

# EBA REPORT ON THE CONVERGENCE OF SUPERVISORY PRACTICES

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# 1. Executive summary

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1. This report provides a summary of the EBA's findings in 2015 regarding the convergence of supervisory practices and the EBA's activities in promoting convergence in supervision. Article 107 of Directive 2013/36/EU includes a specific mandate for the EBA on the consistency of supervisory reviews, evaluations and supervisory measures in Member States. Based on this mandate, the EBA has collected information, analysed relevant supervisory practices and engaged in a considerable development of regulatory products (supervisory methodologies and procedures) and the promotion of convergence in supervision.

## Risks for the single market

2. The effective functioning of the single market requires enhanced convergence of regulatory and supervisory practices between the competent authorities (CAs) of the Member States. Despite the existence of common rules, divergent supervisory practices and outcomes pose a potential risk to the effective oversight of cross-border groups and the development of a level playing field in financial services.
3. In this regard, Commissioner J. Hill at the EBA's fifth anniversary event commented: 'Another area we need to look at as part of the CRR (Capital requirements Regulation) Review is additional Pillar 2 requirements. We know that there are differences in how these rules are applied by supervisors. I want to make the rules clearer, so that the legislation can work as it was originally intended. There needs to be a clear difference between the goals of Pillar 1 requirements that apply to all banks and Pillar 2 requirements that are bank-specific and depend on the level of additional risk that banks bear. This will help us meet our goal of preserving financial stability and supporting banks' competitiveness.'

## Outcome of the 2015 assessment on the convergence of supervisory practices

4. The publication of the EBA Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP)—even if these came into force only in 2016—had a positive impact on a common understanding of the SREP elements in 2015, and was the basis for setting the additional capital requirements, expected articulation and communication of these requirements to institutions.
5. CAs significantly progressed in implementing the new common SREP and, in general, the SREPs and overall supervisory methodologies assessed by the EBA are largely in line with the EBA SREP Guidelines. Most authorities established SREP processes that can be considered adequate to the specificities of their markets, including with regard to the categorisation of institutions, the introduction of business model analysis (BMA), the internal governance and quality assurance arrangements regarding the SREP decisions, and the planning and intensity of supervisory activities that take the proportionality principle into consideration. Within the Eurozone, the implementation of the single supervisory mechanism (SSM) by the ECB

(European Central Bank) is proceeding with significant impacts on convergence inside the SSM, prompted by a consistent SREP process and approach for significant institutions and by joint supervisory activities.

6. Despite the progress achieved, the EBA has identified areas of the SREP where authorities still face challenges to converge, particularly with regard to the setting of institution-specific capital requirements and common scoring of risks and viability. Divergences in supervisory approaches towards the nature and level of capital requirements, as well as in the application of automatic restrictions on distributable amounts—partly due to the lack of clarity in the relevant regulation—generated uncertainty among institutions and investors and, in some cases, temporarily affected capital planning and investment decisions.
7. In other areas under the EBA remit, some progress has been observed in the supervisory use of benchmarking for the ongoing review and initial authorisation of internal models, and on the assessment of remuneration practices, which benefited from the significant work of the EBA in fostering supervisory convergence.
8. An encouraging outcome has been reached in the assessment of recovery plans, which were, for the first time, assessed under the new regulatory framework introduced by the Bank Recovery and Resolution Directive (BRRD). In this case, CAs showed a fair degree of convergence in identifying the main deficiencies in the group recovery plans, which benefited from the EBA's single supervisory handbook on the assessment of recovery plans. However, better home-host coordination has to be achieved for joint decisions on group recovery plans.

