.
 - c. Whether the assumptions underlying internal models and methodologies take into account the guidance established by the EBA Guidelines on IRRBB. In particular,

competent authorities should assess whether the institution's assumptions regarding positions with no contractual maturity and embedded customer options are prudent. Competent authorities should also assess whether institutions include equity in the calculation of economic value and, if they do, analyse the impact of removing equity from that calculation.

- d. Whether the institution's risk measurement systems take into account all material forms of interest rate risk to which the institution is exposed (e.g. gap risk, basis risk and option risk). If some instruments and/or factors are excluded from the risk measurement systems, institutions should be able to explain why to supervisors and to quantify the materiality of the exclusions.
 - e. Whether institution's internal models used for the measurement of IRRBB have been properly developed, independently validated (including whether any expert opinions and judgement employed in the internal models have been thoroughly assessed) and reviewed regularly.
 - f. The quality, detail and timeliness of the information provided by the information systems and whether the systems are able to aggregate the risk figures for all the portfolios, activities and entities included in the consolidation perimeter. Information systems should comply with the guidance established by the EBA Guidelines on IRRBB.
 - g. The integrity and timeliness of the data that feed the risk measurement process, which should also comply with the guidance established by the EBA Guidelines on IRRBB.
 - h. Whether the institution's risk measurement systems are able to identify possible IRRBB concentrations (e.g. in certain time buckets).
 - i. Whether risk managers and the institution's senior management understand the assumptions underlying the measurement systems, especially with regard to positions with uncertain contractual maturity and those with implicit or explicit options, as well as the institution's assumptions regarding equity capital.
 - j. Whether risk managers and the institution's senior management are aware of the degree of model risk that prevails in the institution's risk measurement techniques.
 - k. Whether the use of interest rate derivatives is compliant with the IRRBB risk strategy and whether those activities are performed within the risk appetite framework and with adequate internal governance arrangements in place.
336. Competent authorities should assess whether the institution has implemented adequate stress test scenarios that complement its risk measurement system. In

their assessment, they should evaluate compliance with the relevant guidance established in the EBA guidelines issued in accordance with Article 98(5) of Directive 2013/36/EU.

337. Competent authorities should assess whether the institution has an appropriate monitoring and internal reporting framework for IRRBB that ensures there is prompt action at the appropriate level of the institution's senior management or management body, where necessary. The monitoring system should include specific indicators and relevant triggers to provide effective early warning alerts. Competent authorities should take into account whether the management and control area reports regularly (the frequency will depend on the scale, complexity and level of IRRBB exposures) to the management body and senior management the following information, as a minimum:
- a. an overview of the current IRRBB exposures, P&L results and risk calculation, and the drivers of level and direction of IRRBB;
 - b. significant breaches of IRRBB limits;
 - c. changes in the major assumptions or parameters on which the procedures for assessing IRRBB are based; and
 - d. changes in the interest rate derivatives position and whether these are related to changes in the underlying hedging strategy.

Internal control framework

338. Competent authorities should assess whether the institution has a strong and comprehensive control framework and sound safeguards to mitigate its exposures to IRRBB in line with its risk management strategy and risk appetite. They should take into account:
- a. whether the scope of the institution's control function includes all consolidated entities, all geographical locations and all financial activities;
 - b. whether there are internal controls, operating limits and other practices aimed at keeping IRRBB exposures at or below levels acceptable to the institution, in accordance with the parameters set by the management body and senior management and the institution's risk appetite; and
 - c. whether the institution has appropriate internal controls and practices to ensure that breaches of and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.
339. Competent authorities should assess the limit system, including whether:

- a. it is consistent with the risk management strategy and risk appetite of the institution;
 - b. it is adequate for the complexity of the institution's organisation and IRRBB exposures, and for its ability to measure and manage this risk;
 - c. it addresses the potential impact of changes in interest rates on earnings and the institution's economic value (from an earnings perspective, limits should specify acceptable levels of volatility for earnings under specified interest rate scenarios; the form of limits for addressing the effect of rates on an institution's economic value should be appropriate for the size and complexity of the institution's activities and underlying positions);
 - d. the limits established are absolute or whether breaches of limits are possible (in the latter case, the institution's policies should clearly set out the period of time during which and the specific circumstances under which such breaches of limits are possible; competent authorities should request information about measures that ensure limits are adhered to); and
 - e. the institution has adequate procedures for reviewing its limits regularly.
340. Competent authorities should assess the functionality of the internal audit function. To this end, they should assess whether:
- a. the institution conducts internal audits of the IRRBB management framework on a regular basis;
 - b. the internal audit covers the main elements of IRRBB management, measurement and control across the institution; and
 - c. the internal audit function is effective in determining adherence to internal policies and the relevant external regulations and addressing any deviations.

6.5.4 Summary of findings and scoring

341. Following the above assessments, competent authorities should form a view on the institution's IRRBB. This view should be reflected in a summary of findings, accompanied by a score based on the considerations specified in Table 7. If, based on the materiality of certain risk sub-categories, the competent authority decides to assess and score them individually, the guidance provided in this table should be applied, as far as possible, by analogy.

Table 7. Supervisory considerations for assigning a score to IRRBB

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|---|---|---|
| 1 | There is a low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • The sensitivity of the economic value to changes in interest rates is not material/very low. • The sensitivity of earnings to changes in interest rates is not material/very low. • The sensitivity of the economic value and earnings to changes in the underlying assumptions (e.g. in the case of products with embedded customer optionality) is not material/very low. | <ul style="list-style-type: none"> • There is consistency between the institution's interest rate risk policy and strategy and its overall strategy and risk appetite. |
| 2 | There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • The sensitivity of the economic value to changes in interest rates is low to medium. • The sensitivity of earnings to changes in interest rates is low to medium. • The sensitivity of the economic value and earnings to changes in the underlying assumptions (e.g. in the case of products with embedded customer optionality) is low to medium. | <ul style="list-style-type: none"> • The organisational framework for interest rate risk is robust, with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. |
| 3 | There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • The sensitivity of the economic value to changes in interest rates is medium to high. • The sensitivity of earnings to changes in interest rates is medium to high. • The sensitivity of the economic value and earnings to changes in the underlying assumptions (e.g. in the case of products with embedded customer optionality) is medium to high. | <ul style="list-style-type: none"> • Interest rate risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the control framework for interest rate risk are sound and are in line with the institution's risk strategy and risk appetite. |
| 4 | There is a high risk of significant prudential impact on the institution considering the level of inherent risk and | <ul style="list-style-type: none"> • The sensitivity of the economic value to changes in interest rates is high. • The sensitivity of earnings to changes in interest rates is high. • The sensitivity of the economic value and earnings to changes in | |

| | | | |
|--|-------------------------------------|--|--|
| | <p>the management and controls.</p> | <p>the underlying assumptions (e.g. in the case of products with embedded customer optionality) is high.</p> | |
|--|-------------------------------------|--|--|

- (31). After paragraph 320 of the Guidelines, a new paragraph is added as follows:
‘To address potential capital inadequacies in stressed conditions, competent authorities should take appropriate supervisory measures, including, where relevant, establishing and communicating P2G, which is the quantity (amount) and quality (composition) of own funds that the institution is expected to hold over and above its OCR.’
- (32). Paragraph 323 of the Guidelines is amended as follows:
‘After considering the outcomes of the assessment of risks to capital as specified in Title 6, competent authorities should undertake the following steps as part of the SREP capital assessment process:
- i. determination of the additional own funds requirements;
 - ii. reconciliation of P2R and P2G with any macroprudential requirements;
 - iii. determination and articulation of TSCR and OCR;
 - iv. assessment of the risk of excessive leverage;
 - v. assessment of whether OCR and TSCR can be met in stressed conditions;
 - vi. determination of P2G; and
 - vii. determination of the capital score.’
- (33). Section 7.3 of the Guidelines is repealed and replaced with the following:

7.3 Reconciliation with macroprudential requirements

346. In determining additional own funds requirements (or other capital measures), competent authorities should reconcile the additional own funds requirements with any existing capital buffer requirements and/or macroprudential requirements addressing the same risks or elements of those risks. Competent authorities should not set additional own funds requirements or other capital measures (including P2G) where the same risk is already covered by specific capital buffer requirements and/or additional macroprudential requirements.
- (34). After paragraph 354 of the Guidelines, the example is deleted.
- (35). Paragraph 355 of the Guidelines is amended as follows:
- a. the phrase ‘Also see the example provided in Section 7.9’ is added at the end of the paragraph;
 - b. the example is deleted
- (36). Section 7.7 of the Guidelines is repealed and replaced with the following:

7.7 Meeting requirements in stressed conditions

382. Competent authorities should determine by means of stress testing the adequacy of the institution’s own funds (quantity and composition) in stressed conditions and

whether supervisory measures, including P2G, capital planning and other measures as set out in Title 10, are necessary to address potential inadequacies.

383. To assess capital adequacy in stressed conditions, competent authorities should consider:
- a. the use of the qualitative outcomes (e.g. deficiencies identified in risk management and control) of institutions' stress tests and supervisory stress testing; and
 - b. the use of the quantitative outcomes of ICAAP stress tests, if the ICAAP is deemed reliable in accordance with paragraph 358, and of supervisory stress tests (i.e. outcomes in terms of changes in own funds ratios), pursuant to Article 100 of Directive 2013/36/EU as specified in Title 12 of these guidelines, and including, for example:
 - i. prescribing specific 'anchor' scenarios/assumptions to be implemented by institutions; and
 - ii. conducting system-wide stress tests using consistent methodologies and scenarios run either by institutions or by supervisors.
384. Competent authorities should assess as appropriate the quantitative outcomes of stress tests with regard to the adequacy and quality of the institution's own funds and determine whether the quantity and quality of own funds are sufficient to cover applicable capital requirements, and in particular:
- a. OCR including its combined buffer requirements under the baseline scenario over a forward-looking time horizon of at least two years;
 - b. TSCR under the adverse scenarios over a forward-looking time horizon of at least two years; or
 - c. where relevant, predefined target ratios (fixed threshold) set in the context of a system-wide stress test, for the applicable stress test scenarios.

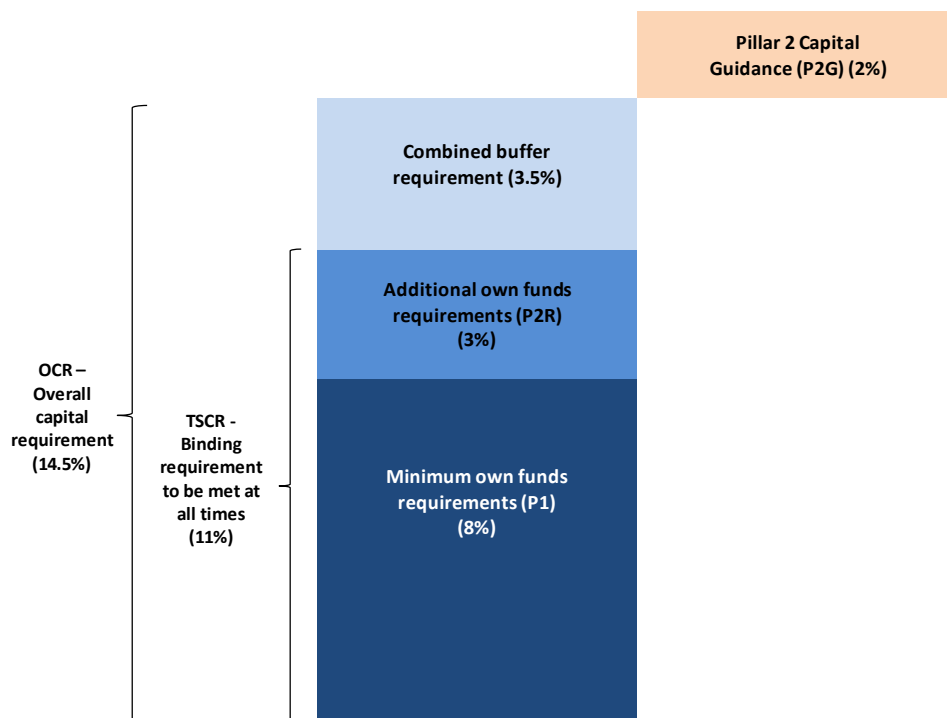
7.7.1 Using P2G to address the quantitative outcomes of stress testing

Determining and setting P2G

385. Competent authorities should determine P2G as specified in this section, and, where the determination leads to a positive value, they should set P2G to address supervisory concerns about the sensitivity of the institution to the adverse scenarios used in the supervisory stress tests.

386. Where the quantitative outcomes of the supervisory stress tests suggest that the institution is not expected to breach its TSCR under the adverse stress test scenario, competent authorities may decide not to set P2G.
387. Competent authorities should determine and set P2G based on the outcomes of the adverse scenario of the relevant supervisory stress tests, including the EU-wide stress tests performed by the EBA or any other relevant supervisory stress tests performed on a system-wide basis using a multi-factor scenario analysis over a forward-looking horizon of at least two years (either top-down or bottom-up).
388. On the basis of establishing a proportionate approach for non-Category 1 institutions and subsidiaries of cross-border groups, for setting and updating P2G competent authorities may consider the outcomes of simplified forms of supervisory stress tests (e.g. through the use of supervisory prescribed 'anchor' scenarios, sensitivity analysis, top-down stress tests conducted by designated authorities, portfolio-level impacts from consolidated-level stress tests) or past supervisory stress tests.
389. Competent authorities should determine and set P2G in accordance with the minimum engagement model specified in Section 2.2.4. In particular, the frequency with which P2G is determined and set should follow the frequency of the capital adequacy assessment under the SREP minimum engagement model.
390. Notwithstanding the previous paragraph, competent authorities should assess whether the existing P2G level is still appropriate whenever the results of new supervisory stress tests are available, and revise the level of P2G if necessary.
391. For institutions for which capital adequacy, according to the SREP minimum engagement model, should be assessed annually (e.g. SREP Category 1 institutions), P2G may be determined and set only every second year instead of annually. In the other year, competent authorities should assess on the basis of all relevant information, including outcomes of past supervisory stress tests together with additional sensitivity analysis (i.e. simplified forms of supervisory stress testing), whether P2G is still relevant or needs to be updated.
392. Competent authorities should generally not use P2G to cover elements of risks that should be covered by the additional own funds requirements in accordance with Section 7.2 of these guidelines.

Figure 6. Stacking order of own funds requirements and P2G (please refer to the example presented in Section 7.9)



393. When determining the size of P2G, competent authorities should ensure that it is set at a level appropriate to cover at least the anticipated maximum stress impact, which should be calculated based on the changes in the common equity Tier 1 (CET1) ratio (i.e. considering both movements in CET1 capital and total risk exposure amount (TREA) in the worst year of stress and taking into account the level of applicable capital requirements and the considerations set out in paragraphs 384 and 394 to 396.
394. When determining the size of P2G, competent authorities should also consider, where relevant, the following factors:
- the year when the maximum stress impact occurs in relation to the starting point and time horizon of the scenarios used in the stress tests;
 - the outcome of a reliable ICAAP stress test, taking into account the specific scenario definitions and assumptions, in particular where they are deemed more relevant for the business model and risk profile of the institution or where the internal scenarios are more severe than the supervisory scenarios;
 - relevant management mitigating actions of the institution that are deemed credible following their supervisory assessment;

- d. information about and supervisory views on the relevance of supervisory stress testing to the institution's strategy, financial plans and business model;
 - e. the quality (composition) of the institution's available own funds, including at the worst year of stress; and
 - f. whether or not the institution is under restructuring or resolution.
395. For the purpose of paragraph 394(b), competent authorities should also consider the extent to which stress scenarios cover all the material risks contributing to the additional own funds requirements in TSCR. Competent authorities should in particular have regard to the fact that macroeconomic downturn scenarios may not entirely capture some risks, for example conduct risk, pension risk or some elements of credit concentration risk (e.g. single name concentration), that may amplify potential losses under the tested adverse scenarios.
396. In addition, competent authorities should consider the extent to which the existing combined buffer requirements and other applicable macroprudential measures already cover risks revealed by stress testing. Competent authorities should offset P2G against the capital conservation buffer (CCB), as P2G and the CCB overlap in nature. Furthermore, while no overlap is in principle expected between P2G and the countercyclical capital buffer (CCyB), competent authorities should, in exceptional cases, offset P2G on a case-by-case basis against the CCyB based on the consideration of underlying risks covered by the buffer and factored into the design of the scenarios used for the stress tests, after liaising with the macroprudential authority. Competent authorities should not offset P2G against the systemic risk buffers (G-SII/O-SII buffers and the systemic risk buffer), as those are intended to cover the risks an institution poses to the financial system.

Communication and composition of P2G

397. Where P2G is set or updated, competent authorities should communicate to the institution the level of P2G and the relevant time limits for its establishment in accordance with paragraph 401. Competent authorities should also explain the potential supervisory reaction to situations where P2G is not met.
398. Competent authorities should communicate to institutions that P2G is expected to be met with CET1-eligible own funds and incorporated into their capital planning and risk management frameworks, including the risk appetite framework and recovery planning.
399. Competent authorities should also communicate to institutions that own funds held for the purposes of P2G cannot be used to meet any other regulatory requirements (Pillar 1, P2R or the combined buffer requirements), and therefore cannot be used

twice. That means that own funds required to meet Pillar 1 (8% of TREA), P2R or the combined buffer requirements cannot be used to cover P2G.

400. Competent authorities should additionally communicate to institutions and, where relevant, other competent authorities all applicable own funds ratios affected by P2G (CET1, T1 and total own funds).
401. When setting and communicating to the institutions time limits to establish P2G, competent authorities should consider at least the following:
 - a. whether or not an institution is under the restructuring or resolution; and
 - b. the potential implications that CET1 denominated P2G may have for other parts of the capital requirements and the ability of institutions to issue additional Tier 1 (AT1) or Tier 2 (T2) instruments.

7.7.2 Capital planning and other supervisory measures to address capital adequacy in stressed conditions

Capital planning

402. When the quantitative outcomes of the stress tests referred to in Section 7.7.1 indicate that, under the given stress scenarios, an institution will not be able to meet the applicable capital requirements, competent authorities should require the institution to submit a credible capital plan that addresses the risk of not meeting its applicable capital requirements.
403. To determine the credibility of the capital plan, the competent authority should consider, as appropriate:
 - a. whether the capital plan covers the entire assumed stress testing time horizon;
 - b. whether the capital plan puts forward a set of credible mitigating and management actions, restricting dividend payments, etc.;
 - c. whether the institution is willing and able to take such actions in order to address the breaches of the applicable capital requirements in the system-wide stress tests;
 - d. whether those mitigating and management actions are subject to any legal or reputational constraints, for instance due to contrary or conflicting former public announcements (e.g. on dividend policies, business plans and risk appetite);
 - e. the probability that mitigating and management action would enable the institution to fully meet its applicable capital requirements within an appropriate timeframe; and

- f. whether the proposed actions are broadly in line with macroeconomic considerations and with known future regulatory changes affecting an institution within the scope and timeline of the assumed adverse scenarios;
 - g. the range of recovery options and their analysis as set out in the institution's recovery plan.
404. When assessing capital plans, the competent authority should, where appropriate, following an effective dialogue with the institution, require the institution to make changes to those plans as appropriate, including to the proposed management actions, or require institutions to take additional mitigating actions that would become relevant given the scenarios and current macroeconomic conditions.
405. Competent authorities should expect institutions to implement the revised capital plan, including further changes made based on the results of the supervisory assessment of and dialogue with the institution.

Additional supervisory measures

406. Competent authorities should, where relevant, consider the application of the additional supervisory measures specified in Title 10, to ensure that the institution is adequately capitalised in stressed conditions.
407. In particular, where the quantitative outcomes of the stress tests indicate that the institution is likely to breach its applicable capital requirements under the adverse scenario within the following 12 months, the competent authorities should, where appropriate, treat such information as one of the possible circumstances within the meaning of Article 102(1)(b) of Directive 2013/36/EU. In such cases, the competent authorities should apply appropriate measures in accordance with Article 104(1) of Directive 2013/36/EU aimed at ensuring sufficient levels of own funds. In particular, when such measures relate to capital, competent authorities should in particular consider one or both of the following, as defined in Article 104(1)(a) and (f):
- a. requiring institutions to hold an appropriate amount of additional own funds in the form of a nominal amount, considering the outcome of the SREP assessment;
 - b. requiring a reduction in the inherent risk of the institution's activities, products and systems.
- (37). In paragraph 369, before the words 'score based', the word 'viability' is added.
- (38). Table 8 is replaced with the following:

| Score | Supervisory view | Considerations |
|-------|---|---|
| 1 | The quantity and composition of own funds held pose a low level of risk to the viability of the institution. | <ul style="list-style-type: none"> • The institution is able to comfortably meet its P2G. • The institution holds a level of own funds comfortably above its OCR and is expected to do so in the future. • Stress testing does not reveal any discernible risk regarding the impact of a severe but plausible economic downturn on own funds. • The free flow of capital between entities in the group, where relevant, is not impeded, or all entities are well capitalised above supervisory requirements. • The institution has a plausible and credible capital plan that has the potential to be effective if required. • The institution's leverage ratio is comfortably above any regulatory minimum and there is no material/a very low risk of excessive leverage. |
| 2 | The quantity and composition of own funds held pose a medium-low level of risk to the viability of the institution. | <ul style="list-style-type: none"> • The institution has difficulty meeting its P2G. Management mitigating actions to address this are assessed as credible. • The institution is near to breaching some of its capital buffers but is still clearly above its TSCR. • Stress testing reveals a low level of risk regarding the impact of a severe but plausible economic downturn on own funds, but management actions to address this seem credible. • The free flow of capital between entities in the group, where relevant, is or could be marginally impeded. |

| Score | Supervisory view | Considerations |
|-------|--|---|
| | | <ul style="list-style-type: none"> • The institution has a plausible and credible capital plan that, although not without risk, has the potential to be effective if required. • The institution's leverage ratio is above any regulatory minimum. There is a low level of risk of excessive leverage. |
| 3 | The quantity and composition of own funds held pose a medium-high level of risk to the viability of the institution. | <ul style="list-style-type: none"> • The institution does not meet its P2G. There are concerns about the credibility of management mitigating actions to address this. • The institution is using some of its capital buffers. There is potential for the institution to breach its TSCR if the situation deteriorates. • Stress testing reveals a medium level of risk regarding the impact of a severe but plausible economic downturn on own funds. Management actions may not credibly address this. • The free flow of capital between entities in the group, where relevant, is impeded. • The institution has a capital plan that is unlikely to be effective. • The institution's leverage ratio is above any regulatory minimum, but stress testing reveals concerns about the impact of a severe but plausible economic downturn on the ratio. There is a medium level of risk of excessive leverage. |
| 4 | The quantity and composition of own funds held pose a high level of risk to the viability of the institution. | <ul style="list-style-type: none"> • The institution does not meet its P2G (or deliberately has not established P2G) and will not be able to do so in the foreseeable future. Management |

| Score | Supervisory view | Considerations |
|-------|------------------|--|
| | | <p>mitigating actions to address this are assessed as not credible.</p> <ul style="list-style-type: none"> • The institution is near to breaching its TSCR. • Stress testing reveals that TSCR would be breached near the beginning of a severe but plausible economic downturn. Management actions will not credibly address this. • The free flow of capital between entities in the group, where relevant, is impeded. • The institution has no capital plan, or one that is manifestly inadequate. • The institution's leverage ratio is near to breaching any regulatory minimum. There is a high level of risk of excessive leverage. |

(39). After Section 7.8, the following section is added:

7.9 Communication of prudential requirements

Example of communicating prudential requirements (see also Figure 6):

As of DATE and until otherwise communicated, INSTITUTION is expected to hold capital to meet a total SREP capital requirement (TSCR) of [11%] of TREA, to be met at all times.

Of this [11%]:

– 8% (comprising at least 56% CET1 and 75% T1) represents own funds requirements specified in Article 92 of Regulation (EU) No 575/2013;

– [3%] represents additional own funds in excess of the requirements specified in Article 92 of Regulation (EU) No 575/2013, of which [2%] (comprising at least XX% CET1 and YY% T1) is to cover unexpected losses identified through SREP and [1%] (comprising at least XX% CET1 and YY% T1) is to cover OTHER [e.g. governance concerns] identified through SREP.

INSTITUTION is hereby reminded that it is also subject to the overall capital requirement (OCR), as defined in Section 1.2 of Guidelines EBA/GL/2014/13, which includes, in addition to

the TSCR, the combined buffer requirement as defined in point (6) of Article 128 of Directive 2013/36/EU, to the extent that it is legally applicable.

As of the date of the joint decision, INSTITUTION is subject to the following combined buffer requirements to be fully met in CET1:

- a [2.5%] capital conservation buffer requirement;**
- a [1%] countercyclical capital buffer (CCyB)* requirement.**

(For the above communication, it should be borne in mind that buffer rates may change prior to the next SREP decision (implying, potentially, a different OCR in the meantime.)

