

# BSG response to EBA CP: Draft Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing under Directive 2013/36/EU

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## Background

The EBA has launched a Consultation Paper on Draft Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing under Directive 2013/36/EU.

- These guidelines are addressed to competent authorities
- These guidelines are intended to promote common procedures and methodologies for the supervisory review and evaluation process (SREP), which is an ongoing supervisory process bringing together findings from all supervisory activities into a comprehensive supervisory overview of an institution.
- These guidelines also aim at achieving convergence of practices followed by competent authorities in supervisory stress testing across the EU countries in accordance with Article 100 of Directive 2013/36/EU.

The review of the SREP Guidelines is carried out in order to implement changes brought by Directive (EU) 2019/878 and Regulation (EU) 2019/876. The main amendments include the following:

- 1) the categorisation of institutions and the application of the minimum engagement model were revised by reflecting the new definitions on small and non-complex and large institutions with a view to better reflecting the principle of proportionality
- 2) the assessment of the risk money laundering and terrorist financing (ML/TF risks) was incorporated across the text

- 3) the provision on Pillar 2 and capital add-ons and the P2G were reviewed
- 4) in order to reflect the separate stack of own funds requirements based on the leverage ratio, clarifications were added on the related separate supervisory assessment of Pillar 2 capital add-ons and the P2G to address the risk of excessive leverage
- 5) the requirements for the assessment of the interest rate risk in the non-trading book, as well as the assessment of liquidity risk and liquidity adequacy were adjusted to align with the current regulatory framework

The review aims also at aligning with other relevant guidelines and technical standards, and best practices. It affects all main SREP elements including (i) business model analysis, (ii) assessment on internal governance and institution-wide control arrangements, (iii) assessment of risks to capital and adequacy of capital to cover these risks and (iv) assessment of risks to liquidity and funding and adequacy of liquidity resources to cover these risks.

## BSG response

The BSG welcomes the opportunity to comment on the proposed consultation paper and considers extremely relevant the role of the EBA to review and amend current guidelines in order to align them with the latest developments in the EU legislation at the time that contributes to supervisory convergence.

Nevertheless there are some topics in which the BSG would like to express its opinion to be taken into consideration when launching the final version of these guidelines:

- **Regarding the proportionality principle**, the BSG considers that if the aim of the EBA is to allow a more proportionate approach towards the assessment and allocation of supervisory resources, it should probably specify further throughout some specific indications.

In opinion of the BSG, proportionality has been very much tight to the concept of size and it would be desirable to go beyond the size of the institutions and take into account for instance geographical application of numerical thresholds (see for instance quantitative limits in retribution for the identification of risk takers, the 1% threshold for NPLs in developing countries, etc).

- **Regarding how to take into account ML/TF risks within SREP**, the BSG shares the view of the EBA in the complementarity that should exist between supervisory authorities and encourage the EBA keep working on the proposed line to ensure a fluent coordination without creating an overwhelming flow of demands to institutions.

- **Regarding the assessment of internal governance**, the BSG would like to encourage the EBA on taking decisive steps to properly tackle recurrent déjà-vu issues such as the recognition of SPE/MPE business models and the recognition of dual and monist management bodies.

- **Regarding the assessment of risks to capital** (credit risk, operational risk, market risk and IRRBB), some members of the BSG would suggest to re-evaluate the importance of the ICAAP. Most banks and financial institutions have been investing time and resources in building capabilities to improve this tool and it is not clear under which circumstances it should be considered as an unreliable tool.

- **Regarding the assessment of liquidity and funding risk** and application of related supervisory measures, the BSG shares EBA approach and encourages it to deep dive into the comparability and level playing field between institutions.
- **Regarding the assessment of operational risk, in particular ICT risk:** the BSG notes that cybersecurity incidents represent a material source of risk, including a potential systemic component, and should be taken into account specifically when evaluating ICT risk.
- **Regarding the communication and justification of additional own funds requirements** to institutions, the BSG welcomes EBA amendments mainly regarding the quantity and composition of own funds requirements as separate justifications.
- **Regarding the methodology for setting P2G**, some members of the BSG are of the view that financial institutions' technical teams should be consulted by the EBA on the matter to ensure that the stress test exercise is a useful tool also for institutions to better understand extreme risks and potential black swans.

The BSG welcomes the EBA objective of enhancing transparency also on how supervisory authorities perform their analysis so that financial institutions and other supervised entities can better understand the factors that should be considered to ensure a sound financial system.

Nevertheless, on the topic of disclosure, the BSG would like to make a call for prudence in the following sense: the BSG supports and would support transparency related to any matter; nevertheless, the BSG clearly acknowledges the difference between transparency and full disclosure. And regarding the publication of the P2G on top of the stress test results, the BSG wonders what is the need that this disclosure is covering and whether it might have unintended consequences for institutions but even more important, for supervisors as well. In the assessment of supervisors, they would have to take into account not only the risks of the institutions but also the impact of the disclosure and the reaction of the market as an additional premium/penalty for the institution.

- Finally, the BSG would also like to remind its view **on the inclusion of climate risk in the supervisory activity**. As we have already expressed in other opinions, the BSG supports the progressive and proportional implementation of this line of work.