### **Expectations and next challenges**

9. Monitoring and analysing supervisory practices and outcomes are necessary ongoing activities in light of their continuous development and the potential impact on the single market.
10. Looking forward, the EBA will continue to monitor the practical application of the single rulebook by CAs, mainly focusing on the consistency of outcomes from the supervisory reviews, both across and within CAs' jurisdictions. To this end, the EBA will conduct peer reviews, benchmarking and deep-dive analyses to assess the level of convergence.
11. The EBA will also continue its work on developing methodologies and procedures for supervisors on emerging risks or areas where the monitoring of practices shows a need for additional guidance or where international standards have been updated. In this regard, the EBA already identified the assessment of information and communication technology (ICT) risk, the development of common risk taxonomy for the SREP and criteria for supervisory benchmarks used in the context of capital adequacy assessment, and the update of the approach to interest rate risk in the banking book.

12. Likewise, the EBA will keep engaging with colleges of supervisors by promoting consistent application of the single rulebook, particularly for the application of joint decisions on capital, liquidity and recovery plans, and by drawing supervisory attention to key risks and themes such as non-performing loans, conduct issues and remuneration practices.
13. The EBA sees the consistent application of automatic restrictions on distributions and the convergence in the use of the stress test as a supervisory tool to determine the need for capital guidance on top of Pillar 2 and buffer requirements as the main challenges for 2016 and beyond that deserve attention and intervention on the European Union (EU) level.
14. Finally, the EBA seeks to extend its training programme for CAs across the single market, provided budgetary constraints can be removed, in order to set the foundations for a common approach and to contribute to the building of a common supervisory culture.

## 2. Background

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15. The main tasks of the EBA include contributing to the establishment of high-quality common regulatory and supervisory standards and practices, contributing to a common supervisory culture, and conducting peer-review analyses of CAs in order to strengthen consistency in supervisory outcomes. The supervisory convergence mandate of the EBA is built around the following main areas:
  - Common supervisory culture and European supervisory handbook;
  - Convergence of the SREP and consistency of supervisory measures;
  - Convergence and consistency in colleges of supervisors;
  - Peer-review analyses of CAs.
16. The mandate related to the convergence of the SREP is included not only in the EBA's founding regulation, but also specifically in the Capital Requirements Directive (CRD) and particularly in Article 107 of Directive 2013/36/EU, which also extends the scope of supervisory convergence to supervisory measures. According to these mandates, the EBA shall promote convergence of the SREP and supervisory measures in order to introduce strong supervisory standards in the EU, assess methodologies used by CAs, assess the functioning of the SREP, report to the European Parliament and Council<sup>1</sup> on the degree of convergence, and issue Guidelines for CAs.
17. This report has been prepared in accordance with this mandate. It covers the main activities undertaken by the EBA to enhance supervisory convergence within the scope of Article 107, as well as noting the remaining challenges and the way forward.
18. The EBA defines convergence as '*a process for achieving comparable supervisory practices in Member States which are based on compliance with the EU rules and which leads to consistent supervisory outcomes.*' Under this definition, there are three components of supervisory convergence:
  - Compliance with rules;
  - Comparability of supervisory practices;
  - Consistency of supervisory outcomes.
19. Compliance with technical standards, Guidelines and recommendations and their application in internal procedures and regulations of CAs is a starting point in achieving supervisory convergence. Monitoring and understanding if CAs apply comparable supervisory practices is the second component and should consider the degree of flexibility (proportionality, supervisory judgement) used in procedures, methods and the intensity of supervision. The

<sup>1</sup> First EBA Report on the convergence of supervisory practices was discussed by its Board in April 2015 and later published: <http://www.eba.europa.eu/documents/10180/950548/Supervisory+convergence+report.pdf/9f49ddf9-232f-4062-b34e-ff671d440081>.

third component of supervisory convergence is comparing supervisory outcomes from the perspective of similar supervisory responses to institutions with similar exposures and risk profiles, in order to achieve consistency in the treatment of institutions across the single market.

### 3. The EBA tools for pursuing supervisory convergence and the scope of practices assessed

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#### 3.1 The EBA convergence tools

20. The EBA has a number of tools to pursue supervisory convergence built around three main elements: regulatory products, training and assessment. These elements are complementary and are part of a recursive ‘assess-guide-train’ process. Identification of divergent supervisory practices and supervisory outcomes leads into the development of regulatory products, for which the training tool is used to ensure they are consistently applied.