INSTITUTION is also subject to [2%] Pillar 2 Guidance (P2G), which is a non-legally binding expectation on top of OCR identified in an idiosyncratic and risk-sensitive way, to address INSTITUTION’s ability to maintain applicable own funds requirements (and effectively systemic risk buffers) in stressed conditions as revealed by the quantitative results of the supervisory stress tests performed in accordance with Article 100 of Directive 2013/36/EU.

For the above example, the capital requirements can be summarised as follows:

| Total SREP capital requirement (TSCR), overall capital requirement (OCR) and Pillar 2 guidance (P2G) | | |
|---|---------------|---|
| Prudential requirements | Amount | Background calculations |
| TSCR ratio | 11.0% | |
| of which: CET1 capital ratio | 6.2% | <i>Pillar 1 CET1 ratio (4.5%) plus P2R CET1 ratio (56% of 3%)</i> |
| of which: T1 ratio | 8.3% | <i>Pillar 1 T1 ratio (6%) plus P2R T1 ratio (75% of 3%)</i> |
| OCR ratio | 14.5% | |
| of which: CET1 capital ratio | 9.7% | <i>TSCR CET1 ratio (6.2%) plus the combined buffer (3.5%)</i> |
| of which: T1 ratio | 11.8% | <i>TSCR T1 ratio (8.3%) plus the combined buffer (3.5%)</i> |
| OCR and P2G | 16.5% | |
| of which: CET1 capital ratio | 11.7% | <i>OCR CET1 ratio (9.7%) plus P2G (2%)</i> |
| of which: T1 ratio | 13.8% | <i>OCR T1 ratio (11.8%) plus P2G (2%)</i> |

* This is the CCyB that is calculated by the institution and applicable as of the date of the joint decision, using the known CCyB buffer rates and exposures of the institution in accordance with Article 140 of Directive 2013/36/EU.

(40). At the end of paragraph 378 of the Guidelines, after the word ‘score’, the following phrase is added: ‘as explained in the following sections’.

(41). Paragraphs 379 and 380 of the Guidelines are deleted.

(42). In paragraph 408 of the Guidelines, the phrase ‘CEBS Guidelines on stress testing’ is replaced with ‘EBA Guidelines on institutions’ stress testing’.

(43). In paragraph 425 of the Guidelines, the word ‘risk’ is added before the word ‘score’.

(44). Table 9 of the Guidelines is replaced with the following:

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|---|---|---|
| 1 | There is a low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • There is non-material/very low risk arising from mismatches (e.g. between maturities, currencies, etc.). • The size and composition of the liquidity buffer is adequate and appropriate. • The level of other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) is not material/very low. | <ul style="list-style-type: none"> • There is consistency between the institution’s liquidity risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for liquidity risk is robust, with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. |
| 2 | There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • Mismatches (e.g. between maturities, currencies, etc.) entail low to medium risk. • The risk posed by the size and composition of the liquidity buffer is low to medium. • The level of other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) is low to medium. | <ul style="list-style-type: none"> • Liquidity risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the control framework for liquidity risk are sound and are in line with the institution’s risk management strategy and risk appetite/tolerance. |
| 3 | There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • Mismatches (e.g. between maturities, currencies, etc.) entail medium to high risk. • The risk posed by the size and composition of the liquidity buffer is medium to high. • The level of other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra- | |

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|--|--|--|
| | | group liquidity, etc.) is medium to high. | |
| 4 | There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • Mismatches (e.g. between maturities, currencies, etc.) entail high risk. • The risk posed by the size and composition of the liquidity buffer is high. • The level of other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) is high. | |

(45). Table 10 of the Guidelines is replaced with the following:

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|---|--|--|
| 1 | There is a low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • There is non-material/very low risk from the institution's funding profile or its sustainability. • The risk posed by the stability of funding is not material. • The level of other drivers of funding risk (e.g. reputational risk, access to funding markets, etc.) is not material/very low. | <ul style="list-style-type: none"> • There is consistency between the institution's funding risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for funding risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. |
| 2 | There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • The risk from the institution's funding profile and its sustainability is low to medium. • The risk posed by the stability of funding is low to medium. • The level of other drivers of funding risk (e.g. reputational risk, access to funding markets, etc.) are low to medium. | <ul style="list-style-type: none"> • Funding risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the control framework for funding risk are sound and are in line with the institution's risk management strategy and risk appetite/tolerance. |
| 3 | There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> • The risk posed by the institution's funding profile and its sustainability is medium to high. • The risk posed by the stability of funding is medium to high. • The level of other drivers of funding risk (e.g. reputational | |

| Risk score | Supervisory view | Considerations in relation to inherent risk | Considerations in relation to adequate management and controls |
|------------|--|--|--|
| | | risk, access to funding markets, etc.) is medium to high. | |
| 4 | There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls. | <ul style="list-style-type: none"> The risk posed by the institution's funding profile and its sustainability is high. The risk posed by the stability of funding is high. The level of other drivers of funding risk (e.g. reputational risk, access to funding markets, etc.) are high. | |

(46). In paragraph 454 of the Guidelines, the word 'viability' is added before the word 'score'.

(47). Table 12 of the Guidelines is replaced with the following:

| Score | Supervisory view | Considerations |
|-------|--|---|
| 1 | The institution's liquidity position and funding profile pose a low level of risk to the viability of the institution. | <ul style="list-style-type: none"> The institution's counterbalancing capacity and liquidity buffers are comfortably above specific supervisory quantitative requirements and are expected to remain so in the future. The composition and stability of longer-term funding (> 1 year) pose non-material/very low risk in relation to the activities and business model of the institution. The free flow of liquidity between entities in the group, where relevant, is not impeded, or all entities have a counterbalancing capacity and liquidity buffers above supervisory requirements. The institution has a plausible and credible liquidity contingency plan that has the potential to be effective if required. |

| Score | Supervisory view | Considerations |
|-------|---|---|
| 2 | The institution's liquidity position and/or funding profile pose a medium-low level of risk to the viability of the institution. | <ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are above the specific supervisory quantitative requirements, but there is a risk that they will not remain so. • The composition and stability of longer-term funding (> 1 year) pose a low level of risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is or could be marginally impeded. • The institution has a plausible and credible liquidity contingency plan that, although not without risk, has the potential to be effective if required. |
| 3 | The institution's liquidity position and/or funding profile pose a medium-high level of risk to the viability of the institution. | <ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are deteriorating and/or are below specific supervisory quantitative requirements, and there are concerns about the institution's ability to restore compliance with these requirements in a timely manner. • The composition and stability of longer-term funding (> 1 year) pose a medium level of risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is impeded. • The institution has a liquidity contingency plan that is unlikely to be effective. |
| 4 | The institution's liquidity position and/or funding profile pose a high | <ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are rapidly deteriorating and/or are below the |

| Score | Supervisory view | Considerations |
|-------|--|---|
| | level of risk to the viability of the institution. | <p>specific supervisory quantitative requirements, and there are serious concerns about the institution's ability to restore compliance with these requirements in a timely manner.</p> <ul style="list-style-type: none"> • The composition and stability of longer-term funding (> 1 year) pose a high level of risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is severely impeded. • The institution has no liquidity contingency plan, or one that is manifestly inadequate. |

(48). In paragraph 463 of the Guidelines, the word 'viability' is added before the words 'score based'.

(49). Table 13 of the Guidelines is replaced with the following:

| Score | Supervisory view | Considerations |
|-------|---|--|
| 1 | The risks identified pose a low level of risk to the viability of the institution. | <ul style="list-style-type: none"> • The institution's business model and strategy do not raise concerns. • The internal governance and institution-wide control arrangements do not raise concerns. • The institution's risks to capital and liquidity pose a non-material/a very low risk of a significant prudential impact. • The composition and quantity of own funds held do not raise concerns. • The institution's liquidity position and funding profile do not raise concerns. • The institution's overall recovery capacity does not raise concerns. |
| 2 | The risks identified pose a medium-low level of risk to the viability of the institution. | <ul style="list-style-type: none"> • There is a low to medium level of concern about the institution's business model and strategy. |

| Score | Supervisory view | Considerations |
|-------|--|---|
| | | <ul style="list-style-type: none"> • There is a low to medium level of concern about the institution’s governance or institution-wide control arrangements. • There is a low to medium level of risk of a significant prudential impact caused by risks to capital and liquidity. • There is a low to medium level of concern about the composition and quantity of own funds held. • There is a low to medium level of concern about the institution’s liquidity position and/or funding profile. • There is a low to medium level of concern about the institution’s overall recovery capacity. |
| 3 | The risks identified pose a medium-high level of risk to the viability of the institution. | <ul style="list-style-type: none"> • There is a medium to high level of concern about the institution’s business model and strategy. • There is a medium to high level of concern about the institution’s governance or institution-wide control arrangements. • There is a medium to high level of risk of a significant prudential impact caused by risks to capital and liquidity. • There is a medium to high level of concern about the composition and quantity of own funds held by the institution. • There is a medium to high level of concern about the institution’s liquidity position and/or funding profile. • There is a medium to high level of concern about the institution’s overall recovery capacity. |
| 4 | The risks identified pose a high level of risk to the viability of the institution. | <ul style="list-style-type: none"> • There is a high level of concern about the institution’s business model and strategy. • There is a high level of concern about the institution’s governance or institution-wide control arrangements. • There is a high level of risk of a significant prudential impact caused by risks to capital and liquidity. |

| Score | Supervisory view | Considerations |
|-------|--|---|
| | | <ul style="list-style-type: none"> • There is a high level of concern about the composition and quantity of own funds held by the institution. • There is a high level of concern about the institution's liquidity position and/or funding profile. • There is a high level of concern about the institution's overall recovery capacity. |
| F | The institution is considered to be failing or likely to fail. | <ul style="list-style-type: none"> • There is an immediate risk to the viability of the institution. • The institution meets the conditions for failing or likely to fail, as specified in Article 32(4) of Directive 2014/59/EU²⁹. |

(50). Paragraph 465 of the Guidelines is replaced with the following:

‘Competent authorities should impose additional own funds requirements and establish own funds expectations by setting TSCR and determining P2G where relevant in accordance with the process and criteria specified in Title 7.’

(51). The following subsection is added after paragraph 476 of the Guidelines:

Supervisory measures based on the outcome of the qualitative review of stress testing

514. Based on the outcomes of the qualitative review of stress testing programmes and if deficiencies are identified, competent authorities should require the institution:

- a. to develop a plan of remedial action aimed at improving stress testing programmes and practices. Where material shortcomings are identified in how an institution addresses the outputs of stress tests, or if management actions are not deemed credible, competent authorities should require the institution to take further remedial actions, including requirements to make changes to the institution's capital plan;
- b. where appropriate, to run specific prescribed scenarios (or elements of those) or using specific assumptions.

²⁹ In particular, the competent authority is of the view that (1) the institution infringes, or there are objective elements to support a determination that the institution will, in the near future, infringe, the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority, for reasons including but not limited to the fact that the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds; (2) the institution's assets are, or there are objective elements to support a determination that the institution's assets will, in the near future, be, less than its liabilities; or (3) the institution is, or there are objective elements to support a determination that the institution will, in the near future, be, unable to pay its debts or other liabilities as they fall due.

Article 32(4)(d) of Directive [2014/59/EU](#) also identifies extraordinary public support criteria for the determination of whether an institution is failing or likely to fail, but these criteria are not considered for the purposes of SREP and the determination made by the competent authorities.

515. Furthermore, competent authorities may apply other supervisory measures as set out in Articles 104 and 105 of Directive 2013/36/EU if these are more appropriate to address the identified deficiencies as described in this section.
516. It is noted that supervisory assessment of the outcomes of reverse stress tests should assist with the assessment of business model viability and sustainability, and the assessment of scenarios used for ICAAP and ILAAP purposes, as well as in recovery planning.
517. Competent authorities should also use the outcomes of reverse stress tests performed by institutions to take into account possible systemic implications. Where several institutions identify similar reverse stress test scenarios that would expose these institutions to severe vulnerabilities, such scenarios should be analysed as an alert about possible systemic implications. Competent authorities should in such cases inform the relevant designated authorities about the nature of the stress scenarios identified.'

(52). After paragraph 499 of the Guidelines, the following sections are added:

10.6 Supervisory reaction to a situation where TSCR is not met

541. TSCR is a legally binding requirement that institutions have to meet at all times, including in stressed conditions. If TSCR set in accordance with these guidelines is no longer met, the competent authorities should consider additional intervention powers in accordance with Directives 2013/36/EU and 2014/59/EU, including withdrawal of authorisation in accordance with Article 18(d) of Directive 2013/36/EU, application of early intervention measures in accordance with Article 27 of Directive 2014/59/EU and resolution actions in accordance with that Directive. When exercising those powers, competent authorities should consider whether measures are proportionate to the circumstances and their judgement on how the situation is likely to develop.
542. A breach of TSCR should also be considered in determining if an institution is failing or likely to fail in accordance with Article 32(4)(a) of Directive 2014/59/EU and the EBA Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail, as it is one of the conditions under which the competent authorities may withdraw authorisation in accordance with Article 18(d) of Directive 2013/36/EU.

10.7 Supervisory reaction to a situation where P2G is not met

543. Competent authorities should monitor whether the amount of own funds expected according to P2G is established and maintained by the institution over time.
544. When the institution's own funds drop, or are likely to drop, below the level determined by P2G, the competent authority should expect the institution to notify it and prepare a revised capital plan. In its notification, the institution should explain what adverse consequences are likely to force it to do so and what actions are envisaged for the eventual restoration of compliance with P2G as part of an enhanced supervisory dialogue.
545. There are generally three situations to be considered by a competent authority in which an institution could fail to meet its P2G.
- a. Where the level of own funds falls below the level of P2G (while remaining above OCR) in institution-specific or external circumstances in which risks that P2G was aimed at covering have materialised, the institution may temporarily operate below the level of P2G provided that the competent authority considers its revised capital plan credible in accordance with the criteria set out in Section 7.7.3. The competent authority may also consider adjusting the level of P2G where appropriate.
 - b. Where the level of own funds falls below the level of P2G (while remaining above OCR) in institution-specific or external circumstances as a result of the materialisation of risks that P2G was not aimed at covering, competent authorities should expect the institution to increase the level of own funds to the level of P2G within an appropriate timeline.
 - c. Where the institution disregards P2G, does not incorporate it into its risk management framework or does not establish own funds to meet P2G within the time limits set in accordance with paragraph 397, this may lead to competent authorities applying additional supervisory measures as set out in Sections 10.3 and 10.5. Where appropriate, the competent authority may decide to review the level of the additional own funds requirements, in accordance with Title 7.
546. Notwithstanding particular supervisory responses in accordance with the previous paragraph, competent authorities may also consider the application of the capital and additional supervisory measures set out in Sections 10.3 and 10.5, where these are deemed more appropriate to address the reasons for the own funds falling below the level determined by P2G.
- (53). Paragraph 503 of the Guidelines is replaced with:
- ‘Where the macroprudential measure, because of its design specificities, does not cover a particular institution (as discussed above), competent authorities may consider, after having consulted the relevant designated authority, extending the effects of the measure

directly to that institution (e.g. by applying the equivalent risk weights to certain classes of exposures targeted by the macroprudential measure).’

(54). After paragraph 518 of the Guidelines, the following paragraphs are added:

‘566. All relevant information regarding the determination of P2G (including its size, the composition of own funds to cover it and supervisory reaction) for parent or subsidiary institutions of a cross-border group should be shared among competent authorities as part of the joint decision process pursuant to Article 113 of Directive 2013/36/EU. In particular, competent authorities should discuss the approach to establishing P2G at solo level where no data from the supervisory stress tests is available at solo level, or, where relevant, agree on the application of P2G at consolidated level only.

567. Where P2G is set, relevant information should be duly reflected in the joint decision document prepared in accordance with Article 113 of Directive 2013/36/EU and Commission Implementing Regulation (EU) No 710/2014, and included as an “information item”, as in the application of other supervisory measures formally outside the scope of the joint decision.’

(55). After paragraph 520 of the Guidelines, a new Title 12 is added as follows:

Title 12. Supervisory stress testing

12.1 Use of supervisory stress testing by competent authorities

570. Competent authorities should, also on the basis of Article 100 of Directive 2013/36/EU, use supervisory stress testing to facilitate SREP and, in particular, supervisory assessment of its key elements, as described in Titles 4 to 9. In particular, supervisory stress testing should help competent authorities, where appropriate, with the following:

- a. The assessment of institutions’ individual risks to capital as referred to in Title 6, or risks to liquidity and funding as referred to in Title 8.
- b. The assessment of the reliability of institutions’ stress testing programmes, as well as the relevance, severity and plausibility of scenarios for institutions’ own stress tests used for ICAAP and ILAAP purposes. This may include challenging institutions’ main assumptions and risk drivers.
- c. The assessment of institutions’ ability to meet TSCR and OCR in the context of the assessment of capital adequacy, as specified in Section 7.7. Depending on the coverage and type of the supervisory stress test, this assessment may be limited only to some elements of TSCR covered by the design features of the supervisory stress

- testing (e.g. additional own funds requirements for individual risk categories, if the stress test covers only such risk categories).
- d. The determination of P2G for institutions.
 - e. The identification of possible vulnerabilities or weaknesses in institutions' risk management and controls on individual risk areas.
 - f. The identification of possible deficiencies in overall governance arrangements or institution-wide controls: supervisory stress testing should be considered by competent authorities as an additional source of information for the purposes of the SREP assessment of internal governance and institution-wide controls referred to in Title 5. In particular, if a competent authority identifies by means of supervisory stress testing, deficiencies in the institution's own stress testing programmes or supporting risk data infrastructure, these should be taken into account in the assessment of the overall governance and risk management framework of that institution.
 - g. The determination of specific quantitative liquidity requirements in the context of the assessment of liquidity adequacy, especially where a competent authority has not developed specific supervisory benchmarks for liquidity requirements. Certain elements of the liquidity supervisory stress tests should, where appropriate, be used as inputs when setting specific liquidity requirements for institutions (e.g. a comparative analysis, under adverse scenarios, of net cash outflows and eligible liquid assets over a set of time horizons, assessment of stressed maturity ladder), as specified in Section 9.4.
571. Furthermore, supervisory stress testing should help competent authorities to assess supervisory organisational procedures and to plan supervisory resources, considering also other relevant information, in particular for the more frequent and in-depth assessment of certain SREP elements in the case of non-Category 1 institutions, and for the purposes of determining the scope of the supervisory examination programme required by Article 99 of Directive 2013/36/EU.
572. Competent authorities should also, where appropriate, use the scenarios and outcomes of supervisory stress tests as additional sources of information in the assessment of institutions' recovery plans, in particular when assessing the choice and severity of scenarios and assumptions used by the institution. In this assessment, the supervisory stress tests scenarios should, where appropriate, in particular where they satisfy the conditions set out in the EBA Guidelines on the range of scenarios to be used in recovery plans, be used as a reference point for the assessment of the institution's own scenarios and assumptions.
573. Competent authorities should also, where appropriate, use supervisory stress testing outcomes to support the analysis needed for the purposes of granting various permissions and authorisations required by Regulation (EU) No 575/2013 or Directive 2013/36/EU, for example in relation to qualifying holdings, mergers and acquisitions, and shares buy-backs.

574. Competent authorities should also use the outcomes of supervisory stress testing, where appropriate, to support a thematic analysis of the potential vulnerabilities of a group of institutions with similar risk profiles.
575. Competent authorities should also, where appropriate, use supervisory stress testing as a way to motivate institutions to enhance their internal stress testing and risk management capabilities: in particular, a supervisory stress test with a bottom-up component could motivate institutions to further develop and improve their data aggregation, risk modelling and IT tools for stress testing and risk management purposes.

12.2 Key elements of supervisory stress testing

576. When deciding on the key elements of supervisory stress testing, competent authorities should consider, inter alia, the following:
- a. Coverage, in terms of covering certain risk factors or multiple risk factors, certain individual portfolios, or activities or sectors/geographies, all or several portfolios.
 - b. Design, in terms of the following: (1) sensitivity analysis (single-factor or simple multi-factor), (2) scenario analysis or (3) reverse stress testing. Competent authorities should choose the design that is most appropriate for the objective pursued by the stress test: sensitivity analysis to a single risk factor or multiple risk factors should normally be favoured when assessing individual risk to capital or risks to liquidity or funding; the scenario analysis approach should normally be favoured when an assessment of overall capital adequacy is sought; while reverse stress testing may, inter alia, be deemed appropriate for assessing the severity of the scenarios used by the institution.
 - c. Scope, in terms of covering the perimeter of cross-border groups: for the purposes of the assessment of the overall capital adequacy of the group, competent authorities should ensure that all relevant group entities are taken into account in stress tests.
 - d. Sample of institutions covered by the stress tests: when planning supervisory stress testing for more than one institution, competent authorities should consider the appropriate sample for the purposes of the exercise, in particular when using supervisory stress testing for thematic assessments of certain business lines/models or impact studies/assessments.
 - e. Approach (top-down stress test, bottom-up stress test, a combination of both, prescribing specific anchor scenarios for institutions).
577. When designing and conducting supervisory stress tests for SREP purposes, competent authorities should consider the outcomes of asset quality reviews (AQR), where available, appropriate and not already incorporated into institutions' financial statements. Combining supervisory stress testing with AQRs can be considered useful in ensuring that the balance-sheet positions of the institutions covered by the supervisory stress tests are reported accurately with improved and comparable starting points across participating institutions.

578. Competent authorities may also consider setting predefined target capital ratios, especially in the context of system-wide stress tests (including country-level stress tests), or setting general or idiosyncratic thresholds. In such cases, these must be suitable and take into account supervisory objectives. Such targets or thresholds should apply consistently to the institutions within the scope of the supervisory stress tests.

12.3 Organisational and governance arrangements within competent authorities

579. Competent authorities should establish an effective programme for supervisory stress testing. This programme should be supported by appropriate organisation, governance and IT arrangements, ensuring that supervisory stress tests can be conducted with appropriate frequency. The supervisory stress testing programme should support the effective implementation of the supervisory examination programme for individual institutions. The programme should also reflect how the competent authority takes decisions regarding the choice of forms of supervisory stress testing in close connection with the objectives of each exercise.
580. The governance, organisation and IT arrangements supporting the supervisory stress testing programme should include at least the following:
- a. Sufficient human and material resources, data and IT infrastructure to design and conduct supervisory stress tests. In particular, the supervisory stress testing programme should be supported by adequate data and an appropriate methodological approach covering all aspects, including scenarios and assumptions (e.g. templates, guidance, documentation), and ensuring both flexibility and appropriate levels of quality and controls.
 - b. A quality assurance process covering stress testing design, development and execution, and the comparability of results across institutions.
 - c. The integration of supervisory stress testing into other relevant supervisory processes. Hence, when required and subject to any legal constraints, the organisation should support the internal sharing of information and utilisation of all aspects of the stress testing programme (e.g. both quantitative and qualitative results).
581. As part of governance arrangements, competent authorities should ensure that the supervisory stress testing programme is reviewed regularly, both qualitatively and quantitatively, to ensure that it is adequate.
582. Competent authorities should ensure that they have processes and arrangements in place for an effective dialogue with institutions regarding supervisory stress tests and their outcomes. This dialogue should reflect the intended objectives, be established in particular but not exclusively when supervisory stress tests are run for the purposes of the assessment

of the overall capital adequacy of institutions and be organised within the more general context of the SREP assessments as set out in these guidelines. For the purposes of such dialogue both at the technical and managerial level, where relevant, the competent authorities should ensure that:

- a. adequate, sufficiently detailed and accurate explanation and guidance is provided to institutions on the application of the methodologies and assumptions used in a bottom-up stress test;
 - b. adequate, sufficiently detailed and accurate instructions are given to institutions with regard to the supporting information required by them to be submitted to competent authorities along with the results of the stress tests;
 - c. explanation is provided to institutions following discussions, where relevant, of the outcomes of supervisory stress tests that lead to the application of supervisory measures. This should be considered by competent authorities in particular in the context of system-wide stress tests that trigger supervisory measures.
583. When applying supervisory stress testing to cross-border groups and their entities, competent authorities should exchange information and, where practically possible, appropriately discuss the process within the framework of colleges of supervisors. In particular, competent authorities should ensure that relevant details on the methodologies, scenarios and major assumptions as well as the results of supervisory stress tests, especially those aimed at assessing capital or liquidity adequacy, are made available and discussed.
584. Competent authorities should also identify what information regarding supervisory stress tests and their outcomes may be publicly disclosed, taking into account the intended purposes of the supervisory stress tests. When deciding on the public disclosure of the results or methodologies of supervisory stress tests, competent authorities should consider their own role in the exercise and the approach chosen (top-down stress test, bottom-up stress test) and also consider the extent of their own analysis to accompany published results.

12.4 Process and methodological considerations

585. The supervisory stress testing programme set out by the competent authorities should ensure at least the following:
- a. When designing methodologies and assumptions for use in supervisory stress tests, competent authorities should decide on the design and features of the exercise that are most suitable for its intended purpose, i.e. that are linked to the supervisory (or other) objectives set by the competent authority.
 - b. When conducting supervisory stress tests on a wider sample of institutions, competent authorities may consider adopting the design of supervisory stress tests

- for different categories of institutions as set out in Section 2.4, especially if the exercise is top-down.
- c. Competent authorities should consider the appropriate timelines for conducting supervisory stress tests, including the time horizon of the scenarios and the period over which the management actions proposed by institutions in the stress test exercise are analysed. The timelines for the exercise should also factor in the dialogue with the institution, where relevant for the intended purpose of the exercise, and the extent to which the data supplied by the participating institution will remain relevant.
 - d. Competent authorities should consider, where relevant for the intended purpose of the exercise, all known future regulatory changes affecting institutions within the scope and time horizon of the exercise.
586. In the case of a scenario analysis stress test, competent authorities should decide whether to run a single scenario to be applied to all institutions included in the scope of the exercise, or to develop institution-specific scenarios for individual institutions (the latter should not be seen as relieving institutions from the responsibility of designing own scenarios for the purposes of ICAAP and ILAAP stress testing), or a combination of the two. Competent authorities should consider the transferability of capital and liquidity resources in stressed conditions and any possible impediments, including legal and operational impediments, that may exist.
587. Furthermore, the following aspects should be considered when developing the methodologies for supervisory stress tests:
- a. For the purposes of the assessment of capital adequacy, competent authorities should consider the impact of the stress test on the institution's P&L, balance sheet, risk exposure amount and leverage ratio, and analyse the impact of the stress test on the capital ratios of institutions covered by the exercise.
 - b. For the purposes of bottom-up stress tests, competent authorities should consider the extent to which they prescribe the methodologies for modelling institutions' balance sheets and P&L. Indicatively, institutions' balance sheets may be taken as static, allowing competent authorities to assess current risks over time. Alternatively, they may be allowed to be dynamic, permitting, for example, a more forward-looking exploration of how institutions' business plans might evolve under the stress scenario or how credit volumes might evolve over time. For enhanced comparability, competent authorities may consider opting for the static balance sheet approach. Conversely, for enhanced feedback on institutions' intended or planned reactions vis-a-vis stresses and shocks, the dynamic balance sheet approach may be favoured.
 - c. Competent authorities should consider how to take account of systemic feedback or second-round effects in the stress tests, where relevant, recognising the limitations of providing ex ante assumptions in the case of bottom-up stress tests.
 - d. For the purposes of bottom-up supervisory stress tests, competent authorities should aim to assess the impact of such exercises consistently and fairly across the

institutions covered by supervisory stress tests, respecting the level playing field. Competent authorities should also consider the extent to which stress test results reflect differences in modelling choices and judgements among institutions, rather than true differences in the risks to which they are exposed.

588. Competent authorities should aim to assess model risk across stress testing exercises and have access to different types of comparative information. It is recommended to have, where appropriate, several perspectives/benchmarks. It is important to recognise that all models are imperfect and to clearly identify known and potential weaknesses. Understanding these limitations and weaknesses of individual institutions' stress testing models can inform the supervisory stress testing process and mitigate potential problems arising from model risk.

(56). Paragraph 522 has been amended as follows:

'Competent authorities should implement these guidelines by incorporating them into their supervisory processes and procedures by 1 January 2016.^{30'}

(57). Annexes 2 to 4 have been deleted.

(58). The following annexes are added to the Guidelines:

Annex 2. Key features and differences between P2R and P2G

| | <u>P2R</u> | <u>P2G</u> |
|--------|--|---|
| Nature | Requirement on top of Pillar 1 and below the combined buffer requirement set in accordance with Article 104 of the CRD | Expectation on top of the combined buffer requirement |
| Scope | (1) Risk of unexpected losses over 12 months not covered by minimum requirements; (2) risk of expected losses over 12 months insufficiently covered by provisions; (3) risk of underestimation of risk due to model deficiencies; (4) risks arising from governance deficiencies ³¹ | Quantitative outcomes of relevant stress tests (other potential areas to be explored further) |

³⁰ The revised SREP Guidelines will apply from 1 January 2019.

³¹ See paragraph 348.

| | <u>P2R</u> | <u>P2G</u> |
|---|---|---|
| Determination | Calculation based on ICAAP as a starting point, where assessed as reliable, supported by, for example, supervisory benchmarks applied in relation to ICAAP calculations, supervisory judgement, etc ³² | Calculation based on the maximum impact of the adverse scenario on the CET1 ratio, adjusted, for example, for credible mitigating actions and other factors, and offset against the own funds held to meet the CCB and in exceptional cases the CCyB if it covers the same risks assumed in the stress test |
| Quality of capital | Regulatory eligible own funds, at least in the same composition as Pillar 1 | CET1 only |
| Relevance for the restrictions on distributions under Article 141 of Directive 2013/36/EU | Yes | No |
| Communication to institution | Part of the TSCR ratio articulated in relation to all Pillar 1 ratios (total own funds, T1, CET1) | As a separate ratio, not part of TSCR or OCR, explaining how it affects all capital ratios (T1 and total own funds) |
| Compliance | Requirements to be met at all times, including in stressed conditions | Institutions are expected to incorporate P2G into their capital planning, risk management and recovery planning, and operate above P2G |
| Supervisory response to breaches | All supervisory measures can be applied; a breach is a potential condition for the withdrawal of authorisation; an institution in breach is considered failing or likely to fail for resolution purposes | No automatic link between the level of own funds falling below P2G and specific supervisory measures, but would trigger enhanced supervisory dialogue and engagement with an |

³² See paragraph 349.

| <u>P2R</u> | | <u>P2G</u> |
|------------|--|--|
| | | institution, as there is a need to provide a credible capital plan |

Annex 3. Overview of 2017 updates to the SREP Guidelines

| 2017 updates/changes to the SREP Guidelines | Section affected in the SREP |
|--|--|
| Pillar 2 capital guidance | Title 1.2 ‘Definitions’ Title 7.1 ‘General considerations’ Title 7.7.1 ‘Using P2G to address the quantitative outcomes of stress testing’ Title 7.8 ‘Summary of findings and scoring’ (including Table 8) Title 7.9 ‘Communication of prudential requirements’ Title 10.3 ‘Application of capital measures’ Title 10.7 ‘Supervisory reaction to a situation where P2G is not met’ Title 11.2 ‘SREP capital assessment and institution-specific prudential requirements’ Annex 2 ‘Key features and differences between P2R and P2G’ |
| Supervisory stress testing | Title 1.1 ‘Subject matter’ Title 1.2 ‘Definitions’ Title 12 ‘Supervisory stress testing’ Title 13 ‘Final provisions and implementation’ |
| Supervisory assessment of institutions’ stress testing | Title 5.6.3 ‘Assessment of institutions’ stress testing’ Title 10.5 ‘Application of supervisory measures’ |
| Alignment of supervisory assessment of IRRBB with the revision of the EBA Guidelines on IRRBB | Title 6.5 ‘Assessment of interest rate risk arising from non-trading book activities’ |
| Scoring framework | Title 1.2 ‘Definitions’ Title 2.2 ‘Scoring in the SREP’ Title 4.1, Title 5.1.1, Title 6.2.4, Title 6.3.4, Title 6.4.5, Title 6.5.4, Title 7.8, Title 8.5, Title 9.6 – ‘Summary of findings and scoring’ Title 6.1, Title 8.1 – ‘General considerations’ Title 10.2 ‘Overall SREP assessment’ (including Table 13) |
| Articulation of TSCR and OCR and communication of supervisory capital expectations to the institutions | Title 7.5 ‘Articulation of own funds requirements’ Title 7.9 ‘Communication of prudential requirements’ |
| Other | General clarifications added to the ‘Background and rationale’ section Title 10.6 ‘Supervisory reaction to a situation where TSCR is not met’ (new section) |

** Note that the numbering of some sections has changed in the updated version. Titles provided in this table refer to the new numbering in the updated version of the guidelines. Some sections have been newly created.*

(59). Competent authorities should implement the above amendments to the Guidelines by incorporating them into their supervisory processes and procedures by 1 January 2019.

Accompanying documents

Draft cost-benefit analysis/impact assessment

Article 16(2) of the EBA Regulation provides that the EBA should carry out an analysis of ‘the potential related costs and benefits’ of any guidelines it develops. This analysis should provide an overview of the findings regarding the problem to be dealt with, the solutions proposed and the potential impact of these options.

This analysis presents an impact assessment (IA) with a cost-benefit analysis of the policy options taken into account for the revisions to the SREP Guidelines described in this Consultation Paper. Given the nature and scope of the revisions, the IA is high-level and mainly qualitative in nature. This section also includes quantitative analyses when appropriate and possible, using available supervisory data.

The analysis presented in this section focused on the newly introduced section on P2G, without covering the other areas, for the following reasons:

- The revisions to the SREP Guidelines do not introduce significant changes to the requirements for supervisory stress testing compared with the EBA Consultation Paper on Guidelines on stress testing and supervisory stress testing, which has been already consulted on, together with the associated impact assessment, at the first draft stage, and therefore an impact analysis related to supervisory stress testing is not carried out in this section.
- Additional clarifications on the supervisory assessment of institutions’ stress testing are based entirely on the EBA Consultation Paper on Guidelines on stress testing and supervisory stress testing, which has already been consulted on, together with the associated impact assessment.
- Additional clarifications related to scoring were considered necessary to align the text of the guidelines with the current supervisory practices without changing the policy direction. These further clarifications do not have a material impact on the SREP Guidelines and therefore an additional impact assessment was not considered necessary.
- Changes introduced to the section on the assessment of internal governance and institution-wide controls represent the alignment of the text with the revised structure and content of the EBA Guidelines on internal governance³³, the requirements of which have been subject to a separate public consultation and impact assessment.

³³ EBA Guidelines on internal governance ([EBA/GL/2017/11](#)).

A. Problem identification

Some of the main problems the revisions to the SREP Guidelines aim to address include the approach to addressing quantitative outcomes of supervisory stress tests in the SREP assessment of capital adequacy, and differences observed in the definition and implementation of P2G, as well as the potential risk these may pose to the level playing field across the EU banking sector.

P2G is currently applied in various jurisdictions (e.g. UK, SE, DK, NO, SSM), but practices differ across jurisdictions. Current practices suggest that the basis for setting P2G differs across jurisdictions, as not all the competent authorities apply it on the basis of the quantitative results of stress testing. For example, in 2016 only 30% of the competent authorities applied P2G on the basis of supervisory stress test results, with banks' P2G levels ranging from 0% to 14.2%. By contrast, 70% of the competent authorities did not apply P2G at all or applied it on the basis of other parameters, rather than solely on the basis of supervisory stress test results³⁴.

Differences in definition and implementation will lead to different approaches and different levels of P2G across Europe, which would not necessarily be justified by the different risk profiles of the banks but would result, rather, from differences in application.

Moreover, it was observed that for some competent authorities the scope of binding Pillar 2 requirements (P2R) is not clearly separated from that of P2G. In theory, while the former aims to address risks partially covered or not covered at all under Pillar 1 requirements, the latter is designed to address supervisory concerns related to the quantitative outcomes of supervisory stress testing. This lack of a clear distinction may create distortions in regulatory practice and markets: P2G should be of a non-legally binding nature and sit on top of banks' total capital requirements (Pillar 1, P2R and combined buffers), and should not affect automatic restrictions on distributions (MDA trigger and calculation). Uncertainty around the basis and the drivers behind P2G versus P2R, and how stress test results are treated in this context across different jurisdictions, could therefore have a substantial impact on markets and investors. These distortions across jurisdictions and markets may result in hampering the level playing field in the EU banking sector, thus affecting fair competition.

B. Policy objectives and baseline scenario

The main objectives of the revisions to the SREP Guidelines are to address problems identified in the implementation of the current SREP framework and also to reflect recent developments. The aims are, inter alia, to clearly distinguish P2R and P2G and to establish a clear link between supervisory stress testing and SREP.

The general objectives of the guidelines are to:

³⁴ Note that these numbers apply to a surveyed sample of 17 NCAs only.

- strengthen and achieve supervisory convergence and eliminate room for misinterpretation in the implementation of the SREP framework;
- ensure a level playing field for banks and jurisdictions across the EU banking sector.

The specific objectives of this update are to:

- link the output of supervisory stress testing to supervisory responses (in the form of P2G) and ensure competent authorities are consistent in its application;
- remove overlaps between P2R and P2G as well as with capital buffers and establish common guidance on general aspects related to the calculation and application of P2G.

More specifically, the revised sections on capital adequacy assessment aim to address the potential gaps and inconsistencies in the application of a particular SREP element and harmonise the approach to using the outcomes of various forms of stress testing in SREP, and, in particular, to using the quantitative outcomes of supervisory stress tests in assessing capital adequacy. The revisions aim to bring additional consistency to practices where the EBA has previously observed divergent approaches employed by competent authorities. In particular, in some cases the current practices do not always establish a consistent interplay between the applied SREP framework, P2R, supervisory stress testing and P2G.

The revised SREP Guidelines clarify how quantitative outcomes of supervisory stress tests should be used in the capital adequacy assessment element of SREP, making sure competent authorities do not incorporate such outcomes into the legally binding TSCR but, rather, reflect them in P2G.

C. Options considered

This section presents the main technical policy options discussed and the decisions made during the development of this update with regard to the new sections introduced on P2G. The next section discusses the reasoning, the advantages and disadvantages, and the potential costs and benefits of the policy options. The reasoning presented is mostly qualitative and includes, where possible, quantitative analysis.

Status quo versus intervention

Option 1a: No action: do not revise/update SREP guidelines (EBA/GL/2014/13)

Option 1b: Regulatory intervention: revise/update SREP guidelines (EBA/GL/2014/13)

Stress test scenario type for P2G purposes

Option 2a: Baseline scenario

Option 2b: Adverse scenario

Calculation of the maximum stress impact

Option 3a: Considering movements in CET1 capital only and keeping TREA constant at reference point

Option 3b: Considering movements in CET1 capital and TREA in the worst year of scenario

Treatment of CRD capital buffers

Option 4a: No offsetting effect between (elements of) the combined capital buffer and P2G

Option 4b: Offsetting P2G against (elements of) combined capital buffer

Quality of capital

Option 3a: Quality of capital for P2G to mirror quality requirements for P2R

Option 3b: P2G to be met only with CET1 capital

D. Assessment of the options and the preferred options

Status quo versus intervention

The current implementation of SREP Guidelines revealed areas where further guidance would be useful to promote harmonisation and consistency across the EU. Moreover, the recent developments in the EU and international fora, as well as the EBA's findings from its ongoing monitoring and assessment of the convergence of supervisory practices, have highlighted the need for some changes in order to reinforce the SREP framework.

In addition to the above, harmonisation of how supervisors reflect their views/concerns regarding institutions' capital positions as a result of supervisory stress tests would also ensure that banks are treated in a consistent manner across the EU. P2G would allow competent authorities to oversee banks' capital levels based on the assessment and analysis of supervisory stress testing scenarios and would allow different capital levels (P2G) for banks depending on the quantitative outcomes of the stress tests.

As indicated in the problem definition, with no further intervention the issues identified would remain (i.e. inadequate background on P2G and the link to supervisory stress testing), and this could lead to inconsistencies and inaccuracies in implementation. Such inconsistencies, without any EBA intervention, might lead to a situation where some competent authorities were incorporating the outcomes of stress tests into the legally binding P2R, thus putting those banks at a disadvantage compared with banks for which stress test results were addressed differently, including by means of non-legally binding P2G. Furthermore, the general objective of a level playing field and supervisory convergence would be compromised.

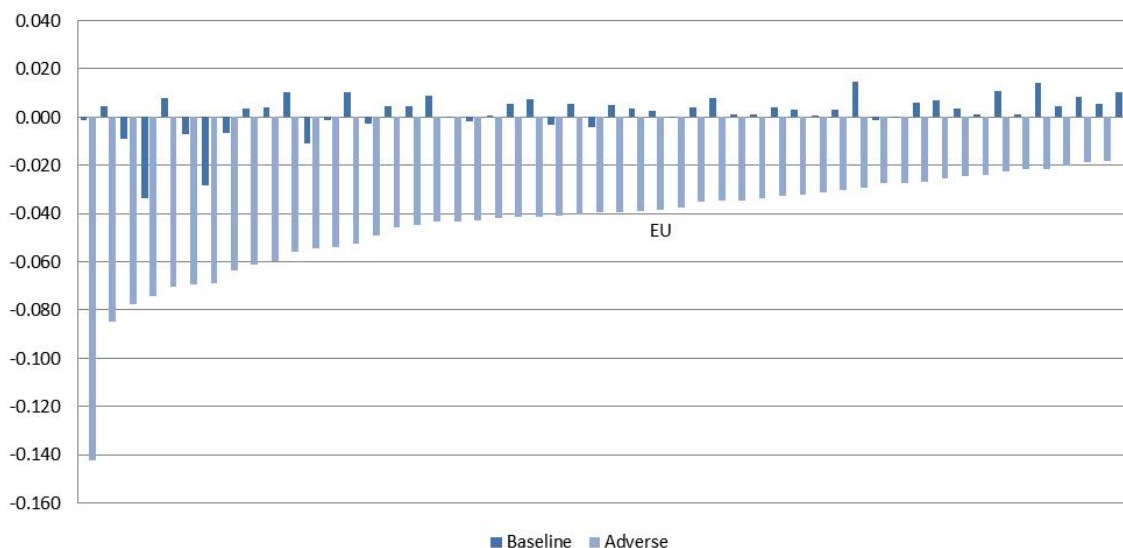
The policy option to intervene is expected to address some of the shortcomings identified in the current regulatory framework by clarifying that stress test outcomes should be not directly incorporated into P2R but, rather, incorporated into P2G. This is done without adding new rules to those that were included in the first version of the SREP Guidelines with regard to P2R. Therefore, no further costs are generally expected, either for competent authorities or for institutions. The impact of the intervention is expected to be positive, as competent authorities and institutions will benefit from greater clarity and markets from more certainty in the form of a level playing field across the EU. The revision of the SREP Guidelines is generally not expected to create further administrative or operational costs for competent authorities or institutions. The preferred option is **Option 1b**.

Stress test scenario type for P2G purposes

In line with the provisions of the guidelines, competent authorities are expected to determine P2G based on the quantitative outcomes of supervisory stress testing. It is therefore key to streamline the methodologies used to determine P2G levels. For general stress testing purposes, competent authorities are required to calculate the depletion of the CET1 ratio of institutions under both the baseline scenario and the adverse scenario. The option to be investigated is whether P2G should be established as a capital expectation based on the baseline scenario (Option 2a) or based on the adverse scenario (Option 2b).

Based on the 2016 EBA stress test results (December 2015 reference data), the following analysis compares the starting CET1 ratio (as of December 2015) with the lowest CET1 ratio during the three-year period (December 2016, December 2017 or December 2018) for each bank. The sample includes 51 EU banks and covers EUR 25.8 trillion in assets (or roughly 70% of the total EU banking sector). As expected, Figure 5 indicates that the maximum depletion of the CET1 ratio between end-2015 and 2018 is more severe under the adverse scenario for all banks. The data shows that CET1 ratios increase under the baseline scenario for most banks (approximately 70% of the banks in the sample) and for the EU on average.

Figure 5 – Maximum change in CET1 ratio under baseline scenario and adverse scenario (by bank and in percentage points)



Source and notes:

2016 EBA stress test data (data as of December 2015).

'EU' indicates the EU (weighted) average.

Adverse and baseline scenario are based on considering the impacts of the scenario on both CET1 and TREA.

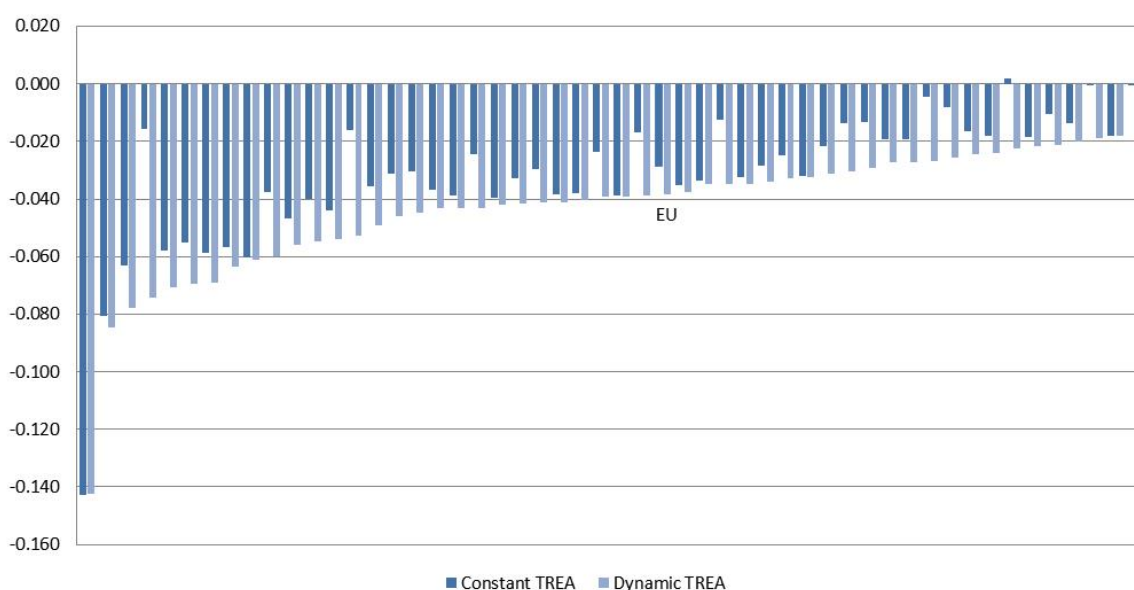
As the baseline scenario is based on macroeconomic forecasts without any adverse component, it is reasonable to argue that taking into consideration an adverse scenario for the determination of P2G provides a more prudent and accurate supervisory approach. Moreover, the purpose of P2G is to ensure that banks will preserve the applicable capital requirements ratio under stressed conditions and not under normal economic forecasts. The hypothetical latter case could call the possibility of the offsetting P2G against the CCB into question. As a result, the preferred option is **Option 2b**, under which, for most of the banks, P2G would be set based on the outcomes of the stress tests under the adverse scenario. It should be noted, however, as supervisory stress testing and the P2G concept apply to all banks, including those undergoing restructuring (and resolution), that the application of P2G based on the outcomes of the adverse scenario without recognising ongoing restructuring and resolution may not be appropriate and may jeopardise the ongoing recovery or resolution process. In these specific cases, competent authorities should take into account (in the form of adjustments) any ongoing restructuring/resolution when determining the P2G applicable to an institution.

Calculation of the maximum stress impact

The calculation of the maximum stress impact under the adverse scenario can be performed according to two different approaches: (i) calculation of the CET1 ratio in the worst year looking only at the impacts of the scenario on CET1 capital while keeping TREA unchanged from the reference date (CET1 in the worst year/TREA in T_0), or (ii) calculation of the CET1 ratio in the worst year taking into account the impact of the scenario on both CET1 capital and TREA in the worst

year. The two approaches may result in quite a different picture for some banks. While the focus of the former is on identifying the maximum loss to be covered by CET1 capital, the latter also takes into account changes in the quality of the portfolio/risk profile of an institution and allows for a potential offsetting or reinforcing effect between the numerator and the denominator of the CET1 ratio.

Figure 6 – Change in the CET1 ratio considering the impacts of the scenarios on CET1 capital only versus impacts on both CET1 capital and TREA (by bank and in percentage points)



Source and notes:

2016 EBA stress test data (data as of December 2015).

'EU' indicates the EU (weighted) average.

Figure 6 shows that considering movements in both CET1 capital and TREA in the worst year of the scenario results overall in a greater depletion in CET1 ratios and can be considered more prudent. For all banks except one, the decrease in the CET1 ratio is greater when movements in TREA are also taken into account, rather than their being kept constant throughout the stress period. In the light of the above and to ensure realistic results reflecting current practices in the context of stress testing, the preferred option is **Option 3b**.

Further analysis suggests that, from a sample of 51 banks, in 43 instances (or almost 85% of cases) the largest drop in the CET1 nominal amount across the three-year period occurs in the same year as the largest drop in the CET1 ratio.