21. Regulatory products represent a powerful convergence tool, which sets the common standards that CAs must follow and comply with. A significant part of the European single rulebook is addressed to CAs—indeed, covering different aspects of supervisory work. This is supported by the Q&A tool that provides a common interpretation of the single rulebook together with possible Opinions the EBA can issue. EBA Guidelines, Recommendations and Opinions are also used as important regulatory tools to establish consistent, efficient and effective supervisory practices.
22. In addition to the single rulebook, the EBA also has the mandate to develop and maintain an up-to-date European supervisory handbook that shall set out supervisory best practices for methodologies and processes on the supervision of financial institutions in the EU as a whole.
23. The EBA prepares its training programme in cooperation with CAs. Based on an increase in demand for supervisory training, the EBA has been recently seeking to extend its training activities by introducing additional tools as online training and developing a core curriculum for supervisors (please see section 7).

24. Finally, with regard to the assessment tools, these can be grouped into the four main categories:
  - Peer reviews;
  - Desk-based reviews;
  - College monitoring;
  - Staff reviews of supervisory practices.
25. Peer reviews: The peer reviews are conducted by dedicated teams composed of EBA staff and staff from CAs under the EBA Review Panel. The peer reviews are focused on the implementation and application of the EBA Guidelines and technical standards. Topics assessed allow for in-depth studies done in the form of self-assessment, followed by a review by peers.
26. The peer review process also supports identification of best practices, which can then be used for further policy work—e.g. the peer review of the EBA Guidelines on stress testing contributed to the review of the EBA Guidelines currently being published for consultation. On the other hand, it is a relatively lengthy process requiring resources from both the EBA and CAs.
27. Desk-based reviews: Desk-based reviews combine the EBA stocktakes with open discussions in the EBA's standing committees (particularly the Standing Committee for Oversight and Practices) and working groups (particularly the Sub-group on Supervisory Effectiveness and Convergence) on different topics that feed into the reviews and identified supervisory priorities. For example, stocktakes on supervisory review and evaluation methodologies in 2012/2013 fed into the development of the new EBA Guidelines on common procedures and methodologies for the SREP. Some of these reviews can be performed by ad hoc teams established on more technical subjects—e.g. review on risk-weighted assets' (RWAs') consistency and benchmarking on remuneration.
28. In general, such reviews help identify commonalities and divergences, emerging issues or inconsistencies of supervisory practices and processes, as well as help enhance mutual understanding among supervisors and the identification of methods to tackle these findings. On the other hand, such reviews are typically based on information provided by CAs via questionnaires, which might be a limitation having a set of neutral and comparable information and can capture a snapshot of practices at a certain moment that may not reflect later developments.
29. College monitoring: Monitoring of colleges of supervisors for the most significant cross-border European banking groups is an ongoing activity performed throughout the year. This allows the EBA to monitor the concrete implementation of both specific standards and Guidelines addressing colleges, as well as supervisory practices more widely—particularly those concerning the SREP reviews and recovery plan assessments.

30. Over the years, this monitoring has turned into a structured deep-dive assessment solely based on information collected and activities performed directly by the EBA staff and which is annually summarised in a report on the functioning of colleges to provide a deeper overview of the progress and challenges. This report also helps identify areas for further work on supervisory methodologies.
31. Staff reviews of supervisory practices: Staff reviews of supervisory practices employ bilateral interactions of the EBA staff and CAs in order to assess particular aspects of supervisory practices as part of the assessment of supervisory convergence (according to Article 107 of Directive 2013/36/EU). This tool enables the EBA to gain a deeper understanding of the application of the single rulebook and other regulatory products, and is also an opportunity to provide bilateral feedback to the relevant authorities in a confidential manner. This tool has been introduced recently as part of the assessment on the implementation of the common SREP framework.