Treatment of CRD capital buffers

The revised guidelines aim to clarify the scope of P2G and eliminate any potential overlap between the additional capital requirements set as P2G and the combined buffer requirement. Banks' capital

levels to be determined through supervisory stress testing are also related to macroprudential capital requirements in the form of the combined capital buffer, including the CCB, the CCyB and systemic risk buffers (G-SII/O-SII buffers and the systemic risk buffer). While capital buffers contribute to institutions' resilience in addition to TSCR, they may overlap with the additional capital that institutions are expected to hold as part of P2G to cope with stress situations, as the main idea of the buffers is for banks to have more capital needed for dealing with stress situations. Accordingly, specific elements of the combined buffer may be considered to be offset against the established P2G amount in order to prevent any double counting when setting capital expectations for dealing with stress situations.

More precisely, the objective of the CCB is to allow an institution to build up capital that can be used in periods of stress. This therefore represents a direct overlap with the additional capital to be held in response to the results of supervisory stress testing, as they are designed for the same purpose, and as a result they could be netted off, i.e. the initial calculated level of P2G reduced by the amount of the CCB.

Secondly, the CCyB aims to protect institutions from periods of excess aggregate credit growth that have often been associated with increased financial system risk. The idea is to build up buffers during times of economic boom, for example when credit supply is growing rapidly, so it can be reduced in times of economic downturn. The CCyB is set by the designated (macroprudential) authorities based on the consideration of certain macroeconomic risks that may also be factored into the design of the scenarios used in supervisory stress testing. In such cases, there may therefore also be an overlap between the CCyB and the capital set based on stress test results, and therefore partial offsetting may be possible.

However, no overlap/double counting is expected when it comes to systemic risk buffers, such as G-SII/O-SII buffers, as these buffers address risks other than those assumed to be covered by stress testing. These particular buffers are institution-specific and are set to compensate for the higher risk that such (systemic) institutions represent to the wider financial system and the potential impact of their failure on the financial system as a whole. Therefore, these elements of the combined buffer should not be used to offset P2G, which is set based on supervisory stress tests.

Without providing any specifications on the treatment of the CRD capital buffers, some of the issues mentioned above would be expected to remain. The operational costs of implementing this option are expected to be negligible for the competent authorities. At the same time, institutions would potentially benefit from recognising the duplications on capital expectations described above, as the objective of this option is to eliminate any potential overlap between P2G and capital buffers. The net benefits of offsetting P2G and relevant capital buffers are expected to be greater than those of no harmonisation. As a result, the preferred option is **Option 4b**.

Quality of capital

The SREP Guidelines specify the quality of capital competent authorities should require institutions to hold to meet P2R, namely at least the same proportion/composition as the quality of capital

required to meet the minimum own funds requirements (competent authorities have the option, however, to require P2R to be fully met with CET1). This is due to the fact that P2R covers the same concept, that of ‘unexpected losses’, as the minimum own funds requirements. Following the same logic, the quality of capital to be held for the purposes of P2G should mirror the quality required for P2R, i.e. at least three quarters of P2R should be met with T1 capital, with at least three quarters of the T1 capital to be composed of CET1 capital.

Requiring P2G to be covered in a similar way to P2R in terms of the proportion of the different capital instruments may, however, have disadvantages:

- First, as P2G is set to cover potential losses revealed by supervisory stress tests and its calculation assumes offsetting against certain elements of the combined buffer (see Option 2b), this would be operationally more difficult to execute if the guidelines required institutions to disentangle the CET1 part of P2G, which would be eligible for offsetting, from other parts. In this case, the operational cost of implementation would be high, without generating greater benefits from using different quality requirements to justify this granularity.
- Second, as P2G is aimed at covering losses stemming from the outcomes of supervisory stress tests and is ultimately aimed at allowing an institution to meet its TSCR under stressed conditions, with CET1 having a greater loss absorption capacity than AT1 and T2, whereas against the above considerations, the preferred approach is to require institutions to hold only CET1 own funds to meet P2G and therefore **Option 5b** is the preferred option.

D. Conclusion

The overall application of the above policy options (i.e. the use of the adverse scenario to calculate the maximum stress impact, considering the movement of TREA in the adverse scenario, allowing offsetting of the maximum stress impact with the CCB only, and in some instances the CCyB, and requiring P2G to be fully met by CET1) may entail a generally higher total supervisory capital demand (OCR plus P2G) for institutions compared with the approach of the current SREP Guidelines, which do not address the matter in detail.

This regulatory intervention, as a predefined, uniform P2G framework across countries based on quantitative supervisory stress test results, by definition will have an impact, and, in this case, it may lead to higher capital demand through the introduction of P2G in addition to TSCR and the combined buffer requirements.

An indicative implementation of the above policy options to the EBA 2016 stress test results for the calculation of implied P2G levels (for the 51 banking groups included in the stress test sample)

would suggest an average P2G level of 3.5%, if applied in 2016, with levels ranging between 0% and 13.6% for individual institutions³⁵.

Nevertheless, a number of key factors should be taken into account before concluding on the explicit impact of the newly introduced P2G framework:

- (i) The CCB will be fully loaded at 2.5% in all jurisdictions from January 2019 (end of transitional provisions as per Article 160 of Directive 2013/36/EU). Therefore, the amount by which P2G can be offset would be steadily increasing by 2019.
- (ii) The abovementioned calculation does not include any supervisory adjustments that would be considered by competent authorities in accordance with the criteria set out in the revised SREP Guidelines when calculating P2G, and would, potentially, further reduce actual P2G levels.
- (iii) A general increasing trend in actual CET1 ratios has been observed across institutions (in the sample) in the last two years, evidencing that institutions are in the process of building up capital to meet capital demand already communicated by the competent authorities (including P2G, which is applicable in some jurisdictions) and any future capital needs.
- (iv) P2R shows a decreasing trend in a number of jurisdictions following the introduction of P2G, thus partly offsetting the increase in overall supervisory capital demand.

Based on the above considerations, and taking into account that some jurisdictions have already been applying P2G in practice, the overall impact of the implementation of these guidelines and the policy options chosen should not be material, while the benefits of a consistent approach to addressing the quantitative outcomes of supervisory stress tests across the EU in accordance with these guidelines should outweigh the costs.

³⁵ This estimation uses the maximum stress impact from the 2016 EBA stress test under the adverse scenario, allowing for movements in both CET1 and TREA. The resulting amounts have been offset with CCB levels as applicable in January 2016. Adjustments have been assumed to be zero.

Feedback on the public consultation

The EBA publicly consulted on the draft revised guidelines. The consultation period lasted three months, from 31 October 2017 to 31 January 2018. Altogether, the EBA received fourteen responses to the consultation, with ten responses published on the EBA website and four responses treated as confidential. This section presents a summary of the key points raised during the public consultation, the analysis and discussion triggered by these comments, and the actions taken to address them (if deemed necessary). All changes to the revised guidelines that have resulted from the public consultation are reflected in this document.

Summary of key issues and the EBA's response

General comments on the revision of the guidelines included, inter alia, suggestions that the review of the guidelines be postponed until the release of the final CRD V, as well as requests for a sufficient implementation period. In addition, clarification was requested on the interaction between SREP and various supervisory stages, and, for example, between capital requirements/P2G and other triggers or thresholds. There were also comments related to unchanged parts of the guidelines, such as regarding the Pillar 1-plus approach.

On scoring, some respondents suggested that more details on how exactly individual scores feed into the overall SREP score be introduced. There were also suggestions that specific wordings on the considerations included in the scoring tables be changed. Furthermore, some respondents asked for more transparency on the scoring applied.

With regard to the revisions made on IRRBB, respondents again suggested waiting until the finalisation of the CRD IV review. Comments also related to concerns regarding the different effects of the outlier test on different banks (i.e. large changes in present value disproportionately affecting institutions with high net asset values) and questions regarding the role of the compliance function in the context of IRRBB management.

With regard to the revised governance section, many respondents would have preferred the introduction of references to existing EBA and Joint Committee guidelines, rather than the use of parallel text. Furthermore, clarifications of specific terms were requested and there were some general remarks on not using EBA guidelines to introduce international standards without an explicit CRR/CRD mandate.

Among the key issues raised by several respondents with regard to P2G were the overlap of P2G and macroprudential buffers and concerns about an overlap of P2R and P2G. Furthermore, it was suggested that the backstop introduced for applying P2G in cases of TSCR breach under stressed conditions be removed and instead that the principle should be applied the other way around (in case of no TSCR breach in the stress scenario, P2G should not be set). Other respondents voiced concern that P2G would introduce additional uncertainty, as the requirement for a capital plan and other supervisory measures could be expected to be introduced even at capital levels above the

MDA trigger (i.e. through P2G). Some respondents further raised concerns about the requirement for P2G to be fully met with CET1 capital, and others disagreed with regard to the paragraph intended to prevent any double counting of CET1 capital to meet P2G and to cover a shortfall in AT1/T2. Some concerns were also raised regarding the communication of capital requirements and ratios, as combined buffer requirements may change before the next SREP cycle, thus changing the implied OCR requirements. The introduction of IFRS 9 and its impact in the context of determining the level of P2G using the worst year of stress was another issue raised.

The majority of respondents did not favour the disclosure of P2G or explicit mention of no disclosure in a separate paragraph.

With regard to stress testing, comments related to, inter alia, the role of internal ICAAP stress tests in the context of P2G, clarifications of definitions, transparency of stress testing programmes (i.e. results to be disclosed to institutions in a timely and comprehensive manner, as supervisory stress tests might be associated with significant pressure on the resources of participating institutions), and communication of supervisory stress testing. Further comments related to, inter alia, the relationship between supervisory stress testing and the scenarios used in banks' recovery plans. Some respondents also commented on the potentially different target ratios in supervisory system-wide stress tests and the implications of these for the level playing field.

The EBA carefully examined all of the comments received (see the table below) and amended the text of the revised guidelines accordingly.

In particular, the EBA provided further clarification in the background section on the relationship between SREP and early intervention and resolution. Several clarifications and cross-references have also been introduced in the internal governance section.

The use of institutions' internal stress test results has been clarified in the context of P2G and some wording has been adjusted in order to ensure consistency in terminology. Clarifications have also been provided in some of the wording related to capital planning. Furthermore, the communication example has been clarified with regard to the applicability of OCR.

The paragraph on the disclosure of P2G has been removed and instead a sentence on disclosure has been included in the background section of the revised guidelines.

Summary of responses to the consultation and the EBA's analysis

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
|--|--|---|--|
| General comments | | | |
| Principle of proportionality | Some respondents stated that they appreciated the focus on proportionality and recommended adapting all aspects of the SREP GL to the proportionality principle. It is important that the SREP process reflects differences in size, complexity and business models. However, respondents felt that specific improvements in terms of proportionality for stress testing were still required. | The principle of proportionality is embedded in the 'Background and rationale' section ('Proportionality in SREP') and is expanded upon within the GL. The principle is recognised in and applies to all aspects of these GL, including varying scopes of stress testing (e.g. simple portfolio-level sensitivity or individual risk-level analyses versus comprehensive institution-wide scenario stress testing, and process-related and methodological considerations regarding supervisory stress testing). | No amendments. |
| Alignment of the SREP processes | One respondent stressed the need to better align EU and SSM initiatives, in particular in relation to the SSM's multi-year ICAAP-ILAAP plan, i.e. it was suggested that the proposed amendments to the EBA SREP GL do not seem to take fully into account the ECB's multi-year plan on SSM GL on ICAAP and ILAAP, published in February 2017. In this respondent's view, it is of utmost importance that the material parts of the SREP process (ICAAP, ILAAP) are consistent between the EBA and the ECB. | The EBA acknowledges the importance of aligning EBA and SSM initiatives and notes that the EBA Pillar 2 Roadmap was agreed with all relevant stakeholders (including the ECB as a competent authority to which the GL apply). | No amendments. |
| Adoption date | As the CRR, CRD and BRRD are currently under review and since the final texts have not yet been agreed, some respondents believe that additional comments on some parts of the SREP GL might be required depending on the outcome of the ongoing revisions. Some respondents suggested that the | The EBA Pillar 2 Roadmap clearly sets out the rationale for the revisions to the Pillar 2 framework (to keep the SREP GL that were published in December 2014, and which have been in force since January 2016, up to date with respect to EU and international standards, promote best supervisory | The timeline communicated through the EBA Roadmap will be followed, as the |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
|----------|---|--|---|
| | <p>review or the finalisation of the SREP GL be postponed until the release of the final CRR/CRD V, i.e. until the legislative process is concluded in order to avoid any misalignment and need for readjustments to the GL that may become necessary as a consequence, and to avoid any unnecessary implementation burden for institutions (e.g. P2G is not explicitly referred to in CRD IV).</p> <p>In addition, one respondent raised concerns regarding the parallel update of several GL: within the SREP GL there are many references to regulatory products that are either not finalised or not yet implemented. The new BCBS GL on step-in risk are currently not yet part of the EU framework; the EBA draft GL on IRRBB are under consultation and, furthermore, the CRD review is looking at the same issue as part of the Level 1 legislative process; the SREP GL refer to the fact that the EBA will review the CEBS GL on outsourcing, without giving further details; and, finally, the draft GL on stress testing (2017/17) are still under parallel review at EBA level. One respondent explicitly suggested that the EBA waits for the adoption of the CRD revision before updating Section 6.5. on IRRBB of the SREP GL.</p> <p>On the other hand, several respondents were of the opinion that the revision of the GL is carried out with appropriate timing and that the GL should be adopted as soon as the CRR II and CRD V are agreed upon. Moreover, within the wider revision of the</p> | <p>practices and address issues identified in the EBA's ongoing work on the assessment of supervisory convergence).</p> <p>Since the publication and first application of the SREP GL there have been a significant number of external developments that affect the SREP framework and which need to be reflected in the updated GL. In particular, this relates to the use of supervisory stress testing in SREP and the wider introduction of P2G in 2016, the revision by the BCBS of its IRRBB framework, which needs to be implemented in the EU legislation, and the clarification of the European framework for the application of the MDA. These concepts have been agreed by the EBA Board of Supervisors and will serve as the basis for the approaches applied in the 2016 and 2017 SREP assessments, as well as for the development of the relevant sections of the SREP GL.</p> <p>The Pillar 2 Roadmap outlines the approach that the EBA is planning to take in relation to the following: (i) update of the EBA GL on common procedures and methodology for SREP; (ii) update of the EBA GL on technical aspects of the management of interest rate risk arising from non-trading activities in the context of the supervisory review process (EBA Guidelines on IRRBB); and (iii) finalisation of the draft GL on stress testing and supervisory stress testing after the public consultation. The Roadmap also clearly communicated in advance the indicative timeline for the revision of the SREP GL (see the Roadmap's Annex, with an indicative timeline for the key</p> | <p>revised GL are needed to achieve convergent supervisory practices. In line with the EBA Pillar 2 Roadmap, a second round of revisions to the SREP GL may follow after the finalisation of the CRR/CRD review, if deemed necessary.</p> |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
|------------------------------|---|--|-----------------------------|
| | <p>CRD IV package, this consultation could help in implementing the new requirements that are being introduced.</p> <p>Timely coordination and precise drafting in both texts will be key to achieving the clarity and harmonisation objectives of all regulators involved in this process. While respondents thought the text was relatively clear, they struggled to reconcile the wording of the (evolving) CRD V Level 1 text with the draft GL in certain areas. In particular, it was noted that more precision in the Level 1 text would be helpful in the following areas: (i) specification that Pillar 2 does not address macroprudential risks, (ii) ensuring that there is no overlap (through offsetting) with risks already covered by the combined buffer requirements, and (iii) the concept of ‘risks or elements of risks’ (versus the EBA language ‘risks or aspects of risks’).</p> | <p>milestones in relation to Pillar 2; specifically, the implementation of the 2017 update of the GL is expected in 2018, while the second round of updates after the CRR/CRD review (if necessary) is expected in 2019.</p> <p>The process of finalisation and subsequent adoption of the CRD V/CRR II (and in the case of CRD V its transposition into national regulatory frameworks) will inevitably take some time. At the same time, the need to align supervisory practices remains urgent, particularly with regard to P2G. Therefore, the benefits of delaying the adoption and implementation of the SREP GL are not viewed as outweighing the need to achieve greater clarity and a level playing field for the European banking sector and its participants in a timely manner.</p> <p>Importantly, it should be noted that the revisions made to the SREP GLs are fully compatible with the current revisions proposed to the Level 1 text.</p> <p>The second revision of the SREP GL, in 2018-2019, will pick up the points finalised in CRD V and developed at the international level that have not been included in this revision (as indicated in the Pillar 2 Roadmap).</p> | |
| Implementation period | <p>Some respondents asked for a sufficient implementation period of at least 1.5 years or for the implementation date to be explicitly linked with the CRD V transition, particularly regarding P2G elements. In addition, one respondent also advocated a later implementation date in order to avoid a situation in which existing risk management</p> | <p>Competent authorities started applying the new tool introduced in this revision (P2G) in 2016. In order to ensure a level playing field, it is essential to pursue convergence on the use of P2G as soon as possible (by introducing P2G into the revised GL). To this end, the EBA maintains the position that this revision of the GL should apply from 1 January 2019, and therefore the</p> | No amendments. |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
|--|---|---|---|
| | requirements have to be adapted continuously. Since the GL were subject to a general review, a new implementation date should be given. | new provision should be applied in the 2019 SREP cycle. This also allows time for the competent authorities (and institutions, where relevant) to adjust. | |
| Responses to questions in Consultation Paper EBA/CP/2017/18 | | | |
| Question 1: What are the respondents' views on the overall amendments and clarifications added to the revised guidelines? | | | |
| <p>Page 14</p> <p>'Background and rationale' section</p> <p>P2R</p> | <p>Some respondents stated that the SREP GL stipulate that institutions should be expected to meet P2R at all times. If a decision on additional capital requirements results in either new additional capital requirements on top of the former capital requirements, or in requirements regarding the quality of additional own funds becoming stricter, institutions will not necessarily be able to meet the requirements immediately (will not 'comply at all times'). Therefore, it is necessary to provide institutions with an adequate timeframe of at least six months to fulfil the new requirements. The wording should be changed as follows: 'Such requirements should be set in a legally binding way and institutions should be expected to meet them in an appropriate timeframe of at least six months.'</p> <p>One respondent commented on the second subparagraph on page 14, 'Competent authorities should take appropriate supervisory measures to ensure that the institution is adequately capitalised where an institution may not be able to meet the applicable own funds requirements in stress situations or is excessively sensitive to the</p> | <p>The EBA notes that P2R are set and communicated to institutions in accordance with these GL; any timelines provided to the institutions for meeting such requirements remain at the discretion of competent authorities and may be linked to the specificities of individual institutions and the circumstances under which P2R are set.</p> <p>Furthermore, changes to P2R are outside the scope of this revision of the SREP GL.</p> <p>On P2G and its determination and setting, please see Q4.</p> | <p>No amendments are made regarding the legally binding nature of P2R and the timeframe.</p> <p>The wording of the definitions of P2R and P2G in Section 1.2 has been changed to 'Pillar 2 requirements' and 'Pillar 2 guidance', respectively.</p> |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
|--|--|---|-----------------------------|
| | <p>assumed scenarios'. Setting P2G where an institution is 'excessively sensitive to the assumed scenarios' would in the respondent's opinion allow competent authorities to apply additional capital guidance to a disproportionate extent. Since P2G is a buffer on top of the additional capital requirements (including institution-specific capital add-ons) it must be limited to situations in which it is absolutely necessary, with reasonable explanations provided.</p> <p>In addition, a change of wording from 'Pillar 2 capital requirements' to 'Pillar 2 own funds requirements' was suggested, to align the GL with the CRR wording and avoid any misunderstandings regarding the wording within the accounting framework.</p> | The terminology has been aligned. | |
| <p>Page 16 'Background and rationale' section Consumer protection</p> | <p>Two respondents considered that consumer protection considerations should not be part of the SREP, since according to them the issues differ significantly across Member States. Therefore, this would imply market disadvantages for institutions in Member States where consumer protection is stricter than in others. Additionally, they believe that the risks resulting from consumer protection are covered through accruals, which reduce CET1, to the legally required extent (i.e. risks that have already been covered through accruals should not be subject to any additional capital requirements). Institutions should at least be informed of the amount of capital needs that the authority considers not covered through accruals, as well as</p> | <p>Consumer protection is not a new area introduced in the revision of the GL (it is already embedded in paragraphs 279 and 292 of the existing GL), and it is mentioned in the introductory part only as one of the areas from which useful information could be derived for SREP purposes (as for conduct and reputational risk). In line with practice so far, due attention will be paid to avoid the imposition of unjustified additional own funds to cover these risks and to avoid any double counting.</p> | No amendments. |

| Comments | Summary of responses received | EBA analysis | Amendments to the proposals |
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| | the corresponding reasoning. This should enable an assessment by the institution of whether there is a need to dedicate an additional amount to accruals (this would also be useful for accounting and perhaps tax purposes). | | |
| Definitions | One respondent suggested the inclusion of a definition of ‘inherent risk’ in Section 1.2, since the term is widely used in the document but not defined, and it is not unusual for the term to be used with different meanings by risk practitioners. | The term ‘inherent risk’ is not a concept newly introduced as part of this revision of the GL. It is widely used in the supervisory community and is related to risk exposure levels (see paragraph 149). | No amendments. |
| Definitions | One respondent suggested a change to the definition of ICT risk: ‘Information and communication technology (ICT) risk means risk of loss due to breach of confidentiality, failure of integrity of systems and data, inappropriateness or unavailability of systems and data. It also includes every economical effect (losses, opportunity costs, lost profits, high costs) of the inability to change IT within reasonable time and costs when the environment or business requirements change (i.e. agility)’. This definition suggests that the effects of lack of agility in IT are not usually related to losses in accounting terms, but more often related to the types of losses indicated above (opportunity costs, lost profits...). | Relevant elements of ICT risk are already covered in the definition proposed by the EBA, and their further elaboration in the manner suggested, instead of clarifying things, could instead lead to misinterpretation. | No amendments |
| Definitions | One respondent raised questions about the relevance of the risk score for an individual | Risk scores indicate the likelihood that a risk will have a significant prudential impact on the institution (e.g. potential loss). Risk scores do take | No amendments |

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| | <p>institution; it numerically expresses the risk an institution faces without taking into account its ability to mitigate the risk through available resources (small versus large institutions), thus implying that the same exposures should lead to the same risk score.</p> | <p>into account risk management and control factors but do not take into account capital or liquidity to cover such risks. Therefore, the different abilities of institutions with similar exposures to mitigate their risk will be reflected in their risk scores.</p> | |
| Titles | <p>One respondent suggested the following amendments: renaming ‘Title 4. Business model analysis’ as ‘Title 4. Assessing business model risk’ and ‘Title 7. SREP capital assessment’ as ‘Title 7. Assessing risks of quantity and composition of capital’. The reason for both suggestions is greater consistency with the overall risk approach of the methodology.</p> | <p>Title 4 is intended to be understood in a broader context than ‘business model risk’ only, and changing the wording could lead to a misconception about the type of the assessment that is actually conducted with respect to the business model of the institution. Similarly, changing the wording of Title 7 would entail a narrowing of its context.</p> | No amendments. |
| <p>Scoring: Classification of findings Summary of findings and scoring</p> | <p>To allow banks to deploy their resources in a more targeted manner so that they can achieve a better score, one respondent suggested that the findings on which the derivation of the individual viability ratings will be based should be formally classified – similarly to in supervisory assessments – and the relationship between the findings and the viability scores should be documented. The respondent suggested adding the following text to paragraphs 87, 136, 410 and 493: ‘In the summary, the individual findings should be classified on a scale from 1 to 4 (1 = low severity, 4 = critical severity) and the methodology for deriving the viability score from the individual finding classifications [and the risk scores for sub-categories] should be communicated to the institution.’</p> | <p>The scoring section has been revised with the aim of clarifying the difference between risk and viability scores. Furthermore, the definition of a score of ‘1’ has been reviewed in order to reflect current practice by competent authorities. The proposed changes would go beyond the scope envisaged for this revision and would indeed introduce a whole new scoring definition.</p> <p>The main drivers of the assessment (and the level of detail thereof) can be communicated to the institutions at the competent authority’s discretion.</p> | No amendments. |

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| Assessment of institutions' stress testing | <p>One respondent considers that the analysis in which competent authorities are to use institutions' internal stress testing to validate the quantitative risk measurement results produced by internal models does not make sense, since these internal models are not usually developed on the assumption of a stress situation (i.e. assuming fundamentally different environmental conditions). Validation of these internal models based on stress test results is not possible. The respondent suggested that the final sentence of the relevant paragraph be deleted.</p> <p>Another respondent asked for clarification regarding the way in which institutions should use reverse stress testing to inform internal models, especially as paragraph 92 of the Consultation Paper on the the GL on institutions' internal stress testing acknowledges that the two are not comparable, as each addresses different points in a institution's loss distribution (going versus gone concern).</p> <p>A few respondents claimed that, although analysing the qualitative suitability of stress tests makes sense, especially in the context of assessing risk management, if internal quantitative outcomes are factored into the supervisory assessment, this may lead to misguided incentives (e.g. internal stress tests could deliberately be calculated positively in order to achieve lower</p> | <p>Although this topic is essentially outside the scope of these GL, as mentioned in paragraph 92 of the GL on institutions' stress testing, institutions using internal models for credit risk, counterparty credit risk and market risk, when carrying out reverse stress testing, in accordance with Articles 177, 290(8) and 368(1)(g) of Regulation (EU) No 575/2013, should endeavour to identify severe, but plausible, scenarios that could result in significant adverse outcomes and potentially challenge institutions' overall viability. Institutions should see these reverse stress tests as an essential complement to their internal models for the calculation of capital requirements and as a regular risk management tool for revealing possible incoherence and inadequacies of these internal models. Severe stress scenarios, even without being necessarily taken as an indication that the modelling of the inputs into, for example, the IRB formula are inadequate, should be seen more as possible evidence of model risk, which may lead to a breakdown in the model's predictability.</p> <p>In addition, if the institution's stress testing is adequate, i.e. if the outcome of, for example, ICAAP stress is reliable, it would be a very useful tool for different purposes (e.g. P2G adjustment purposes). Since the institution's stress testing is subject to assessment in line with Section 5.7.3, if the situation described occurs, it might in certain cases lead to the conclusion that some elements of the stress testing programme are not adequate. Hence this would have an impact, first, on the viability score for internal governance and institution-wide controls,</p> | No amendments. |

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| | P2R/P2G requirements). Subparagraph a of paragraph 112 should therefore be deleted. | and then, consequently, also on the overall assessment of the institution and P2R. | |
| Capital reduction in stressed conditions | One respondent noted that severely stressed conditions do not necessarily always lead to capital reduction (e.g. the overall P&L may still be positive after a hit caused by credit migrations or trading losses) and asked that paragraph 122 be rephrased. | <p>The formulation used in paragraph 122 does not per se require that the overall effect on capital or the P&L be negative; it requires in a stress scenario used for ICAAP purposes the capital ratio is negatively affected as a result of, for example, credit rating migrations, a reduction in net interest margins or trading losses.</p> <p>The wording, however, should be changed to refer to a negative effect on the capital ratio, rather than simply capital.</p> | The wording of the paragraph has been amended as follows: ‘Competent authorities should ensure that in a stress scenario used for ICAAP purposes the capital ratio is negatively affected as a result of, for example, credit rating migrations, ...’. |
| Comparison of internal and supervisory stress testing | One respondent noted that comparisons of internal and supervisory stress testing need to be performed with care (especially when using outcomes from supervisory stress tests as a means of challenging internal scenario assumptions), because outcomes of supervisory stress tests are often driven by specific non-scenario-driven constraints, such as caps and floors, for the sake of comparability (paragraphs 122 and 124). | Paragraph 122 makes reference to Title 12, where it is clearly stipulated that when designing methodologies and assumptions for use in supervisory stress tests, competent authorities should decide on the design and features of the exercise that are most suitable for its intended purpose. In addition, paragraph 124 includes the wording ‘where appropriate’ to make the same point. | No amendments. |
| Anchor scenario | Some respondents are of the view that the concept of an anchor scenario is not sufficiently clear. For credit risk, it must be clarified if the supervisory stress test for smaller and less complex banks will be formulated in terms of | As defined in the GL on institutions’ stress testing, ‘anchor scenario’ means a type of scenario, usually designed by a competent authority, intended to set the severity standard for a particular stress test that is imposed on institutions. Paragraph 587(b) allows | A cross-reference to the definition of ‘anchor scenario’ in the GL on |

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| | shocks resulting from macroeconomic variables or in terms of shocks resulting from ‘standardised credit approach’ risk factors. If the first alternative is prescribed, it should be borne in mind that, in general, the abovementioned category of banks has no satellite models readily available, and some ‘bridge solution’ would therefore need to be provided. | competent authorities, when conducting supervisory stress tests on a wider sample of institutions, to consider adopting the design of supervisory stress tests for different categories of institutions as set out in Section 2.4 of the GL, especially if the exercise is top-down. | institutions’ stress testing has been introduced. |
| Stress testing and MREL | One respondent commented that, since it may make sense to analyse the impact of stress tests on an institution’s MREL requirement, paragraph 126 should clarify that this will not be used as a basis for calibrating the MREL requirement. | <p>This topic is out of the scope of this revision of the GL. It should also be borne in mind that neither Directive 204/59/EU, nor any other regulations impose such an obligation.</p> <p>Since the GL do not explicitly state that MREL calculations should be based on the impact of stress tests, they imply that there is no such presumption.</p> | No amendments. |
| Future regulatory changes in terms of stress testing | Several respondents remarked that ‘future regulatory changes’ in relation to stress testing is too far-reaching a concept. Some believe that further clarification is required on how competent authorities will decide whether or not future regulatory changes should be considered, i.e., to avoid different interpretations among jurisdictions, objective criteria should be defined in the SREP GL and supervisors should also inform the institutions at an early stage about the regulatory changes that must be considered for stress testing. One respondent proposed a change to paragraph 127 as follows: ‘In the assessment of | <p>By default, final regulatory products always need to be considered. Hence there is no reason to explicitly mention this (rather, the paragraph is in place as a reminder to consider future developments not yet finalised).</p> <p>Regarding thresholds in general, please see Q6. In addition, thresholds and future regulatory changes are not as a rule elements of the same stress testing programme; whether or not they are used will depend on the purpose of a given stress test.</p> | No amendments. |

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| | <p>stress test results, competent authorities should also consider all known finalised future regulatory changes affecting institutions within the scope and time horizon of the stress test exercise’.</p> <p>Another respondent stated that it would welcome clarity on how these changes relate to the setting of thresholds used to assess the results of the stress test, which should be adjusted accordingly to reflect additional requirements that will be introduced during the stress test time horizon.</p> | | |
| Peer groups | <p>Some respondents highlighted the topic of transparency in relation to peer groups and emphasised that transparency must be ensured regarding the use of peer groups. Where peer groups are used to assess institutions, this should be explicitly communicated to the institution, together with the methodology used to select the group. Institutions must be able to understand their relative positioning, which is key information for a complete understanding of their SREP assessment. It was suggested that the following wording be added to the paragraphs in question: ‘Competent authorities should inform institutions about the peers and the rationale behind building homogeneous peer classes used for comparison in their decision’ (paragraphs 151, 160 and 187).</p> | <p>This topic is outside the scope of this review, and the treatment of transparency and peer groups is at the discretion of the competent authorities.</p> | No amendments. |
| Section 6.5 – Assessment of interest rate risk arising from non-trading book activities | | | |
| General comments | | | |

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| General comments | One respondent proposed to have a reference to the assessment of IRRBB in the trading book (Section 6.3) in Section 6.5. In particular, a case in which large parts of the IRRBB in the trading book have already been hedged by non-trading book positions should be analysed. Viewed in isolation, the risk estimate would be too high and hence also the own funds requirements. | The EBA would like to clarify that the focus of the assessment under section 6.5 should be on the interest rate risk from non-trading activities. | No amendments. |
| General comments | One respondent proposed the EBA to wait for the adoption of the revised CRD before updating Section 6.5 on IRRBB. | The EBA clarifies that a transitional and progressive approach is adopted to the implementation of the BCBS framework, to bridge the time gap between the implementation date of the BCBS IRRBB Standards (January 2018) and the entry into force of the revised CRD/CRR framework. The approach is focused on ensuring consistency between the different policy products. | No amendments. |
| <i>6.5.1 General considerations</i> | | | |
| Materiality threshold for basis risk | One respondent argued that an immateriality threshold should be applied to basis risk in paragraph 311(b), as for many institutions it is insignificant compared with overall interest rate risk. | The EBA clarifies that, as specified in paragraphs 313 and 314, through the assessment of the inherent level of IRRBB, competent authorities should determine the main drivers of the institution's IRRBB exposure and evaluate the potential prudential impact of this risk on the institution. To determine the scope of the IRRBB assessment, competent authorities should first identify the sources of IRRBB to which the institution is or might be exposed so that they can take into account the materiality of the risk to which the institution is exposed. | No amendments. |
| Option risk | One respondent pointed out that options that are not interest rate sensitive but nonetheless have an | The EBA welcomes the comment and wishes to clarify that implicit options that are not automatically | No amendments. |

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| | <p>impact on IRRBB are not mentioned in paragraph 311(c); for example, in private housing finance the option to allow unscheduled repayments and the option to lock in interest rates for over 10 years can be exercised for other reasons but would still impact IRRBB.</p> | <p>exercised should also be taken into account in relation to option risk. The definition is deemed to provide sufficient leeway for such options to be included.</p> | |
| <i>6.5.2 Assessment of inherent IRRBB</i> | | | |
| Assessment of inherent IRRBB | <p>One respondent requested that an additional point (d) be included in the main steps for the assessment of inherent IRRBB for competent authorities (paragraph 313). The additional point would state that competent authorities should take into account an assessment of the institution's overall situation (total own funds requirements, ratio of IRRBB to total risk, quality of interest rate risk management, etc.).</p> | <p>The EBA clarifies that the proposed point to be added with regard to the assessment of inherent IRRBB is deemed to be covered by point (a) of paragraph 313 ('preliminary assessment').</p> | No amendments. |
| Supervisory outlier test | <p>One respondent pointed out that the supervisory outlier test (paragraph 315(b)) systematically disadvantages institutions that have accumulated a high level of assets in their interest rate book thanks to a stable investment policy. The high present value basis of the interest rate book means that particularly stable banks (with a high net asset value) are especially likely to be impacted by relatively high changes in present value. As a result, the outlier criterion cannot serve as an objective measure for assessing IRRBB across countries, and therefore the outlier test cannot be linked to automatic measures in terms of own funds.</p> | <p>The EBA notes the remark that the design of the supervisory outlier test disadvantages banks with high hidden reserves and wishes to clarify that the approach taken is in line with the approach of the BCBS Standards. The supervisory outlier test establishes no automaticity between breaching the supervisory outlier test threshold and supervisory measures, and embedded gains are taken into account in the ICAAP and in the supervisory assessment of the outcome of the supervisory outlier test.</p> | No amendments. |

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| Derivatives | <p>One respondent pointed out that derivatives are the only financial instrument used to hedge interest rate risk (paragraph 316(c)). For this purpose, competent authorities should analyse widely and economically the structure of the institution's balance sheet in its EVE and NII evaluation before any requirement on derivative uses.</p> | <p>The EBA notes the comment and clarifies that the main steps of the assessment process as set out in Section 6.5.2 entail an assessment by the competent authorities of the structure of the institution's assets, liabilities and off-balance-sheet exposures, as well as the sources and drivers of IRRBB, including the impact on earnings and economic value of a change in interest rates according to the methodology used by the institution.</p> | No amendments. |
| Main features of the institution's assets, liabilities and off-balance-sheet exposures | <p>One respondent argued that the separate examination of the credit portfolio required by paragraph 319 is not critical for understanding interest rate risk. What is decisive is the total cash flow before and after steering the interest rate portfolio. The complexity arises when interest rate options are added, regardless of whether they are generated by the customer business or the interbank business.</p> <p>The respondent also asked for clarification as to why in paragraph 319 less liquid instruments are particularly emphasised.</p> | <p>The EBA clarifies that the elements listed in paragraph 319 are intended to enable competent authorities to better determine the complexity and the interest rate risk profile of institutions. The nature of IRRBB embedded in fair value instruments, including less liquid instruments such as Level 3 assets and liabilities, has been included in view of their potential impact on the measurement of IRRBB in terms of both economic value and earnings.</p> | No amendments. |
| Sensitivity of cash flows | <p>One respondent requested that to be clarified in paragraph 323 that the separate analysis of fair value instruments makes sense only for the NII perspective.</p> | <p>The EBA clarifies that the impact of fair value instruments on the measurement of IRRBB can be in terms of both economic value and earnings. In this respect, competent authorities should pay attention to the sensitivity of cash flows to changes in the valuation of fair value instruments under both EV and NII.</p> | No amendments. |
| Proportionality | <p>One respondent asked for the principle of proportionality to be explicitly addressed in</p> | <p>The EBA clarifies that the scope and depth of the assessment under paragraphs 319 to 328 should be</p> | No amendments. |

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| | <p>paragraphs 319 to 328. The current requirements are deemed to be too detailed and too technical, and the concern is that competent authorities could lose sight of an institution’s overall situation.</p> | <p>proportionate to the category of the institution (from 1 to 4), which reflects the size and complexity of the institution and the level of systemic risk it poses.</p> | |
| <p>Review of shock and stress test outcomes</p> | <p>One respondent pointed out that the total cash flow should be considered as a single figure and not just selected time buckets. Different cash flow structures can result in exactly the same risk/return profile.</p> | <p>The EBA welcomes the comment and agrees that the total cash flow should be considered and not just the individual time buckets.</p> | <p>No amendments.</p> |
| <p><i>6.5.3 Assessment of IRRBB management and controls (both risk management and compliance, and internal audit control functions)</i></p> | | | |
| <p>Compliance function</p> | <p>One respondent indicated that the compliance function as a qualitative element of risk management is not suited to having a role in IRRBB management (except for the general requirement to ensure compliance with applicable rules and regulations).</p> | <p>The compliance function has been included here since it forms the second line of defence together with the risk management function. The compliance function monitors compliance with legal and regulatory requirements and internal policies, provides advice on compliance to the management body and other relevant staff, and establishes processes to manage compliance risks and to ensure compliance.</p> | <p>No amendments.</p> |
| <p>IRRBB strategy</p> | <p>One respondent mentioned that interest rate risk is not automatically linked to cyclical changes in the economy. Entering into IRRBB is a conscious management decision. The IRRBB strategy is oriented on benchmarks or rules but must be dependent on the level and steepness of the yield curve, and not on macroeconomic indicators. The respondent therefore asks that the requirement in this regard be removed.</p> | <p>The EBA clarifies that the reference to the institution’s IRRBB strategy taking into account the cyclical aspects of the economy and the resulting shifts in the composition of IRRBB activities is already included in the current version of the SREP GL. This consideration forms part of a sound IRRBB strategy.</p> | <p>No amendments.</p> |

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| Risk identification, measurement including internal models, monitoring and reporting | One respondent pointed out that using derivatives does not necessarily mean incurring a risk. Derivatives can also be used solely for risk mitigation/closing out. The special significance attributed to derivatives here is not clear and the respondent suggests deleting paragraph 335(k). | The EBA observes that the provision on an assessment of whether the use of interest rate derivatives is compliant with the IRRBB risk strategy and whether those activities are performed within the risk appetite framework and with adequate internal governance arrangements in place has been interpreted differently than what was intended. The focus of the provision was not to single out derivatives in a negative way but to provide guidance to competent authorities on the assessment of the implementation of interest rate derivatives. | No amendments. |
| Additional own funds requirements (scope of P2R) | A number of respondents requested the SREP GL to clarify that P2R can be applied only when material risks are not covered by Pillar 1, and that these additional requirements cannot be used to reverse policy choices adopted in the Level 1 text. This would include, for instance, not using P2R to override transitional or grandfathering arrangements, or Pillar 1 exemptions (e.g. for exposures currently receiving a specific risk weight treatment, such as a 0% risk weight for certain sovereign exposures, or for exposures that are explicitly exempted from Pillar 1 requirements, such as exemptions from capital charges for CVA for exposures to EU corporates). While competent authorities must indeed have sufficient flexibility in their use of P2R requirements, the current approach taken in the SREP GL was viewed by some as enabling Pillar 1 requirements to be completely overridden. | No changes have been made to the GL with regard to P2R. This topic is outside the scope of this review, and the text regarding P2R is sufficiently clear and in line with the relevant Level 1 text. | No amendments. |

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| Diversification versus Pillar 1-plus approach | <p>Some respondents commented on the recognition of diversification benefits and questioned the Pillar 1-plus approach. Specifically, it was stated that the benefits of diversification, either between risks or across geographies, were not recognised in the SREP GL. In addition, the respondents considered that the approach to Pillar 2 should not be just a Pillar 1-plus approach but involve a comprehensive overview of the risk profile of the institution, and that this could be achieved only by assessing the risk holistically, using models or approaches that reflect the benefits of no correlation between the different elements. In their understanding, the framework should incentivise the development of comprehensive models by accepting their use in Pillar 2 when they meet supervisory expectations in terms of quality and reliability.</p> <p>Specifically, in the respondents' opinion, paragraph 352 represents a clear limitation of these benefits when determining additional own funds to cover unexpected losses. They agree that Pillar 1 requirements should be a floor for OCR but argue that this should not mean that Pillar 1 requirements for credit risk should set a floor for credit risk internal economic capital. Otherwise, the EBA GL would not be aligned with the need for institutions to develop sound, effective and comprehensive internal capital processes, as clearly defined in Article 73 of Directive 2013/36/EU.</p> | This topic is outside the scope of this review. | No amendments. |

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| | <p>Another option suggested was a simple and comparable methodology capturing the main features of diversification. Even though this would be second best, in the respondents' opinion it would offer a better trade-off between accurate risk assessment and ensuring harmonisation than the current framework.</p> | | |
| Supervisory benchmarks | <p>One respondent proposed that the benchmarks used for the assessment should be made transparent to institutions, so that the latter can comment on them and so that best practices are promoted across the peer group. Accordingly, the respondent suggested that the following wording be added to paragraph 362: '... they should explain to the institution the underlying rationale and details of these general underlying principles behind the benchmarks'.</p> | <p>This topic is outside the scope of this review; this matter remains at the discretion of the competent authorities.</p> | No amendments. |
| Communication and transparency of prudential requirements | <p>Some respondents noted a strong legal need for more transparency in relation to the allocation of total additional own funds to single risks, considering that the assumptions of the competent authority as well as the resulting scores may lead to significant consequences, which may in extreme cases even lead to an institution being considered failing or likely to fail. Therefore, the respondents believe that the total additional own funds determined in the SREP decision should be mapped to the single risks underlying them. Another respondent suggested that the risk assessment system methodology should be made as transparent as possible, including through the</p> | <p>This issue is out of the scope of this review.</p> <p>However, the latest EBA convergence report discusses the progress achieved on this and related issues. A good degree of progress has been made by competent authorities in the implementation of the SREP GL. Challenges remain primarily in the area of the methodologies used for the capital adequacy assessment and in determining institution-specific additional own funds requirements. Implementation in these areas will continue to be monitored by the EBA.</p> | <p>No amendments made to the general requirement. The example of communication of TSCR, OCR and P2G has been clarified.</p> |

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| | <p>disclosure of the entire assessment report (not only the SREP letter), and by clarifying the relationship between the score for each SREP area of analysis and the overall score, as well as the relationship between the overall score and the SREP final capital and liquidity requirements.</p> | | |
| <p>Supervisory considerations for assigning the overall SREP score</p> | <p>Some respondents remarked that the overall SREP assessment as defined in Chapter 10 seems to be insufficiently transparent for institutions, i.e. it is not clear to what extent the findings and scoring, for example the single viability scores, influence the overall SREP score, if they are weighted or equivalent to other elements. Respondents asked for the introduction of detailed information regarding the influence of single scores on the overall SREP score.</p> <p>One respondent suggested introducing more precise criteria to qualify the evaluation of low and medium-low risk (in Table 13) in general, and another suggested that the criteria should be adjusted to allow more precision with regard to the differences between medium-low, medium-high and high levels of risks in relation to recovery capacity.</p> <p>One respondent stated that the description should be amended to avoid any inconsistencies in decisions and, because an approach based purely on the maximum score would be excessively conservative, the respondent suggested using commercial rounding of the average of the individual categories to derive the score. In</p> | <p>Additional clarifications relating to scoring were considered necessary to align the text of the GL with current supervisory practices without changing the policy direction. These revisions clarify the two types of scores – risk scores and viability scores – and the overall SREP score, which indicate, respectively, the potential prudential impact of a risk on an institution, the threat posed to the institution’s viability stemming from the SREP element assessed and the institution’s overall viability. (This is explained in detail in Title 2.2.) Furthermore, to help facilitate communication within competent authorities and colleges of supervisors and foster comparability and a level playing field among institutions, further clarifications have been included in relation to the assessment of the SREP elements that competent authorities have to score from 1 (low risk) to 4 (high risk) to reflect the ‘supervisory view’ of each specific element.</p> <p>The GL do not propose any automatic aggregation of scores, their components or supervisory considerations supporting these scores, nor is there a weighting of different considerations or elements of the scoring framework. Supervisory considerations</p> | <p>No amendments.</p> |

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| | <p>addition, the respondent did not believe that it was appropriate to place recovery capacity on the same level as business model or overall internal governance (inter alia), as it is addressed as a sub-category of the assessment of risks to capitalisation and liquidity. Hence the respondent suggested that the criteria in Table 13 relating to recovery capacity should be deleted or, alternatively, that there should at least be a transparent explanation of the criteria to be used for assessing recovery capacity as adequate (or not), or a quantitative scale for assessing when recovery capacity should be estimated as low, medium or high (taking into consideration the fact that recovery capacity is based on a large number of assumptions).</p> <p>Other respondents suggested that the criteria in Table 13 relating to recovery capacity should be adjusted to make clear that recovery capacity is considered a sub-category of the assessment of risks to capital and liquidity, i.e. that diversification and business model should be given much more weight in assessing the viability score, as they could constitute clear mitigating factors that could make an institution more resilient and able to absorb unexpected losses.</p> | <p>are provided merely to help supervisors in assigning different scores.</p> <p>With regard to recovery capacity, as for other considerations mentioned in the tables on summaries of findings, the significance of this consideration for the overall SREP score will depend on the specific circumstances of each institution, i.e. it is not factored into the scoring in an automatic way.</p> | |
| Colleges of supervisors | Two respondents suggested that the words ‘methodologies and approaches used by the different authorities in the college’ should be added to paragraph 561, and that these methodologies and approaches should be discussed and coordinated within the framework of | <p>This issue is outside the scope of this review.</p> <p>Furthermore, the issue is already covered in this paragraph, in a more granular form (see points (b) and (c)). In practice, colleges are a platform for the exchange of information between home and host</p> | No amendments. |

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| | <p>colleges of supervisors, since they could be very different, sometimes even contradictory, and in the case of a cross-border group this could cause difficulties. Hence the respondents would appreciate a consensus – or at least a mutual understanding between the supervisors – regarding the different approaches and methodologies within the supervisory college.</p> | <p>authorities, including information on the methodologies mentioned.</p> | |
| Annex 2. | <p>One respondent pointed out that in Annex 2 (page 230) the references in point (4) should be updated (e.g. ‘CEBS Guidelines on stress testing’).</p> | <p>The annex tables on references are outdated and have been deleted.</p> | <p>The annex tables on references have been deleted.</p> |
| <p>Question 2: What are the respondents’ views regarding ‘the interaction between SREP and other supervisory processes, in particular the assessment of recovery plans’, addressed in the ‘Background and rationale’ section?</p> | | | |
| <p>Interaction between SREP and other supervisory processes, in particular the assessment of recovery plans</p> | <p>Two respondents suggested that if recovery plans and market conduct (page 16) lead to a capital add-on, it must be determined to what extent the capital add-on results from weaknesses in the recovery plan. This is particularly relevant in the context of MREL. When setting the MREL quota, the resolution authority must assess the capital need of the business that may remain after the resolution action has been taken. Depending on the preferred resolution action, the remaining business may differ significantly from the current institution’s business. Weaknesses identified in the recovery plan should no longer exist after the resolution action has been taken and therefore any additional need for own funds resulting from the recovery plan should not be included in the MREL recapitalisation amount. In this light, it is necessary</p> | <p>The idea of the additions made in this part of the GL is to further elaborate on the links between SREP and other supervisory processes, also taking into account the requirements of other EBA GL, in particular the EBA GL on triggers for use of early intervention measures (EBA/GL/2015/03) and the EBA GL on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail (EBA/GL/2015/07).</p> <p>The aim was not to discuss details but to provide a bigger picture of the interactions. Recovery planning considerations should not lead to capital add-ons as such; rather, they should feed into the BMA and Internal Governance assessment.</p> | <p>No amendments on the links on page 16 or on the proportionality aspects.</p> <p>The reference to ‘post-recovery strategy’ has been deleted.</p> |