### 3.2 Supervisory practices assessed and main sources of information

32. The EBA applied the above-mentioned tools and relied on relevant sources of information to conduct its assessment on different aspects of supervisory reviews, evaluation and measures in 2015 and Q1 2016, the outcomes of which have been included in this report.
33. The main focus of the EBA assessment concerned supervisory practices in the areas of:
  - The SREP practices and approaches to the determination of specific prudential requirements on capital and liquidity;
  - Practices in the assessment of selected material risks (conduct risk, ICT, risk taxonomy);
  - Practices in the assessment of selected governance elements (remuneration, ‘fit and proper’);
  - Review and benchmarking of internal models;
  - Assessment of recovery plans.
34. Additionally, in consideration of the entry into force of the EBA Guidelines on the SREP at the beginning of this year, the EBA started assessing the implementation of some key elements by CAs in view of the forthcoming SREP decisions on capital and liquidity and the link with the recovery and resolution framework.
35. As mentioned, the data, information and documents used by the EBA for assessing the degree of supervisory convergence are mostly provided by CAs in application of specific provisions of the CRD (e.g. remuneration, benchmarking) on a voluntary basis following ad hoc requests from the EBA (e.g. the EBA SREP Guidelines implementation, conduct risk assessment, fit and proper procedures). This is normally done through the established Standing Committees or Working Groups or collected by the EBA staff as members of the supervisory colleges (e.g. setting institution-specific prudential requirements, assessment of recovery plans).

36. In this regard, the on-site visits on the SREP Guidelines implementation, as well as the participation to colleges, offered the EBA the possibility of having a close contact with supervisory practices and proved to be a very effective way of assessing the degree of convergence.

## 4. Supervisory review and evaluation practices

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37. Supervisory review and evaluation practices are at the basis of supervisory convergence, as they provide the key inputs that form the basis on which CAs impose measures. Therefore, comparability in these areas is a necessary condition for the consistency of supervisory outcomes and a level playing field.
38. Covering a broad range of supervisory activities, the SREP represents the core instrument of the ongoing prudential supervision and is the basis for the supervisory determination of the level and quality of own funds and liquidity held by institutions against the risks they are exposed to. Under the SREP, CAs assess aspects such as the business model, governance (including remuneration policies and fit and proper criteria), the impact of stress tests and the outcome of ongoing reviews of internal approaches. All these elements of supervisory work are eventually combined to form a comprehensive view on the viability of an institution.
39. Significant differences in the SREP methodologies across Member States might lead to an inconsistent application of supervisory measures across the EU and, in the context of cross-border banking groups, might also cause difficulties in supervisory cooperation. The creation of the SSM has certainly brought more consistency in the Eurozone, thanks to the definition and implementation of shared processes and methodologies for significant institutions. Nonetheless, this convergence casts a stark light on potential differences in supervisory practices across the entire single market. Recognising the impact of the level of divergence on the functioning of the single market, one of the main priorities for the EBA in 2015 was to foster and assist CAs in a consistent implementation of the EBA SREP Guidelines published in December 2014, prepared under the mandate of Article 107 of Directive 2013/36/EU.
40. The EBA has consequently pursued this objective by monitoring and analysing the work of colleges for the largest European banking groups, particularly the joint decisions on institution-specific prudential requirements, as well as by assessing the adjustments to practices and methodologies that CAs are introducing in preparation for 2016—the year of the implementation of the EBA SREP Guidelines.
41. To this end, the EBA employed on-site visits to CAs as an additional tool in the convergence assessment and conducted 10 bilateral visits (to ECB/SSM and all non-SSM CAs) aimed, inter alia, at a broader understanding of key aspects of the overall SREP process and of selected SREP elements. This allowed the EBA to gain more insight into the practices that were at the basis of the issues identified in joint decisions in 2015 and provided a forward-looking view on possible issues in the 2016 SREP cycle.

42. These activities were accompanied by the monitoring and promotion of best practices in the colleges of supervisors established for cross-border banking groups and a number of training activities focused on the SREP.