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| | <p>to demonstrate what amount of the additional own funds requirements results from weaknesses in the recovery plan.</p> <p>According to some respondents, proportionality aspects should be taken into account. A detailed comparison should not constitute a mandatory requirement for the supervision of smaller and medium-sized institutions. One of these respondents suggested that the assessment of recovery plans by competent authorities as an element of SREP should be removed from the scope of the GL for smaller and medium-sized institutions for reasons of proportionality (also to take account of the limited resources available to the supervisors). In addition, smaller institutions should be explicitly exempted from the requirement to closely compare coordinated management approaches such as recovery planning, ICAAP/ILAAP and risk assessment framework, as the EBA GL would otherwise counteract the intended reduction in complexity for small institutions (see the CRR/CRD review).</p> <p>One respondent is of the opinion that the term ‘post-recovery strategy’ is misleading and should be deleted. Recovery planning merely comprises strategic analyses relevant before or for the recovery event, and does not include the strategic direction of a bank after recovery has been completed. Because of the large number of ways in which a recovery event can be structured, it is not</p> | <p>The principle of proportionality is embedded in the SREP GL throughout.</p> <p>The term “post-recovery strategy” used on page 16 refers to the business strategy of the institution after the execution of a recovery option(s). However, it is acknowledged, that it may be confusing in this context.</p> | |

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| | possible to rationally define a concrete post-recovery strategy. | | |
| Link between SREP and early intervention and resolution | <p>One respondent requested more detail to be included in the subsection ‘Link between SREP and early intervention and resolution’ regarding what the competent authorities’ powers are, i.e. if the Single Resolution Board is included, and, if so, to what extent it could use SREP results for its recovery and resolution planning.</p> <p>Some respondents asked for more explicit explanations of the interaction between ongoing supervision and early intervention, taking into account the requirement for consistency between the ICAAP/SREP, P2G, recovery requirements and early intervention. In particular, comments were raised concerning the explanations of how different capital levels and triggers interact, and how P2G is integrated into various thresholds and triggers (early intervention triggers), including the calibration of capital adequacy scores acting as triggers for early intervention and failing or likely to fail determinations.</p> | <p>CRD supervisory measures are clearly separated from early intervention measures taken by the supervisor in accordance with the BRRD and those are again clearly separated from the resolution measures taken by the relevant competent authority. Figure 4 sufficiently reflects this. Regarding the SREP results, their use in the context of recovery and resolution is explained in the EBA GL on triggers for use of early intervention measures, as well as in the EBA GL on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail. References to those GL are embedded in the SREP GL text. In addition, relevant references have been added in the ‘Background and rationale’ section, as the aforementioned GL should be read in conjunction with the revised SREP GL.</p> | <p>Figure 4 has been better explained (see also comment on Figure 4).</p> |
| SREP as the basis for early intervention | <p>One respondent, while agreeing that consistency between SREP and early intervention and resolution may be necessary, argued SREP alone cannot be a basis for early intervention or a failing or likely to fail determination. SREP is not sufficient for such decisions, as they may need to be taken within a timeline that is not compatible with a full</p> | <p>This topic is outside the scope of this review.</p> <p>Note also that, as per paragraph 503 of the Consultation Paper, when determining that an institution is failing or likely to fail, as reflected by an overall SREP score of F, competent authorities should engage with the resolution authorities to consult on</p> | <p>No amendments.</p> |

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| | <p>SREP process. Fast-moving events may not be captured within the SREP process quickly enough for SREP to be a useful tool for decision-making. In addition, SREP alone cannot be the basis for such important decisions as early intervention or resolution. In both cases, an independent decision process is required, taking account of all circumstances at the time, which may not be adequately reflected in an SREP score. The respondent suggests that this be clarified in the 'Background and rationale' section, and that, where reference is made to SREP scores in paragraphs 38 and 39, rather than being described as a trigger for a decision, to be described as 'contributing to the analyses conducted in deciding whether or not to apply early intervention measures'. Such decisions cannot be based on a scoring process. They may be informed by a scoring process, but decisions should be made as a result of a holistic analysis of the institution and its situation in relation to the market, in the circumstances prevailing at that time.</p> <p>Another respondent commented that SREP outcomes should not mechanistically inform other supervisory processes and thus be linked to them. In the respondent's view, for example, the possibility of an IPS/DGS intervening at an early stage should be included in the wording of numbers 12, 13, 16 and 17 (Background and rationale) and paragraph 395.</p> | <p>findings following the procedure specified in Article 32 of Directive 2014/59/EU.</p> | |

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| Figure on the link between ongoing supervision, early intervention and resolution | <p>One respondent suggested further improving the explanation of the differences between the dotted and the other lines in Figure 4. Furthermore, the respondent felt that it was far too early to initiate supervisory measures in accordance with the CRD when the SREP score was 2 (medium-low level of risk to the institution’s viability). Supervisory measures should not be initiated before the score is 3.</p> <p>In addition, a line should be drawn between supervisory measures (CRD) and early intervention measures (BRRD). A situation could occur where a further deterioration of the institution’s situation happens after CRD measures are taken. According to Figure 4, that should lead to resolution. However, early intervention measures under the BRRD could be the next step. Finally, all lines should have arrows in both directions, since the recovery of the institution could result from interventions by the authorities.</p> <p>Some respondents consider that Figure 4 should include the possibility of an entity deciding to apply its recovery plan on a voluntary basis.</p> <p>The red line between recovery and ongoing supervision could be better defined; resolution is linked to the failure of the recovery plan.</p> | <p>Competent authorities have the discretion to apply supervisory measures at any time, and the decision should not be linked solely to a specific score.</p> <p>Solid black lines represent ‘standard’ continuous supervision, while the dotted black lines represent situations in which the triggers for the implementation of early intervention measures or CRD supervisory measures are activated. The solid red lines represent situations or circumstances in which an institution must be considered failing or likely to fail.</p> <p>The figure addresses only supervisory activities, which take into consideration actions by the institution in any case (including the activation of measures/options from the recovery plan).</p> <p>According to Figure 4, resolution is linked to the SREP assessment, CRD measures or early intervention measures. The recovery plan is not included, as Figure 4 is about supervisory activities.</p> | <p>Figure 4 has been amended to include more explanations, in particular regarding the dotted versus straight lines.</p> |
| Recovery plan considerations | <p>One respondent noted that the recovery plan is referred to such that only ‘consistency of recovery planning’ is to be assessed as part of governance and institution-wide controls, while other aspects,</p> | <p>The assessment of internal governance and institution-wide controls should be informed by the outcomes of the assessment of recovery planning arrangements and recovery plans. It is acknowledged</p> | <p>The wording has been amended</p> |

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| | such as credibility, are not considered. However, in other sections of the draft EBA GL that reflect the BRRD requirements, the scope of the assessment is much wider (e.g. Section 5.9, paragraph 132, etc.). | that recovery planning should be considered in a wider context here and the wording has been amended accordingly. | accordingly, to refer also to credibility. |
| Consistency of governance across different products | One respondent noted that the governance of recovery plans should be consistent with that of other supervisory reports, such ICAAP and ILAAP. In addition, it should be aligned with the risk appetite framework. However, not all the elements detailed in the SREP GL would be included in recovery governance, as the recovery plan is developed for a different purpose. Some items, such as the process for creating new products or the remuneration policy, are not included in the scope of a recovery plan, so they should not be considered in recovery evaluation. | This issue is outside the scope of this review. As stated in paragraphs 132 and 133, the assessment of internal governance and institution-wide controls should be informed by the outcomes of the assessment of recovery planning arrangements and recovery plans, while the assessment of the recovery planning itself is done in line with Articles 6 and 8 of Directive 2014/59/EU. The paragraphs in question are not intended to suggest that all the elements of SREP should be included in the recovery plan; rather, the focus is on the various elements informing each other. | No amendments. |
| Recovery plans and early intervention | Some respondents noted that, according to the EBA GL on triggers for use of early intervention measures (EBA/GL/2015/03), the indicators for early intervention measures should consider minimum and additional requirements without taking into account any buffer requirements set out in Chapter 4 of Title VII of Directive 2013/36/EU. In this light, a breach of capital buffers should not lead to a score for capital adequacy of 4, since such a score could initiate early intervention measures. Therefore, bullet point 2 of score 3 and score 4 in Table 8 should be amended as follows: score 3: 'The institution is using its capital buffers. There is potential for the institution to breach its TSCR if the | TSCR does not include capital buffers, so there is no clash with the cited GL regarding early intervention measures (where the trigger of 1.5% above own funds proposed in Article 27 of Directive 2014/59/EU is an example of a threshold that the competent authority may choose to set in relation to capital indicators). In addition, a competent authority may set the threshold at the level most relevant for the particular institution in question, reflecting its actual capital requirements. When an institution is breaching TSCR, it is too late for early intervention, while the combination of 4 and F (overall score) is a trigger for early intervention. | No amendments. |

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| | <p>situation deteriorates.’; and score 4: ‘The institution is breaching its TSCR.’</p> <p>In addition, it was noted that Article 27 of the BRRD stipulates that the set of triggers that should be set for the assessment of the need for early intervention measures may include the institution’s own funds requirements plus 1.5%. The wording clearly states that only the own funds requirements and not any non-binding guidance should be considered. The stacking order of own funds requirements and P2G shown on page 152 clarifies that P2G is set on top of the buffers. In addition, the SREP GL define P2G as non-binding guidance that does not stipulate a legal requirement for the institution. Finally, since not even the buffers that are stacked below P2G are included in the own funds requirements according to Article 27 of the BRRD and the relevant GL on triggers for use of early intervention measures (EBA/GL/2015/03), P2G, as even less binding guidance, should not be included among the early intervention triggers. Therefore, some respondents called for an explicit alignment with the cited legal texts (the BRRD and the EBA GL), and for the inclusion of a clarification that the early intervention triggers include only own funds requirements under Article 92 of the CRR and additional own funds requirements under Article 104(1)(a) of the CRD, and not P2G or capital buffers.</p> | <p>The risk framework and recovery planning mentioned in paragraph 399 are not to be confused with early intervention measures. The recovery planning indicators should reflect P2G, but this would be expected to be in the form of early warning indicators (not to be confused with early intervention triggers) and not necessarily hard recovery triggers. The recovery plan indicators framework, in turn, would be expected to take into account early intervention measures.</p> <p>Falling below the level of P2G does not trigger any automatic supervisory reaction (including early intervention measures). Instead, the institution will be subject to intensified supervisory dialogue. The supervisory response will depend on the circumstances under which the institution fails to meet its P2G.</p> | |
| <p>Question 3: What are the respondents’ views on how the assessment of internal governance and institution-wide controls has been aligned with the revised EBA Guidelines on internal governance (Title 5)?</p> | | | |

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| Integration of the new EBA GL on internal governance | <p>Several respondents argued that it was unclear if the SREP GL required the incorporation of certain selected paragraphs of the GL on internal governance or if it would be more convenient to state their general application by direct reference to them. This would avoid institutions and competent authorities having to perform a double process of interpretation, as the SREP GL include only certain extracts from the GL on internal governance (without expressly excluding all the rest from the scope of the SREP assessment). One respondent gave some examples of differences in wording in the two GL (paragraphs 91(j), 91(k) and 94(e) of the SREP GL versus paragraphs 27, 71, 118 and 120, respectively, of the GL on internal governance) or of paragraphs in the SREP GL that make no clear direct reference to the GL on internal governance (e.g. paragraphs 92(h), 96(h), 97(b), 97(h), 97(i) and 100(4)).</p> | <p>The GL on internal governance are addressed to institutions and competent authorities and set out the requirements on institutions' governance arrangements. The SREP GL focus on the supervisory review and specify areas on which the review should focus; they are not intended to alter the GL on internal governance. Article 91 specifies some aspects that should be assessed in every case; competent authorities are free to assess the compliance of institutions with the whole set of requirements set out in the GL on internal governance.</p> | <p>No amendments.</p> |
| Proportionality of the requirements for smaller institutions | <p>One respondent stated that the changes resulted in a considerably more comprehensive assessment of internal governance (EBA/GL/2017/11) as part of the SREP. Application in full would disproportionately burden less significant institutions, and so a greater emphasis should be placed on a proportionate and risk-based approach to the assessment of internal governance.</p> | <p>The supervisory review to be conducted and the depth of the analysis to be undertaken are decided following a risk-based approach. A stronger focus on governance arrangements is appropriate, as weaknesses in governance arrangements have been one underlying factor in the financial crisis.</p> | <p>No amendments.</p> |

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| International standards in the assessment of internal governance | <p>Some respondents argued that international standards should not be imposed on institutions as if they were binding legal instruments, and nor should they be equated with EU or national laws and other regulations, especially if the latter allow institutions a degree of discretion in their application, which international standards do not (paragraph 88).</p> <p>Some respondents doubted if the GL would achieve their objective of establishing consistent, efficient and effective supervisory practices, considering that they might, rather, make supervisory tasks more difficult and cumbersome and lead to less degree of harmonization in the field of supervision of institutions across Europe.</p> <p>Including the international standards as part of CAs' assessment tools poses uncertainty for institutions. Given that the SREP GL do not specify the framework of application of said international standards, which on one hand means that institutions will not know what to expect from their SREP, and on the other hand this may create an uneven playing field where different CAs make use of different standards.</p> | <p>Institutions are subject to national and European legislation. International standards are in particular relevant for significant institutions, but are or will usually be taken into account in the EU legislation. The guidelines have been amended and the reference to international standards has been deleted.</p> | <p>The relevant paragraph has been amended.</p> |
| Meaning of the term 'management body' | <p>Two respondents proposed including an introductory paragraph stating that the term 'management body' takes into account all existing board structures, and that the terms 'management body in its management function' and 'management body in its supervisory function' are</p> | <p>With regard to the assessment of governance arrangements, the underlying governance requirements are set out mainly in the GL on internal governance and the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders.</p> | <p>No amendments.</p> |

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| | <p>used without referring to any specific governance structure (or specifying that when the term ‘management body’ is used without reference to the supervisory or the management function, the functions allocated to the ‘management body’ should be allocated to the appropriate body under applicable national law). The Guidelines on internal governance provide that national competent authorities should specify, where necessary, to which body or members of the management body functions apply, as do the Joint ESMA and EBA GL on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU (GL on assessment of suitability) (paragraphs 10 and 11).</p> | <p>Those GL clarify that they are intended to apply to all existing board structures without interfering with the general allocation of competences in accordance with national company law or advocating any particular structure. Accordingly, they should be applied irrespective of the board structure used (a unitary and/or a dual board structure and/or another structure) across Member States. The management body, as defined in points (7) and (8) of Article 3(1) of Directive 2013/36/EU, should be understood as having management (executive) and supervisory (non-executive) functions. Consequently, the SREP GL follow the same logic. Further clarification is not necessary.</p> | |
| Range of tasks of the management body | <p>Two respondents considered that the SREP GL, similarly to other existing EBA GL, imposed a wide range of operative tasks on the management body, i.e. that the involvement of the management body as a requirement and an assessment factor in practically all areas of a bank was too onerous. In the respondents’ view, the governance structure of the institution has to ensure that the decisions of the management body are implemented and monitored properly. Hence, these respondents would appreciate a balanced approach here (paragraphs 91(c) and paragraph 98).</p> | <p>The GL are not intended to introduce additional operational tasks for the management body. It is obvious that the management body, while it cannot delegate its responsibilities or decisions on key policies, may delegate most operational tasks. Paragraphs 91 and 98 have been clarified.</p> | <p>The relevant paragraphs have been amended.</p> |
| Link to other relevant GL | <p>One respondent remarked that some provisions in paragraph 91 related to the GL on assessment of</p> | <p>A reference to the relevant GL has been added.</p> | <p>The paragraph has been amended</p> |

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| | suitability and, as a consequence, these GL needed to be referred to at the beginning of this paragraph. | | |
| Setting up of committees | One respondent suggested that in paragraph 91(b) it should be specified that the setting up of committees should take into account the proportionality principle. | The setting up of committees is subject to Directive 2013/36/EU and the requirements are further clarified in the EBA GL on internal governance. | No amendments. |
| Disclosure of governance framework | One respondent stated that the requirement in paragraph 91(k) with regard to the internal governance framework went beyond the requirements of the GL on internal governance (Title VII of these GL stipulates internal communication with all relevant staff, while, for interested members of the public and the owners of the institution, disclosure requirements and annual reporting already provide sufficient information), and that therefore this paragraph should be deleted. | Article 435 of the CRR and Article 106 of the CRD require the disclosure of some governance arrangements, which are further specified in paragraph 217 of the EBA GL on internal governance and the EBA GL on disclosure requirements under Part Eight of Regulation (EU) No 575/2013. | A reference has been added. |
| Consolidated versus group wide | One respondent stated that in paragraphs 91(c) and 98(a), the application of requirements was specified on a ‘group-wide basis’ and questioned whether this corresponds to application on a consolidated basis. Alternatively, it was questioned whether this was a new notion, as application on a consolidated basis is specified in Section 5.10 of the SREP GL (paragraph 109). | The GL have been amended and the reference to ‘group-wide basis’ has been replaced with a reference to ‘consolidated basis’. | Paragraph amended. |
| Key function holders (1) | According to one respondent, since the requirements set out in paragraphs 91(e) and 92 | The assessment of key function holders is part of robust governance arrangements and specified in the | No amendments. |

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| | are not included in CRD IV and hence not covered by some national legislation either, further explanation of them is required. | Joint ESMA and EBA GL on the assessment of the suitability of members of the management body and key function holders. Paragraph 92 refers to the applicable CRD provision and EBA GL. | |
| Key function holders (2) | <p>One respondent suggested that in paragraph 92(a) after ‘ongoing basis’, a comma should be inserted in order to clarify that notification to the relevant competent authority does not need to be on an ongoing basis in order to be in line with the GL on assessment of suitability. The respondent also asked for an explanation of this paragraph with respect to key function holders.</p> <p>Another respondent suggested that the sentence ‘arrangements aimed at ensuring that the individual and collective suitability of the management body and key function holders are implemented and carried out ...’ be replaced with the following: ‘arrangements aimed at ensuring that the individual and collective suitability of the management body and the individual suitability of key function holders are implemented and carried out ...’. The actual wording is not consistent with the GL on assessment of suitability, as collective suitability applies exclusively to the management body.</p> | The GL have been clarified accordingly. | The relevant paragraph has been amended. |
| Key function holders (3) | According to one respondent, with regard paragraph 92(b), the diversity policy cannot apply as specified in the GL on assessment of the suitability to the management body in its management function (there is an issue with | The requirements on diversity are specified in the Joint ESMA and EBA GL on the assessment of the suitability of members of the management body and key function holders. To clarify the GL, the text on the assessment of how diversity is taken into account | The relevant para has been amended. |

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| | <p>gender when this body is made up of two individuals), and the respondent asks for an explanation. Additionally, as regards the ‘number of members of the body’, that is not specified in the GL on assessment of suitability (the quantitative aspect, according to the respondent, refers to the underrepresented gender only).</p> <p>Other respondents believe that further indications should also be provided with respect to the application of the ‘diversity policy’ in relation to the institution’s organisational model and the role of the ‘management body’ (be it strategic supervision, management or control).</p> | <p>when recruiting members has been made a separate point.</p> | |
| Key function holders (4) | <p>With regard to the assessment of the suitability of members of the management body and key function holders, two respondents consider that it should be clarified how the elements listed in these point of paragraph 92 must be assessed since they are referred to “soft” qualities that are not easy to quantify and/or compare against peers.</p> | <p>It is not intended to provide detailed guidelines above the joint EBA and ESMA GL on the assessment of the suitability of members of the management body and key function holders and the EBA Guidelines on internal governance on those points. Some areas need to remain subject to qualitative judgement that takes into account the nature, size and complexity of the institution.</p> | <p>No amendments.</p> |
| Remuneration policies and practices | <p>According to two respondents, the currently ongoing developments on the review of CRD regarding variable remuneration seem to indicate that institutions may deviate from specific requirements where certain conditions are fulfilled. Therefore, paragraph 95(d) should also be amended to reflect the relevance of the application of certain provisions, provided that the institution does not use vehicles or practices to circumvent</p> | <p>The GL are based on the currently applicable CRD framework. A suggestion related to changes in the CRD framework on remuneration cannot be taken into account, as it may still change further. This paragraph is in line with the CRD and the GL on sound remuneration policies.</p> | <p>No amendments.</p> |

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| | <p>remuneration requirements. One respondent suggested the following amendment: ‘the variable remuneration for identified staff is based on performance and where relevant the requirements on deferral, retention, pay-out in instruments and the application of malus and claw back are respected and the institution does not use vehicles or practices to circumvent remuneration requirements’.</p> | | |
| Attitude towards risk management | <p>One respondent considered that, although the encouragement of a positive attitude towards risk management, as mentioned in paragraph 96, was an overarching aspect of an institution’s risk culture, it could not be defined specifically or reviewed as part of the internal control framework; hence the respondent suggested deleting that particular clause.</p> | <p>The paragraph has been changed to take the comment into account.</p> | <p>The relevant paragraph has been amended.</p> |
| Risk management framework | <p>One respondent suggested that in paragraph 98(d), ‘Whether the institution has established and independent risk management function ...’, with regard to the term ‘risk management function’, the GL should clarify the concrete risk functions that should be independent, as well as what they should be independent from. Whether ‘risk management’ includes both ‘taking on’ and ‘control’ risk activities, the requirements regarding independence among different functions (business units, taking on risks, risks control) and the roles of the first and second lines of defence should also be clarified.</p> | <p>The independence of the internal control function and the organisation of the three lines of defence, including the risk management function, are specified in the EBA GL on internal governance. The same holds true with regard to risk management covering both ‘taking on’ and ‘control’ activities.</p> | <p>No amendments.</p> |

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| Additional clarifications on risk strategy and other risk-related concepts | <p>Several respondents suggested that more precision was required on the definition of ‘risk strategy’ and other risk-related concepts. Specifically, some risk-related terms (e.g. ‘risk strategy’, ‘risk appetite’, ‘risk appetite statement’, ‘risk management framework’, ‘risk policy’) are not always used consistently, thus creating confusion; there is no definition of ‘risk policy’ (see paragraph 100(f)), either in the SREP GL or in GL on internal governance; the risk strategy seems to encompass the risk appetite and the risk management framework under the GL on internal governance (paragraph 23(b)), but the SREP GL frequently treat risk appetite and risk management as separate elements from the risk strategy (e.g. paragraph 99). Another respondent remarked that, in addition to the terms previously mentioned, there were references to ‘risk limits’, ‘risk tolerances’ and ‘risk thresholds’, with, however, no clear definitions, which would be required to ensure harmonisation across the banking industry.</p> | <p>The paragraph is in line with the CRD. The comment regarding ‘risk policy’ has been accommodated.</p> | <p>The relevant paragraph has been amended.</p> |
| Application of internal governance at consolidated level and implications for group entities | <p>Other respondents stated that it was important that SREP assessments were conducted taking into account the wide array of national differences, which are taken into account in the GL on internal governance (inter alia, in paragraphs 83, 87 and 196), and suggested reviewing the section’s wording in that regard.</p> <p>Additionally, the SREP GL should not only envisage whether ‘group-wide policies and procedures are implemented consistently at subsidiary level’ but</p> | <p>This paragraph is in line with the EBA guidelines on internal governance.</p> <p>In line with article 109 CRD, governance arrangements, processes, mechanisms should be implemented consistently within group including in subsidiaries that are financial institutions not directly subject to CRD. Institutions should take into account the sectoral rules for those subsidiaries and the local rules when those subsidiaries are outside the EU. This</p> | <p>No amendments.</p> |

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| | <p>also note that the assessment to be done by CAs will duly account for national differences and the principle of proportionality, having in mind that the way in which group-wide arrangements, processes and mechanisms are implemented in a Group's subsidiaries will depend on whether the subsidiaries are themselves subject to CRD on an individual level and, importantly as regards subsidiaries not themselves subject to CRD, on whether these arrangements, processes and mechanisms can be accommodated to their national laws and regulations.</p> | <p>paragraph is in line with the CRD and consistent with the GL on internal governance.</p> | |
| <p>Internal governance – Summary of findings and scoring</p> | <p>A few respondents made a comparison of this section with the GL on assessment of suitability (paragraph 49), according to which the calculation of directorships is relevant for significant institutions only. In this light, in some national competent authorities in consolidated groups only the consolidating institution is considered significant and, as a result, only the consolidating institution is subject to the limitation on directorships, whereas the affiliated institutions are subject to the time commitment only. Therefore, the following amendments to the wording regarding scores were suggested. Score 1: 'The time commitment of the members of the management body is appropriate and where relevant they comply with the limitation of the number of directorships.'; score 2: 'The time commitment of the members of the management body is largely appropriate and where relevant they</p> | <p>It should be specified that the limitation on directorships applies to all members of the management body who hold a mandate within a significant institution. All institutions need to ensure that all the members of their management body comply with the limitation on directorships; to this end, they need to establish if a member holds a mandate in a significant institution, apply the counting rules and, if need be, apply for approval of an additional directorship.</p> <p>Regarding the application of diversity, it is not sufficient to just adopt a policy; institutions need also to implement the relevant processes and should meet the requirements defined in policies.</p> | <p>The relevant wording has been amended.</p> |

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| | <p>comply with the limitation of the number of directorships.’; score 3: ‘There are doubts about the largely appropriate time commitment of the members of the management body or where relevant some members do not comply with the limitation of the number of directorships.’; and score 4: ‘The time commitment of the members of the management body is insufficient or where relevant the majority of the members does not comply with the limitation of the number of directorships.’</p> <p>The respondents also made a comparison of this section with Chapter 12 of the GL on assessment of suitability, according to which institutions should set (qualitative or quantitative) targets regarding diversity in the management body. If the targets are not met, significant institutions should document the reasons why, the measures to be taken and the timeframe for the measures. The requirements on compliance with the targets are to be specified in the diversity policy. This means that the targets do not have to be achieved immediately, but as described in the policy. Hence, according to these respondents, if an institution complies with all the abovementioned requirements of these GL, it should always receive a score of 1. In line with the GL on assessment of suitability, the respondents suggested an amended wording for scores 1 and 2. Score 1: ‘The institution has adopted a diversity policy that fosters a diverse board composition and complies with the targets or has set appropriate measures to achieve the</p> | | |

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| | <p>targets.’; and score 2: ‘The institution has adopted a diversity policy that fosters a diverse board composition and largely complies with the targets but has not yet set appropriate measures to achieve the targets.’</p> <p>Similar comments were made by a few other respondents, arguing that, since diversity targets set by institutions will be measurable only once the deadline set by the institution (if applicable) has been reached, in no case should these be assessed before said deadline with the effect of downgrading SREP scores for the institution.</p> | | |
| Annex 2 Point 1 | <p>A few respondents remarked that, since the regulatory requirements stated in Annex 2, point 1, arise not from CRD IV but from national implemented regulations, this point should be amended as follows: ‘National provisions implementing Articles 73 and 74, 88, 91 to 96 and 98 of Directive 2013/36/EU’.</p> | <p>These GL further specify EU legal requirements to foster harmonisation.</p> | <p>No amendments.</p> |
| ‘Senior management’ concept | <p>One respondent considered that the use of the ‘senior management’ concept in the SREP GL was not in line with the GL on internal governance or with the GL on assessment of suitability (the ‘key function holders’ concept is also used in these GL).</p> | <p>The SREP GL are not in conflict with the other GL. The purpose of referring to the senior management in the SREP GL is to ensure that the full governance structure is captured, including those persons who are not part of the management body but who exercise executive functions, are accountable to the management body and are responsible for the day-to-day management of the bank.</p> | <p>No amendments.</p> |
| Question 4: What are the respondents’ views on the provisions of the newly introduced Pillar 2 capital guidance? | | | |
| Variability of P2G methodology | <p>Several respondents welcome the transparency included in the SREP GL with regard to the</p> | <p>Details of and the methodology for the determination of P2G are provided in Section 7.7. of the revised</p> | <p>No amendments.</p> |

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| | <p>methodology on the computation of P2G and its link to relevant supervisory stress tests (including those performed by the EBA). They also welcomed the possibility of updating the computation of P2G using a simplified version of a stress test. However, the need for a certain level of continuity in terms of the methodology was suggested, in order to avoid unnecessary fluctuations in the capital ratios (including P2G).</p> | <p>SREP GL (more details on actual practices have also been included in the EBA 2017 convergence report).</p> <p>The intention of the relevant paragraph on the possibility of updating the computation is to provide the necessary flexibility to competent authorities and cater for the implementation of the proportionality principle when determining and setting P2G. The methodology is not expected to result in unnecessary fluctuations in capital ratios.</p> | |
| Institutions' internal stress testing and P2G | <p>One respondent argued that internal stress test results should have no quantitative effect on P2G, including the results of reverse stress tests run by banks as part of their ICAAP, as this could create disincentives for institutions when designing stress tests.</p> <p>Another respondent considered that it would be helpful if the SREP GL could also include, where appropriate, references to internal stress testing in Section 7.7.2. in order to avoid any risk of misinterpretation and ensure alignment with the principle set out in paragraph 383 that refers to both internal and supervisory stress testing.</p> <p>Some respondents further noted that it was unclear to them whether only the supervisory stress tests or also internal ICAAP stress tests would be relevant for the setting of P2G. While paragraph 388 refers solely to the results of the adverse scenario of relevant supervisory stress tests, paragraph 395 states that, when determining the size of P2G, also 'the outcome of reliable ICAAP</p> | <p>Paragraph 383 (in Section 7.7) covers the general use of stress testing to assess capital adequacy.</p> <p>Supervisory stress tests should be used at the outset to determine and set P2G, based on the outcomes of the adverse scenario (paragraph 388). For P2G purposes (covered in Section 7.7.2), and in accordance with paragraph 395 in this section, it is possible for institutions' ICAAP stress test outcomes to be considered as an adjustment in the determination of P2G (only when the ICAAP stress tests are considered reliable). Paragraph 395(b) has been clarified further.</p> | <p>The relevant paragraph has been clarified further, and now reads 'the outcome of a reliable ICAAP stress test, taking into account the specific scenario definitions and assumptions, in particular where they are deemed more relevant for the business model and risk profile of the institution or where internal scenarios are more severe than the supervisory scenarios'.</p> |

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| | <p>stress test to assess severity of the results' should be considered. More precise rules for what the basis for P2G setting is would be welcome.</p> | | |
| Baseline versus adverse scenario | <p>Some respondents stated that the concepts of 'baseline' and 'adverse' scenarios should be defined more precisely. In addition, the links between the scenarios and the EBA stress test exercise should be clarified. Furthermore, it should be emphasised that the stress test should not become an excessive administrative burden, and should be done taking into account the size and business model of the bank, in accordance with the proportionality principle.</p> | <p>The terms 'baseline' and 'adverse' refer only to a scenario's relative assumptions or the severity of deterioration of the scenario expressed in terms of the underlying macroeconomic and financial variables (or any other assumptions), as explained further in the draft EBA GL on institutions' stress testing (EBA/CP/2017/17). The EBA stress test exercise is based on two sets of scenarios (baseline and adverse) and has been agreed with other relevant EU institutions. As regards the potential excessive administrative burden, paragraph 389 caters for a proportionate approach for non-Category 1 institutions and subsidiaries of cross-border groups.</p> | No amendments. |

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| Predefined (target) capital ratios in supervisory stress testing | <p>Several respondents raised concerns that competent authorities might be able to introduce different thresholds for institutions and also opposed the use of predefined target capital ratios (set at an arbitrary/artificial level) defining a pass or fail. Setting different predefined target capital ratios for banks and jurisdictions would undermine the essence and usefulness of a system-wide exercise. One respondent suggested the deletion of paragraph 580, while another stated that greater clarity with respect to the setting of thresholds would be welcome and that the wording referring to concepts related to system-wide stress tests might need to be revisited to better reflect the SSM situation.</p> | <p>Regarding the predefined target ratios mentioned in paragraphs 385 and 580, it is important to note that these are target ratios set by competent authorities in the context of system-wide stress tests. It remains at the discretion of competent authorities to set predefined target ratios for the purposes of paragraphs 382 to 385. This allows competent authorities the flexibility to assess capital in stressed conditions, outside the context of P2G.</p> | No amendments. |
| Determining and setting P2G and backstop | <p>Some respondents suggested that, for legal certainty reasons, paragraph 387 should be changed as follows: ‘Where the quantitative outcomes of the supervisory stress test suggest that the institution is not expected to breach its TSCR under the adverse scenario competent authorities should not set P2G.’</p> <p>Others suggested that the reasons leading competent authorities to set P2G when the quantitative outcome of stress tests does not lead to any breach should be detailed. The inclusion of examples in the Consultation Paper could be helpful for institutions, from a forecasting perspective and in order to strengthen their capital management.</p> | <p>P2G should be a discretionary supervisory tool, which, like any other supervisory measure, can be used by competent authorities at their discretion. This paragraph provides a backstop for when competent authorities have to use P2G: in case of a breach of TSCR.</p> <p>The dialogue with institutions, the application of supervisory measures and the communication of findings are already referred to in Section 2.1.5. In addition, the communication of P2G is described in Section 7.7.2 (‘Communication and composition of P2G’ (paragraphs 398 to 402)).</p> | No amendments. |

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| Supervisory stress test methodology | <p>A few respondents asked for the GL to specify how the results of supervisory stress tests should be used to determine P2G and for more detailed, quantitative explanations on the inclusion of stress test results in P2G, e.g. concerning the set of risk factors and the calibration of those factors. According to the comments, this is essential for the harmonisation of supervisory stress test scenarios across jurisdictions. Significant differences between the calibrations of competent authorities' stress tests would cause a fragmented setting of P2G throughout the EU/EEA and thus be an additional source of regulatory divergence.</p> <p>Additionally, some respondents believe that, in the consideration of stress test results for setting P2G, particular attention should be paid to the scenario used as a basis for the stress test, both the probability of occurrence and plausibility of the underlying scenario. Stress test results should be explicitly or implicitly weighted according to the scenario's occurrence probability, to avoid unreasonable capital requirements derived from extremely low-probability scenarios. In addition, if all the institutions in a sample use a unique methodology, it is possible in the case of some institutions, to introduce significant distortions of economic reality. If there is a potential for a significant impact of such distortions on the stress results of certain institutions, their feedback in this respect should be considered in the process of setting P2G.</p> | <p>The use of supervisory stress tests, including those that could be used for P2G purposes, is covered in detail in Title 12. In accordance with paragraph 584, competent authorities should ensure that they have processes and arrangements in place for an effective dialogue with institutions regarding supervisory stress tests and their outcomes. The determination of P2G is described in Section 7.7.2, paragraphs 394 to 397.</p> <p>These GL do not set methodologies for the stress tests conducted by the EBA in cooperation with other competent authorities in accordance with Article 22 of Regulation (EU) No 1093/2010.</p> <p>The scenario used as a basis for the stress test and the universal methodology should be considered by the competent authorities, where relevant, when determining the size of P2G in accordance with paragraph 395.</p> | No amendments. |

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| Frequency of setting/reviewing P2G | <p>According to one respondent, paragraph 391 grants a very large degree of flexibility to competent authorities; the respondent would advocate for a restriction on the frequency of the revision of the P2G level (i.e. except in the case of very specific circumstances, the P2G level revision should occur not more often than on a yearly basis).</p> <p>Some respondents suggested the following change to paragraph 392, to ensure a level playing field and for proportionality reasons: ‘P2G should [instead of “can”] be set every second year’.</p> | <p>The setting of P2G is linked to the minimum engagement model, and in particular the assessment of capital adequacy and supervisory stress testing. Depending on the circumstances of the institution and supervisory priorities, both can be performed more frequently. Both will lead to setting/reviewing P2G.</p> | No amendments. |
| Overlap between P2G and P2R | <p>Some respondents believe that the approach according to which P2G can or should ‘cover certain aspects of the same risks addressed by P2R’ is questionable, bearing in mind that, in line with its purpose as prescribed by Article 104 of CRD IV, P2R must cover all material risks run by the institution due to its own activities and not covered under other legal requirements of the CRR/CRD (Pillar 1, buffers, large exposure and leverage ratio). These same risks should not be reflected in other requirements or guidance. This would increase the non-transparency of P2G and the regulatory capital requirements. P2R should be set only in situations where P2G is not an appropriate tool for achieving the relevant goals. One respondent suggested rewording paragraph 393 as follows: ‘Generally’ should be deleted. ‘P2G may cover certain aspects of the same risks addressed by P2R, to the extent that it covers aspects of those risks that are not</p> | <p>The EBA agrees that there should be no overlap between P2G and P2R, applied in accordance with these guidelines. It is noted that section 7.2 specifies where P2R should be applied, whereas section 7.7 specifies the circumstances for applying P2G.</p> <p>The wording of para 393 has been amended to ensure consistency in terminology. The EBA may further review the text following the finalisation of CRD V.</p> <p>Paragraph 396, among other, highlights the fact that macro-economic downturn scenarios may not entirely capture some risks and gives examples of the ones that appeared most frequently in practice (e.g. in the institutions’ stress testing scenarios) and elaborates important aspect of P2G setting (i.e. it addresses stressed conditions.)</p> | <p>The relevant paragraph has been amended as follows: ‘Competent authorities should generally not use P2G to cover elements of risks that should be covered by the additional own funds requirements in accordance with Section 7.2 of these guidelines.’</p> |

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| | <p>already covered.’ It should be specified that the competent authorities bear the burden of proving that the risks addressed by P2R are not already covered.</p> <p>Several respondents considered that paragraph 393 should explain in detail which of the ‘certain aspects’ of P2R should additionally be included in P2G.</p> <p>Another respondent requested greater clarity on distinguishing the stressed and unstressed components of P2R to avoid duplication of regulatory capital requirements (in particular in relation to IRRBB and pension risk) through a redrafting of paragraph 393 (as well as paragraph 396). It would also be helpful to clarify what is meant by ‘certain aspects of the same risks’ (and any relationship this has with the concept of ‘elements of risks’ used in the CRD V). The respondent thought this referred to the ‘stressed versus unstressed’ components of risk, but more precision in the drafting would be helpful and avoid interpretation differences in the future.</p> | | |
| Minimum level of P2G | <p>One respondent stated that there should be no minimum level whatsoever for P2G; rather, an individual level covering microprudential stress effects should apply to each institution, provided that those effects exceed the CCB.</p> | <p>The setting and determining of P2G described in these GL, including netting with macroprudential measures as well as other adjustments, do not involve any minimum level for P2G, nor do they GL imply that the CCB is the only possible element that can be used for adjustment purposes.</p> | No amendments. |

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| Distribution of losses across the stress test horizon for P2G purposes | <p>Some respondents suggested a more holistic view of how losses are distributed over the forward-looking time horizon when it comes to the determination of P2G. The focus only on the year when the maximum stress impact occurs could, in some cases, distort the results. If this emphasis remains, the distribution of losses should be recognised through supervisory adjustments in determining the size of P2G.</p> <p>Some respondents also suggested finding solutions for one-off events, such as IFRS 9 implementation, that would affect the worst year.</p> | <p>The list of possible adjustments leaves sufficient room for discretion on the issues mentioned. In particular, paragraph 395(a) should cover issues such as the impact of IFRS 9 on the first year of stress.</p> | No amendments. |
| ICAAP severity and adjustments | <p>One respondent stated that in its experience different institutions choose different levels of severity for internal stress testing, depending on their risk appetite. The current formulation may encourage institutions to use less severe scenarios to potentially reduce P2G, and the respondent suggested the addition of the following text at the end of sentence: ‘... taking into account the specific scenario definitions and in particular where internal scenarios are more severe than the supervisory scenarios;’.</p> | <p>The wording of the paragraph in question has been changed as suggested, also taking into account business model relevance.</p> | <p>The relevant paragraph has been changed to ‘the outcome of a reliable ICAAP stress test, taking into account the specific scenario definitions and assumptions, in particular where they are deemed more relevant for the business model and risk profile of the institution or where the internal scenarios are more severe than the</p> |

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| Potential double counting of macroprudential risks (P2G and buffers) | <p>Some respondents stated that it would be necessary supervisors to demonstrate the risks covered by P2G, for several reasons. It would be necessary to inform institutions to what extent macroprudential risks were addressed by P2G, to avoid any doubling counting of capital needs. It should be explained within the SREP decision to what extent risks were addressed through P2G that were not covered by all the other macroprudential buffers.</p> <p>Some respondents stated that, while it was clear that P2G should not be offset against the systemic risk buffer, it was unclear to what extent, and based on what criteria, P2G should/could be offset against the CCB and the CCyB. One respondent suggested that the EBA should be more specific in defining the rules for when P2G can be offset by the CCyB or allow a full netting between both buffers (CCyB and CCB).</p> <p>Another respondent stated that, currently, the ECB and the EBA diverge in their publications over the inclusion of the systemic risk buffer in stressed minimum capital requirements. That is, ECB's ICAAP GL offset P2G against both the CCB and the systemic risk buffer. These differences in approach have a very material impact on the minimum capital requirements and might complicate capital planning and damage both investors' and consumers' confidence in banks. One respondent</p> | <p>The proposed approach to the offsetting of the combined buffer elements is the outcome of policy discussions during the preparation of these provisions, taking a conservative approach to this new supervisory tool.</p> <p>P2G is fully offset against the CCB, while it can be offset against the CCyB in exceptional cases. There is sufficient flexibility for competent authorities to consider the specificities of particular institutions (e.g. adjustments) and local conditions.</p> | <p>supervisory scenarios'</p> <p>No amendments.</p> |

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| | <p>pointed out that there are currently jurisdictions in which the systemic risk buffer is activated to cover macroprudential risks, such as elevated levels of house prices and the household debt burden, that potentially overlap with P2G. Consequently, when the systemic risk buffer is set to cover macroeconomic risks and does not reflect risks an institution poses to the wider system, the competent authority should also offset P2G against the systemic risk buffer.</p> <p>Several respondents argued that overlaps between P2G and other applicable macroprudential measures should also be avoided.</p> <p>Some respondents stated that, according to the wording of the proposed CRD review (Article 104(b)), the guidance is intended to cover cyclical economic fluctuations. Therefore, overlapping of P2G and the CCyB may occur and the need to offset P2G against the CCyB should be assessed in every case. The respondents noted that P2G should not be used as an instrument for addressing macroprudential risks. Recital 9 of the current CRD review proposal clarifies that own funds add-ons should not be used to address macroprudential risks. Furthermore, all of the buffers are defined within a directive (CRD IV) that is not directly applicable but, rather, has to be implemented in national law. Imposing macroprudential buffers through a directly applicable SREP decision of the competent</p> | | |

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| | <p>authority would call into question the effectiveness of the buffers that are set at national level.</p> <p>Two respondents considered that P2G should be fully offset against the CCB, as both capital requirements have the objective of covering stress effects, and suggested the following change in the wording: ‘Competent authorities should fully offset P2G against the capital conservation buffer’.</p> | | |
| Transparency on the determination of P2R and P2G | <p>Some respondents remarked that supervisory approaches in terms of determining the levels of P2R and P2G, as well as the scoring rules, were not sufficiently transparent for banks, which presented an obstacle to efficient capital planning. They suggested explaining the exact methodology, so that banks would be able to manage their P2R and P2G expectations in a forward-looking manner. One respondent considered that greater transparency on the determination of individual P2G levels was necessary. As a general principle, institutions should be able to base their capital planning and actions on the supervisory dialogue regarding P2R/P2G, which demands sufficient transparency about the reasons for defining supervisory actions and P2R/P2G; hence paragraph 398 should be clarified accordingly. Additionally, some respondents argued that benchmarking stress test outcomes (in both qualitative and quantitative terms) would be useful for institutions in order to classify their individual P2G. Therefore, respondents suggested the regular publication/notification of aggregate</p> | <p>Methodological aspects of the P2R determination are not within the scope of this review, and, as already outlined, the main aspects of this are not changed but only explained in more detail in certain areas. The nature of the P2G determination, setting and communication is in turn described in Section 7.7.2, which should be read together with other parts of the GL in order to gain a comprehensive understanding of the process.</p> <p>Supervisory dialogue on supervisory stress tests and outcomes is covered in paragraph 584. The specifications relating to any of the factors in paragraph 395 could be elaborated on at the discretion of the competent authorities.</p> <p>The level of transparency remains at the discretion of the individual competent authority.</p> | No amendments. |

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| | (benchmarking) information on stress test outcomes and/or P2G (but not at the level of individual institutions) by competent authorities. | | |
| Meeting P2G with CET1 | <p>Some respondents opposed the requirement in paragraph 399 and Annex 5 for P2G to be fully met with CET1 and suggested instead that the use of other capital instruments should be allowed, mirroring P2R’s capital quality. According to paragraphs 384 et seq., P2G has to be set such that sufficient capital is available that even in an adverse stress scenario TSCR is not breached over a period of at least two years. First, it was argued, it is possible to use buffers as a general principle. Second, AT1 capital instruments are also suitable for absorbing losses. In this way, an adverse scenario that materialised could initially be absorbed by AT1 capital without the buffer requirement being affected. However, even if the losses extended to the buffer, compliance with TSCR would still be guaranteed. In the respondents’ view, the requirement to use only CET1 for P2G is far too conservative, which is why they were strongly in favour of allowing other capital instruments, as in Article 92 of the CRR.</p> <p>A few respondents also noted that the EBA does not have a mandate to specify a tightening of the expected Level 1 requirements, and that P2G is conditional on CRD V. Specifically, Article 104(b) of the Commission’s draft of CRD V stipulates the use of own funds and, in contrast to P2R in accordance</p> | <p>Having P2G covered in the same way as P2R in terms of the proportion of the different capital instruments might have a number of disadvantages. Specifically, P2G is aimed at covering losses stemming from the outcomes of supervisory stress tests (in terms of maximum CET1 ratio depletion) and is ultimately aimed at allowing an institution to meet its TSCR under stressed conditions, with CET1 having a higher loss absorption capacity than AT1 or T2. Additionally, P2G is set to cover potential losses revealed by supervisory (or institutions’) stress testing, and its calculation assumes offsetting with certain elements of the combined buffer. Such offsetting would be operationally more difficult to execute if the GL required institutions to disentangle the CET1 part of P2G, which would be eligible for offsetting, from other parts. The operational cost of implementation would be high, without generating greater benefits from using different quality requirements to justify this granularity.</p> | No amendments. |

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| | with Article 104(a)(4), no T1 sub-ratios are specified. | | |
| P2G and recovery planning | Some respondents are of the opinion that P2G should not be included in the recovery plan, as P2G sits on top of the combined capital buffer requirement and does not entail any automatic restriction on distribution (MDA) in accordance with Article 141 of Directive 2013/36/EU. Including P2G in the capital indicators would run counter to the buffer concept of the combined capital buffer requirement – which specifically provides for a temporary shortfall in a crisis – and could trigger an obligation to issue an ad hoc release (at the latest after the shortfall) and thus result in the (unintended) publication of the P2G requirement. An institution can temporarily fall below the P2G expectation in a stress or crisis event without a decision about recovery status being automatically required. P2G should not therefore have any impact on the recovery plan. The respondents therefore suggested deleting the term ‘recovery planning’ in paragraph 399 and Annex 5. | Paragraph 399 should not necessarily be read as indicating that P2G should become part of the actual trigger levels. Rather, it aims to ensure that P2G is part of the risk management framework and is taken into account for recovery planning, for example in the form of early warning indicators. The latter do not trigger any automatic recovery actions. | No amendments. |
| Double counting of own funds held for the purpose of P2G | A number of respondents opposed not allowing double counting of CET1 capital for P2G purposes and for the purposes of covering AT1/T2 shortfalls. They suggested that this changes the hierarchy of the staking orders and that double counting should be allowed, i.e. it should be permissible to use CET1 held for P2G purposes to cover a shortfall in AT1/T2 instruments. | Own funds held for the purpose of P2G are meant to protect institutions from the outcomes of a particular stressed scenario, as established by the quantitative outcomes of that scenario. Therefore, they cannot be used to meet any other regulatory requirements (P1, P2R, CB) that are not linked to that stress scenario. This means that own funds cannot be used twice, to cover P2G and to cover any shortfall in AT1 or T2 instruments to cover TSCR. Should they be used to | No amendments to paragraph 400 or 402. The example in Section 7.9 has been amended in order to better reflect the nature of the CCyB |

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| | <p>One other respondent stated that, in its understanding, the wording of paragraph 400 did not determine the order in which the requirements were to be fulfilled. In the event of a shortage of capital, it might be relevant to consider whether the minimum capital requirements of Pillar 1 or P2G should be covered first. The SREP GL allow the interpretation that P2G has priority; own funds 'cannot be used twice: to cover P2G and to cover for any shortfall of AT1 or T2'. This means that own funds are first used to cover P2G and only then to cover a shortfall in AT1/T2 instruments. In fact, that P2G takes priority in this regard has already been indicated by supervisors. However, this interpretation implies that, in case of an AT1/T2 shortfall, the application of the MDA would be dependent on the size of P2G. This is in direct contradiction to Annex 5, according to which P2G should have no relevance for the level of and adherence to the MDA, as well as to the spirit of paragraph 403, according to which non-disclosure of P2G is expected. Therefore, the respondent requested that paragraph 400 be deleted. The requirement to take P2G into account in all capital ratios could then be integrated into paragraph 401. They respondent asked, alternatively, for clarification that the stacking order shown in paragraph 393 (Figure 6) is authoritative, as P2G would otherwise have an influence on the application of the MDA.</p> <p>Other respondents stated that the requirement in paragraph 400 was not in line with the recent</p> | <p>cover a shortfall in AT1 or T2 and P2G, if the scenario assumed for P2G materialised, the institution would not have sufficient own funds.</p> <p>P2G remains not directly MDA relevant, and there is no contradiction with Annex 5. If there is an AT1 shortfall and institutions use their P2G to cover that shortfall, this will not necessarily trigger MDA, but it will trigger specific supervisory attention, as explained in these GL.</p> <p>The EBA agrees that the chart from the presentation at the public hearing should be included in the background section.</p> | <p>and to make some general changes to the wording.</p> |