#### 4.1 The SREP and approaches to the determination of prudential requirements

43. The publication of the EBA SREP Guidelines (coming into force in 2016) already had a positive impact on a common understanding of the SREP elements in 2015—the basis for setting the additional requirements—and on the articulation and communication of these requirements. Indeed, as observed during the on-site visits, all CAs started implementing key elements of the EBA SREP Guidelines last year in order to be ready for full compliance in 2016.
44. The EBA SREP Guidelines have provided all CAs, including the SSM, with a solid basis for building their methodology around the EU common framework, which has consequently contributed to increasing the level of supervisory convergence in a substantial part of the EU banking market.

##### **Impact of the SSM on supervisory convergence in the Eurozone**

In 2015, the SREP was—for the first time—carried out according to a common methodology that implemented the EBA SREP Guidelines for the 120 largest banking groups in the Eurozone.

Where applicable, the adoption of the supervisory measures stemming out of the risk assessment of those institutions was based on decisions jointly taken with non-SSM CAs in the context of supervisory colleges, and under the monitoring of the EBA.

The consistency of the assessment and the measures was checked via extensive peer comparisons and horizontal analyses, which were possible on a wide scale for the first time, allowing all institutions to be assessed in a consistent manner and thus promoting a more integrated single banking market. In the course of 2015, and drawing on the first SREP cycle, the SSM has continued completing and refining its harmonised methodology. This is, for instance, the case for assessing banks' internal capital adequacy assessment processes, their liquidity and their funding positions.

In late 2015, the SSM has also issued its stance on a package of circa 100 options and discretions that are in the hands of the supervisors.

45. As a notable improvement and innovation compared to previous practices, BMA has been embedded in the SREP by CAs, which explicitly added the viability and sustainability of the business model and strategy to the overall assessment, thus further enhancing the forward-looking character of the SREP (see section 4.5).
46. Well established are the practices for assessing governance and internal controls, which have constantly improved over time and extended to cover new regulatory elements such as remuneration policies.

47. On the other hand, divergences across supervisory practices for the imposition of additional capital requirements have been observed. These, in combination with the lack of clarity in the relevant regulation, sparked uncertainty in some cases among supervisors, institutions and investors on the nature of Pillar 2 requirements and on the functioning of the distribution restrictions framework pursuant to Article 141 of the CRD.
48. The main findings of the EBA assessment in the area of supervisory review and evaluation practices are described in the following sections. They mostly refer to the assessments of risks to capital and to the determination and imposition of capital requirements.

#### **4.1.1      Setting additional own funds requirements as an outcome of the risk assessment**

49. CAs have shown continuous improvements in preparing the comprehensive group risk assessment reports under the framework of colleges of supervisors for cross-border banking groups. Indeed, risk assessment reports, which include the outcome of the supervisory review and evaluation of institutions' governance arrangements, business model, and capital and liquidity adequacy, generally covered all the most material risks and were sufficiently detailed to provide for a good understanding of the banks' risk profiles and specific risks to capital and liquidity.
50. Proposal for additional own funds requirements (capital add-ons) and liquidity requirements were incorporated in these reports as well, as an important input to the process of reaching joint decisions.
51. However, in a number of cases, the additional capital requirements were set in a holistic way, without decomposing the capital requirements on the basis of the underlying risk drivers. In the context of cross-border groups, the discussion was not supported by the risk-by-risk decomposition of capital requirements by risk types and elements of risks not covered in Pillar 1 or buffer requirements, which is an integral part of group risk assessment and a key element for the reasoning of the joint decisions. The lack of transparent decomposition of capital add-ons at group level also makes the discussion among supervisors in the colleges more difficult, and does not help reaching consistency and reconciling decisions on consolidated and individual capital requirements.
52. In a number of cases, CAs failed to make an appropriate link between the outcome of the institution-specific assessment and the proposed additional capital requirements. This was either due to macroprudential requirements being used instead of the outcome of the SREP, or due to host authorities requesting additional capital for the entities under their supervision to be set at the same level as the requirements for the group.
53. The EBA also observed cases of extensive use of Pillar 2 requirements for macroprudential purposes (e.g. to address concerns on the real estate market in the country) as an alternative to other solutions allowed under Pillar 1 (e.g. increase of RWAs or of floor for Loss Given Default parameter, or LGD) or specific buffers (e.g. systemic risk buffer), meaning that a large

proportion of additional own funds requirements was not strictly linked to the outcomes of the underlying SREP assessments. Besides reciprocation issues, the use of Pillar 2 for addressing macroprudential issues—when other specific tools are envisaged and used by other CAs—can have a material impact on the single market. In particular, the level of combined buffer (it is proportional to RWAs and therefore to Pillar 1 requirements only) can vary considerably and thus the application of automatic restrictions on distributions pursuant to Article 141 of the CRD.

#### 4.1.2 Composition and articulation of capital requirements

54. When setting the composition of capital to meet the additional own funds requirements, all CAs used at least the same composition as applied for the minimum capital requirements in Pillar 1, though, in many cases, stricter requirements were imposed (i.e. additional capital requirements to be met only by Common Equity Tier 1 (CET1) capital).
55. For the latter, however, in most of the cases, the prudential requirements set by CAs were expressed and communicated to institutions only in terms of the CET1 ratio, creating uncertainty in terms of the total capital ratio and the overall capital requirements applicable to the institutions. Such uncertainty was integrally mirrored on triggers for automatic restrictions on distribution and preparation of capital conservation plans pursuant to Article 141 and Article 142 of the CRD respectively, which depend on the level of capital requirements. In most of the cases, this was addressed through bilateral and public communication by CAs.
56. Looking into the 2016 SREP assessment, it is expected that differences in the quality of capital required to meet the additional own funds will continue. The EBA SREP Guidelines provide a minimum harmonisation on this matter. On the other hand, the communication of the prudential requirements (based on the EBA SREP Guidelines) is clearly expected to be provided in terms of the total SREP capital requirements as a sum of minimum capital requirements and the additional requirements. This should provide the clarity needed for the institutions on the applicable requirements based on the SREP assessment.

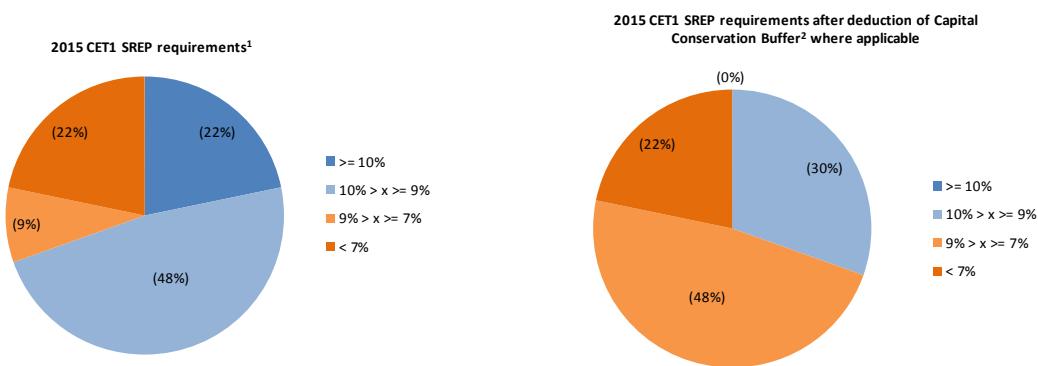
#### 4.1.3 Interplay between additional own funds requirements and interaction with capital buffers and capital planning

57. The aim of the imposition of the additional own funds requirements under the SREP (based on the CRD) is to cover risks not covered or not fully covered by Pillar 1 capital requirements or the combined buffer requirements.
58. However, the EBA observed cases where the capital conservation buffer was allegedly included within the institution-specific capital requirements imposed on the basis of the SREP assessment, based on the non-justified assumption of full overlap between elements of the SREP and the combined buffer requirements. On one hand, this practice was specifically adopted in the context of the significant institutions under the SSM's supervision, justified by a need to smooth the effect of Member States' discretions on the early phasing-in of the

capital conservation buffer. On the other hand, the EBA notes that, going forward, imposing buffer requirements as part of additional capital requirements risks creating confusion for the recipient and other stakeholders between binding requirements and ‘useable’ buffers—the imposition of which is not under the scope of the SREP assessment nor of joint decisions reached by the relevant CAs.