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| | <p>understanding of the stacking order given in paragraph 394 and that this was also being discussed as part of the current review of the CRD.</p> <p>One respondent suggested the inclusion of the schematic representation of P2G calculation as illustrated in slide 7 of the presentation given during the associated public hearing in the SREP GL, in order to aide consistent interpretation of P2G going forward. The presentation clearly indicates the different steps involved in setting P2G, i.e. the determination of the so-called ‘maximum stress impact’ followed by supervisory adjustments (including credible mitigating management actions) and offsetting with the CCB and, where relevant, the CCyB.</p> <p>Regarding paragraphs 400 and 401, one respondent sought clarification that P2G would not have any effect in future on the MDA and should not therefore affect the restrictions on distribution.</p> | | |
| Communication of P2G | <p>According to one respondent, despite the example given in Section 7.9, it remains unclear whether the inclusion of P2G in all capital ratios is a definitive requirement or merely a possible communication of prudential requirements for the supervisory authorities. Should P2G be included in all capital ratios, this would constitute a further increase in capital requirements, in which case, the respondent argued, an impact analysis should first be carried out and, based on the results of this analysis, a decision should be made as to the average level at which P2G should be introduced</p> | <p>The example in Section 7.9 should be understood as a guiding example of best practice.</p> <p>The timeline for application is January 2019, and this has been communicated in advance. Furthermore, when communicating P2G to institutions, competent authorities should also communicate time limits and should consider any institution-specific circumstances, including restructuring and resolution and AT1/T2 shortfalls, as explained in paragraphs 400 to 402.</p> | No amendments. |

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| | <p>for institutions. For this further increase in capital requirements, there should be a multi-year phase-in period, as in the case of other regulatory adjustments.</p> <p>Some respondents remarked that how OCR were to be communicated should be left to the discretion of the competent authority. It is common practice for some supervisors to communicate only a desired CET1 ratio and not an OCR. Therefore, the respondents suggested the deletion of paragraphs 400 and 401, as well as the table in Section 7.9. Others would welcome specific examples regarding paragraphs 401 and 402, and welcomed the example of the communication of SREP decisions to institutions.</p> | | |
| Capital planning | <p>Some respondents are of the opinion that, through the revisions, very extensive powers will be given to supervisors to change even banks' business decisions. In this regard, they disagree with allowing business decisions to be overruled by a supervisory authority and recommend at least clarifying paragraphs 406 and 407.</p> <p>Another respondent stated that, according to paragraphs 404 to 407 and paragraph 547(a), as well as Annex 5, the SREP GL require institutions whose own funds are sufficient to meet OCR but fall below P2G to submit a capital plan to the competent authority. Under Article 142 of CRD IV, this measure is necessary only if the institution does not meet the combined buffer requirement</p> | <p>According to Article 104 of the CRD, competent authorities can require institutions to present a plan at their discretion, depending on institutions' circumstances. Such plans will be assessed by the competent authorities and institutions are expected to implement them.</p> | <p>Relevant paragraphs have been amended or added.</p> |

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| | <p>(i.e. OCR). The requirement thus constitutes an inappropriate tightening of the CRD requirements and should be deleted. This is also necessary in the light of the facts that institutions prepare internal capital plans as part of ICAAP (see the normative perspective of the ECB’s SSM ICAAP guide) and that the relevant information about regular data capture for SREP must be provided to the competent authorities.</p> <p>One respondent commented that, throughout Section 7.7.3, it remained unclear where the ‘capital plan’ is merely part of the stress test assessment – i.e. hypothetical, conditional on the scenarios considered – and where institutions are required to actually take action on certain elements of the capital plan. The respondent asked for clarification. Furthermore, clarification was sought regarding the relationship between the ‘capital plan’ required after negative stress test results and (1) the regular capital plan as part of strategic and operative planning and (2) the recovery plan already containing an implemented framework governing which actions are to be taken, when and how.</p> <p>Additionally, some further specifications, namely in paragraph 405(a), could be beneficial in terms of clarifying whether the assumed time horizon relates to the time horizon of stress testing or of strategic/operative capital planning, and more information in paragraph 405(d) regarding the public announcement would also be useful.</p> | <p>Whether the plans requested by supervisors based on the outcomes of the stress test will be different from the institutions’ own (ICAAP) capital plans will depend on the institution-specific circumstances. Competent authorities, as part of their supervisory engagement, may require modifications to the plans.</p> <p>Paragraph 405(a) has been amended to clarify that the time horizon refers to the stress testing horizon: ‘whether the capital plan covers the entire assumed stress testing time horizon’.</p> <p>The EBA notes that the capital plan may contain both conditional actions and actions that the institution may wish to take immediately, for example holding a certain level of managerial buffer. In that case, the implementation of the capital plan would mean that the institution actually held that level of buffer.</p> | |

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| | <p>Another remark was that, to ensure an effective dialogue with the institution, the competent authority should consider that, for process-related reasons, material changes in the planning framework can be required only before or right at the beginning of the process i.e. that requirements to change material planning parameters later on cannot be appropriately taken into account. Furthermore, management actions and additional mitigating actions for the capital plan are directly derived from the recovery plan. Changes to the actions should therefore also be included in the feedback on recovery planning to ensure consistency.</p> <p>Clarification was requested regarding what was meant by the term ‘implement’, since mitigating actions considered conditionally upon potentially severe stress scenarios should not necessarily be (and usually are not) taken immediately. For how long would the revised plan be valid, since capital planning is updated annually? Would the revised plan be valid only until the next regular update of the capital plan?</p> <p>In addition, regarding paragraph 405(f), respondents considered that the phrase ‘future regulatory changes’ referred to regulatory changes that were already known and finalised and that were to be applied within the time horizon of the capital plan. Hence, they suggested changing the wording to: ‘f. whether the proposed actions are broadly in line with macro-economic</p> | <p>Paragraph 405 now includes an additional point (g): ‘the range of recovery options and their analysis as set out in the institution’s recovery plan’.</p> <p>Paragraph 405(f) has been amended to include the word ‘known’. The word ‘known’ indicates that there is final version of the regulation that is tackled, so it would be redundant to add the additional adjective ‘finalised’. Paragraph 405(f) has been changed to ‘whether the proposed actions are broadly in line with macroeconomic considerations and with known future regulatory changes affecting an institution within the scope and timeline of the assumed adverse scenarios’.</p> <p>Competent authorities have the discretion to apply supervisory measures at any time. Distribution restrictions can be applied by supervisors at any point as part of supervisory measures.</p> | |

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| | <p>considerations and with known and finalised future regulatory changes affecting an institution within the scope and timeline of the assumed adverse scenarios’.</p> <p>A few respondents mentioned that, while a potential P2G breach does not trigger automatic restrictions on distributions, the competent authority has the power to require an updated capital plan and, if necessary, to take supervisory measures, which means that it is possible that the competent authority could restrict distributions before an institution reached the trigger related to the combined buffer level. This creates uncertainty and does not ensure transparency with regard to the requirements, either for the institution itself or for investors.</p> | | |
| P2G and supervisory considerations for assigning a score to capital adequacy | <p>Several respondents noted that Table 8 introduced a new input to the determination of the capital score, and therefore the P2R, whether or not the institution is able to comfortably meet its P2G. Therefore, they understood that the same risks that justified a determined P2G could also impact P2R if the institution was breaching, or close to breaching, P2G, and they saw this as a source of double counting. It was also added that the notion of ‘comfortably’ was subjective and added an additional discretionary element to the buffer.</p> | <p>The capital score in Table 8 is not an input to the determination of P2R. Rather, the capital score should in fact be determined based on an institution’s ability to meet its capital demand, given its existing own funds resources. Therefore, no double counting will result from the inclusion of P2G in the table. On the contrary, P2G is an important element of capital demand.</p> | No amendments. |
| Communication of prudential requirements | <p>Some respondents raised concerns about the communication of the combined buffer requirement (and OCR), as some capital buffers are macroprudential tools in the hands of the</p> | <p>The EBA acknowledges the issues raised regarding the applicability and timing of the buffers. The proposed amendment has been made, stating the date on</p> | <p>The example has been amended accordingly.</p> |

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| | <p>macroprudential authorities and, in the case of cross-border groups, the consolidating authority is simply not able to calculate the combined buffer requirement, and especially not for a year ahead. Furthermore, the consolidating supervisor can and has the power to communicate the P2R and P2G, but has no information and consequently no power to communicate the combined buffer requirement. The respondents suggested clarifying the Pillar 1 and Pillar 2 requirements in the joint decision and adding that the institution ‘is hereby reminded that it is also subject to the overall capital requirement (OCR), as that ratio is defined in Section 1.2 of GL EBA/GL/2014/13, which includes, in addition to TSCR, the combined buffer requirement as defined in point (6) of Article 128 of Directive 2013/36/EU, to the extent it is legally applicable’.</p> | <p>which the level of the buffer is set and highlighting the fact that it could changed over time.</p> | |
| <p>Supervisory reaction to a situation where P2G is not met</p> | <p>Several respondents considered that the implications of breaching P2G vis-à vis other requirements should also be clarified. It would be welcomed if the SREP GL established the proper framework to understand the ‘binding degree’ of the capital guidance and included a menu of options available to supervisors in the case of banks breaching P2G.</p> | <p>There is no automatic link between the level of own funds falling below P2G and specific supervisory actions (Annex 5). The latter will depend on the reasons why banks fall below their levels of P2G. Section 10.7 on the supervisory reaction to a situation where P2G is not met explains in more detail potential supervisory activities with regard to P2G breaches.</p> | <p>No amendments.</p> |
| <p>Application of SREP to cross-border groups</p> | <p>Some respondents sought clarification regarding the purpose of and background to paragraph 389.</p> | <p>The paragraph in question (together with paragraph 568) explains the application of the P2G elements defined in Title 7 on a consolidated basis for cross-border groups, particularly from the perspective of communication of P2G within supervisory colleges.</p> | <p>No amendments.</p> |

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| | | <p>These two paragraphs have been included based on the diverging practices observed last year and aim to set out best practice.</p> | |
| Question 5: What are the respondents' views regarding disclosure of P2G (paragraph 403), bearing in mind the criteria for insider information? | | | |
| Disclosure of P2G | <p>The majority of respondents recommended not requiring the disclosure of P2G and that it should be stated that P2G is not to be disclosed under any circumstances. Some considered that Pillar 2 disclosure requirements should be limited to P2R, which can be relevant for investors, since it has an impact on the MDA. Additionally, several respondents had concerns about the possibility that local authorities (e.g. market authorities) might require the disclosure of P2G, which would be likely to create disclosure pressure across the markets and possibly make the requirement binding. Some respondents therefore recommended that the EBA specify that P2G disclosure should not be required by local authorities under any circumstances.</p> <p>One respondent suggested that, in Annex 5, in the line 'public disclosure', it would be preferable to state that 'institutions are expected to treat all information as confidential'. Another respondent mentioned that current drafts of CRD V (Article 104(b)) discuss the incorporation of an exclusion regarding the use of insider information in accordance with Article 17(1) of Regulation (EU) No 596/2014.</p> | <p>In order to maintain consistency of provisions related to disclosure between P2R and P2G, there will not be a specific provision related to P2G disclosure. However, as it is important to highlight the flexible nature of P2G, a reference is provided in the background section.</p> | <p>The paragraph has been deleted and the first part of the paragraph has been moved to the background section.</p> |

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| | <p>On the other hand, several respondents considered P2G relevant information for investors, which therefore should be published or at least the institution should be allowed to decide whether to publish it or not, since it might consider this information relevant for its investors. Respondents argued that this would significantly increase transparency and would be in line with the disclosure principles formulated in the CRR.</p> <p>A few respondents highlighted that they would appreciate feedback from the supervisor on their relative P2G positioning within the peer group, if the proposed P2G disclosure requirement is amended.</p> | | |
| Question 6: What are the respondents' views on the introduction of supervisory stress testing in the revised guidelines (Title 12)? | | | |
| Use of supervisory stress testing | <p>Several respondents highlighted that the role of supervisory stress testing should be to challenge institutions' own stress testing and to support supervisors' decisions. They agreed there must, however, be a balance between the emphasis put on supervisory stress tests in decision-making and the quality of the whole stress testing process. One respondent asked for clarification of the scope of 'competent authorities'.</p> <p>Another respondent considers that the use of supervisory stress tests should be limited to special, definable situations and issues that require uniform data resources that can be aggregated. The requirements governing supervisory stress testing</p> | <p>As stated in paragraph 572, the use of supervisory stress testing is intended to facilitate SREP and the supervisory assessment of its key elements, which include institutions' own stress testing programmes. The balance mentioned is one of the important premises that has to be considered in designing and conducting the supervisory stress testing programme, as highlighted in Section 12.3. of the GL. Within the scope of the GL, the competent authority has the same scope as the competent authority as defined in point (40) of Article 4(1) of Regulation (EU) No 575/2013.</p> <p>As mentioned in Title 12, namely in paragraphs 578, 584 and 587, competent authorities should decide on</p> | No amendments. |

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| | <p>should therefore concentrate on these special cases for obtaining comparable data on concrete issues, which could result in valuable information gains.</p> <p>One respondent pointed out that amendments to stress testing methods that are relevant for determining P2G would need to be published promptly, so that they could be incorporated by institutions.</p> | <p>the methodologies and assumptions, including the design and features of the supervisory stress testing programme, taking into account what is most suitable for its intended purpose, taking into consideration supporting information, the availability of data and that the data will remain relevant.</p> <p>The EBA will, in line with its powers, as in the previous period, have a role in the EU-wide stress tests that will be conducted in accordance with the timely published and consistent methodologies, scenarios and key assumptions, and which will be developed, as before, in cooperation with the ESRB, the ECB and the European Commission. The stress testing programme will encompass all relevant facts and changes, where necessary, in line with the aims of the stress testing exercise. The same comment applies to other relevant competent authorities, although it is at their discretion to decide on these matters, and not within the scope of these GL.</p> | |
| Stress testing and communication with the institution | <p>Regarding the use of supervisory stress testing for planning the primary focus of supervisory activities, one respondent emphasised the importance of sufficient consultation, while another posed a question relating to proportionality, i.e. asked for more information about what is expected of small institutions.</p> | <p>In general, as defined in paragraph 584, an effective dialogue with institutions regarding supervisory stress tests and their outcomes, and which reflects the intended objectives of stress testing, should be established. However, when it comes to the supervisory examination programme, bearing in mind that, according to the Article 99 of CRD, supervisory examination programmes must include the institutions for which the results of the stress tests indicate significant risks to their ongoing financial soundness or indicate breaches of national provisions transposing CRD and of CRR, the obligation of the</p> | No amendments. |

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| Role of supervisory stress testing in relation to recovery plans | Some respondents argued that supervisory stress testing cannot be used to analyse the scenarios used in the banks recovery plans. While it makes sense to compare recovery scenarios used in recovery plans with ICAAP and ILAAP scenarios, recovery scenarios are not comparable with supervisory stress tests because they serve totally different purposes. One respondent commented, concerning the link between supervisory stress tests and recovery scenarios, that it appreciated that the evaluation methods are to be consistent, and that stress tests can form a useful starting point for recovery scenarios. | <p>supervisor is clear and cannot be subject to consultation, and nor can small institutions be per se exempted from this rule.</p> <p>The EBA included in the text of paragraph 574 the wording ‘where appropriate’ due to the fact that not every supervisory stress test would correspond to the purpose targeted in the recovery stress test scenario. However, where the rationale of the institutions’ and supervisory stress test scenarios are the same in nature, the use of supervisory stress test scenarios could prove beneficial for the examination and/or further improvement of the stress testing programmes of both the supervisors and the institutions. In addition, it should be borne in mind that the supervisory stress tests are not limited to system-wide stress testing but can also encompass the institution-specific scenarios that can be used for these purposes. Finally, the methods used for such assessments will in every case take into consideration the main objectives of the recovery plan scenarios.</p> | No amendments. |
| Design of stress tests | One respondent commented that, bearing in mind the wording of paragraph 578 (b)(3), it was unclear how sector-wide reverse stress tests should help in assessing the severity of institutions’ internal scenarios. Due to the fundamentally different designs of stress tests and reverse stress tests, the respondent considered that no significant information on the severity of stress test scenarios could be gained from the results of reverse stress tests. Hence, the respondent suggested the following wording: ‘b. ... be deemed appropriate for | As stated in paragraph 578(b), when deciding on the design of a stress test, supervisors should bear in mind the purpose or the objective of the stress test. Additional explanations given in the text should be considered primarily as recommendations or examples of current best practice, not as explicit obligations to use, for example, reverse stress testing for a specific purpose. Nevertheless, reverse stress testing has so far mainly been used in the area of recovery planning, although it can be a useful tool in other areas (please see the draft EBA GL on | No amendments. |

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| | <p>assessing the severity of the scenarios used by potential vulnerabilities of the institutions’.</p> <p>In addition, the respondent noted that the nature of reverse stress tests leads to a focus on certain risk drivers; therefore, a sector-wide reverse stress test might lead to severe distortions when comparing the performance of one institution with that of another. The respondent therefore suggested rephrasing such that supervisory reverse stress tests should be performed not sector wide but on single institutions (or homogeneous groups).</p> <p>Another respondent argued that the goal of achieving a similar level of detail and scope of instruments with regard to the scope and organisation of supervisory stress testing as for internal stress testing was not realistic or always necessary, i.e. the adequacy of institutions’ own stress tests is already assessed, so these results already offer supervisors a starting point for planning the main focus of their assessments.</p> | <p>institutions’ stress testing, particularly Section 4.6.5), and it is the right tool to assess the severity of scenarios used for other purposes.</p> <p>The GL does not require that reverse stress testing be conducted on a sector-wide basis.</p> <p>Title 12 as a whole represents the integration of supervisory stress testing requirements and requirements on supervisory assessments of banks’ stress testing from the EBA Consultation Paper on GL on stress testing and supervisory stress testing, in the context of SREP performed by competent authorities in accordance with Article 100 of CRD. The aim of this guidance is not to replicate the requirements for institutions regarding their stress testing programmes. Furthermore, as stated in multiple paragraphs of the GL, an institution’s stress testing has its role in its business activities, and its place in SREP.</p> | |
| Dialogue on stress test outcomes | <p>Several respondents considered that, for the purposes of supervisory dialogue with institutions regarding outcomes (paragraph 584(c)), more transparency would be appreciated in terms of the identified issues or deficiencies that lead to supervisory measures.</p> <p>One respondent is of the opinion that the SREP GL give the impression that a parallel standard set of ongoing stress test calculations should be</p> | <p>As regards the comment that more transparency would be appreciated in terms of the identified issues or deficiencies that lead to supervisory measures, that is exactly the intention of the proposed paragraph 584(c), and going into more detail would lead to the other extreme, as was remarked upon by some participants.</p> <p>The industry has divided opinions on paragraph 584 and the level of detail necessary for these purposes.</p> | No amendments. |

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| | <p>established by the competent authorities, although this would not provide additional benefits compared with the information that is already available in institutions. According to the respondent, there is no justification in this respect for the massive increase in information and reporting requirements that can be expected from the ‘effective dialogue’ with institutions as prescribed in paragraph 584.</p> | <p>This paragraph was added to the GL with the idea of establishing common ground and minimum elements to be covered within the supervisory dialogue on stress testing programmes. The EBA does not see the usefulness of deleting any of those requirements due to potential negative effects with regard to a level playing field that could arise in such a case.</p> | |
| <p>Supervisory stress testing and cross-border groups</p> | <p>Several respondents welcomed the initiatives to encourage dialogue with colleges of supervisors overseas when applying supervisory stress testing to cross-border groups (paragraph 585), paying particular attention to scenarios, definitions and the range of risk factors provided.</p> | <p>The proposed paragraph is a consequence of the best practice determined in previous stress testing exercises.</p> | <p>No amendments.</p> |
| <p>Publication of stress test results</p> | <p>Several respondents considered that, regarding the publication of results of supervisory stress tests, although this is always done by competent authorities, banks should consent to publication after checking that the final version is consistent with the final submission. They suggested that comments in this regard to be added to paragraph 586.</p> | <p>Since the results of stress testing may require a specific treatment in terms of confidentiality, and the manner in which issues of confidentiality are addressed at the level of different competent authorities is outside the scope of the GL, it would not be appropriate to add such an explicit requirement to the text.</p> | <p>No amendments.</p> |
| <p>Stress test methodologies</p> | <p>A couple of respondents noted that the supervisory stress testing programme should be transparently disclosed to institutions in a timely and comprehensive manner, as supervisory stress tests may be associated with significant pressure on the resources of participating institutions (especially where a new methodology is introduced). Some argued that supervisory stress test methodologies</p> | <p>The main elements of the supervisory dialogue, which include the methodologies that will be used in the supervisory stress testing programme, as well as the timeline, are defined in sufficient detail in paragraph 584. Bearing in mind the constant changes in the environment as well as the changes in risk drivers over time, it would be hard to achieve full standardisation as suggested, but the role of Title 12</p> | <p>No amendments.</p> |

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| | <p>should be stabilised over time and consistently applied across different supervisory stress testing exercises.</p> <p>One respondent suggested that the process for supervisory stress testing exercises should be standardised: the methodology and the template for supervisory stress testing should be systematically submitted to stakeholders in a consultation paper and the calendar should be the same every year as far as possible. The respondent also suggested defining a fixed period to run the stress testing exercise, pursuant to Article 100 of CRD. Several respondents supported the recommendation addressed to competent authorities to consider appropriate timelines for conducting supervisory stress tests.</p> <p>In addition, several respondents mentioned proportionality, arguing that less complex institutions should be provided with an appropriately simplified version of stress tests, requiring only manageable additional inputs.</p> <p>Some respondents suggested that, since supervisory bodies in different countries require stress test results with different degrees of detail, using different forms and in different formats, it might be more efficient and save time – both for the participating institutions and for the supervisors – if a general interface organised like a database were established.</p> | <p>as a whole is to harmonise and to a certain extent standardise the process of supervisory stress testing.</p> <p>Stipulating a fixed timeline could be limiting; as in previous and ongoing supervisory stress testing exercises, the timeline should be agreed in line with the objectives and, consequently, the scope, design, coverage, sample and approach used in the individual exercise.</p> <p>As previously mentioned, the principle of proportionality is embedded in the text of the entire GL and explicitly in the area of stress testing. This principle applies to all the relevant aspects of supervisory stress testing, including coverage, design, scope, sample and approach, that will be used in each exercise.</p> <p>The suggestion regarding a general interface could be a valid point however outside the scope of these GL.</p> | |

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| Institution-specific scenarios | <p>One respondent considered the stipulation in paragraph 588 that competent authorities can also develop institution-specific scenarios contradicted the goal of obtaining comparable data on concrete issues. Therefore, the respondent suggested deleting the words ‘or to develop institution-specific scenarios for individual institutions (the latter should not be seen as relieving institutions from the responsibility of designing own scenarios for the purposes of ICAAP and ILAAP stress testing), or a combination of the two’.</p> | <p>Bearing in mind the use of stress testing described in paragraph 572 and various situations that could occur in practice where a need for institution-specific scenarios could arise, the suggested amendment, i.e. deleting this passage, could lead to limited possibilities for supervisors. It could also have a potential negative impact on institutions, for example if the reasons leading to the design of such scenarios were a consequence of specificities of the business model of the institution (or some of its elements) and the ‘standard’ scenarios could lead to a misinterpretation of the results of stress testing.</p> | No amendments. |
| Stress test assumptions | <p>One respondent made comments related to static and dynamic balance-sheet assumptions. Since some assumptions can be useful for a specific purpose (e.g. zero credit growth), but can also be seen as reducing the realism and thus the probability of a scenario, the approach used by the supervisor should therefore be applied carefully, and, if results are published, the consequences of the approach for the results should be communicated.</p> | <p>As in the previous period, for typical stress testing programmes or other similar exercises, if the results of the programme or exercise are published, the main elements of the stress testing programme or exercise and the main underlying assumptions will also be published, together with explanations where necessary.</p> | No amendments. |

Responses were received from the following during the public consultation on the draft Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing:

1. Association for Financial Markets in Europe (AFME)
2. The Banking and Insurance Division of the Austrian Federal Economic Chamber (WKO)
3. Deutsche Zentral-Genossenschaftsbank (DZ BANK AG)
4. European Association of Co-operative Banks (EACB)

5. European Banking Federation (EBF)
6. French Banking Federation (FBF)
7. German Banking Industry Committee (GBIC)
8. Italian Banking Association (ABI)
9. MDB Group
10. Spanish Banking Association (AEB)

In addition, four confidential responses were submitted.