59. The charts below show how the distribution of the 2015 SREP capital requirements (the sum of minimum and additional own funds requirements) in terms of CET1 for the 23 largest European Economic Area (EEA) cross-border banking groups monitored by the EBA would change when deducting the phased-in capital conservation buffer for banks where this overlap is contemplated. While, in the left chart, about 70% of institutions are subject to CET1 ratio requirements above 9%, this share falls to 30% in the right chart, with no banking group required to hold a CET1 ratio of 10% or more and a significant shift of the distribution towards the 7-9% range from above classes, meaning a range of net additional own funds between 2.5% and 4.5%.

**Figure 1: Distribution of the SREP CET1 requirements**



<sup>1</sup> For 23 large EEA cross-border banking groups closely monitored by the EBA.

<sup>2</sup> For banking groups where the CCB has been included in the joint decision on capital, the CCB has been deducted taking into account the country-specific phase-in envisaged.

60. In the opposite direction to the latter, but with adverse effects on the level playing field as well, is the practice of some CAs of issuing non-binding sector-wide capital recommendations that set the minimum level of capital institutions should hold or are related to the restrictions for dividends distribution, while no additional own funds are imposed on an institution-specific basis.
61. Looking forward to the 2016 SREP and beyond, both cases deviate from the EBA SREP Guidelines and the EU prudential framework. This is also further clarified by the EBA Opinion on MDA<sup>2</sup> (see further) and both cases are concrete threats to the single market and the level playing field.

<sup>2</sup> <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-24+Opinion+on+MDA.pdf>.

62. These practices also make the level of triggers for the determination of a bank as failing or likely to fail ambiguous, as the fulfilment of capital requirements (including Pillar 2) is one of the criteria for it.

#### **4.1.4      Interplay between additional own funds requirements and restrictions on distributions**

63. The level playing field in the banking sector depends both on the quantification of the requirements and on the nature of such requirements, which determines the consequences and the supervisory measures undertaken in case they are breached or banks are on the verge of doing so.
64. This aspect is clearly addressed by the EBA SREP Guidelines, which clarified the binding nature of additional capital requirements imposed under the SREP and the stacking order of all capital requirements and envisages the combined buffer laying on top of the sum of minimum capital requirements (Pillar 1) and additional capital requirements (Pillar 2).
65. In this regard, the EBA analysis found that while all CAs have legal powers to impose additional own funds and liquidity requirements based on the relevant CRD articles,<sup>3</sup> there are differences in using these powers in practice.<sup>4</sup> In the majority of authorities, the communication of additional capital (and/or liquidity) requirements is done in the form of imposing binding requirements (e.g. by issuing a formal decision from a CA or in the form of a letter from management).
66. However, in a number of cases, the imposition of requirements is achieved through a two-step approach: (1) measures are imposed as recommendation/guidance/expectation, and then (2) in the case of non-compliance or disregard by an institution, the requirements are enforced in a legally binding and enforceable form.
67. Despite the form used, all CAs expect the additional own funds (and/or liquidity) requirements to be met by the institutions concerned.
68. However, in most of the cases where a non-enforceable legal form is used, the additional requirements are not necessarily perceived as binding by the institutions. Mainly as a consequence of the lack of clarity in the relevant regulation, none of the relevant CAs consider such requirements for the determination of restrictions on distributions, which—pursuant to Article 141 of the CRD<sup>5</sup> (i.e. maximum distributable amount or MDA)—would follow a breach of the combined buffer requirement.

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<sup>3</sup> Article 104 of the CRD on supervisory powers and Article 105 of the CRD on specific liquidity requirements.

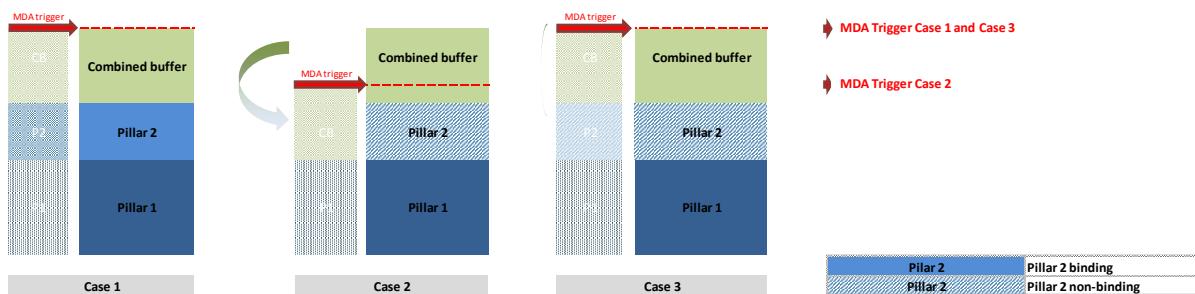
<sup>4</sup> The EBA collected the current practices by a stocktake and discussion in its working groups.

<sup>5</sup> Article 141 of the CRD restricts profits' distribution to any institution that is breaching the combined buffer requirement.

69. The following chart particularly shows how observed differences in the legal nature of the additional own funds (Pillar 2) requirements affect the determination of the trigger of distribution restrictions.

**Figure 2: Different approaches to the MDA trigger**

**MDA trigger levels for a bank with the same capital requirements under three different supervision regimes**



70. While for institutions supervised by authorities falling under case 1, the trigger is set at a level that corresponds to the sum of all capital requirements (minimum, imposed by supervisors and the combined buffer), for those under case 2, the trigger would disregard the Pillar 2 and be proportionally lower. Case 3 is legally more complicated as, while the CA sees the trigger as high as under case 1, this is not legally enforceable until the additional own funds are given an appropriate legal status.
71. This creates a general issue of a level playing field across the single market and conflicts with other provisions, notably those related to the conditions for authorisation, early intervention triggers and failing-or-likely-to-fail assessments that include Pillar 2 requirements among those to comply with. It also generates uncertainty in the market and affects institutions' capital and recovery planning capacity.

#### 4.1.5 Use of stress testing

72. Stress testing is one of the tools that CAs use within the SREP for identifying additional risks and for understanding potential changes in the capital (and liquidity) adequacy over a period of stress. This tool has been implemented by the majority of CAs as a component of the SREP framework.
73. The EBA SREP Guidelines explain how the outcomes of stress testing should be used in conjunction with the SREP. Risks not covered or not fully covered in Pillar 1 are identified and contribute to a new minimum capital requirement under Pillar 2. Stress tests are used, inter alia, to assess the ability of an institution to meet all applicable capital requirements (regulatory and supervisory) in adverse hypothetical events. If the stress test identifies a potential impact on regulatory capital requirements, then supervisors have a range of tools at their disposal, including the establishment of specific monitoring metrics, or capital guidance, that is not a legal requirement and sits above the combined buffer. Only in the

event of an imminent threat to the institutions' applicable binding capital requirements, additional capital can be required.

74. The EBA noted that CAs nonetheless make different use of stress testing when assessing the adequacy of capital and setting the additional own funds requirements. In particular, the methodologies of certain authorities envisage using the outcome of stress testing to set a capital buffer or guidance correctly above the combined buffer requirement, while others do not exclude using the outcomes of stress tests (mostly supervisory stress tests) to impose additional own funds requirements for any own funds shortfalls revealed by the adverse scenarios for individual risks or in aggregate without clarity on whether this is restricted to an imminent threat. Furthermore, other authorities use stress tests outcomes, and particularly stressed assumptions in supervisory benchmarks, to determine additional own funds requirements on a risk-by-risk basis. Greater clarity is expected in 2016.

## 4.2 Status of the implementation of the EBA SREP Guidelines

75. The implementation of the EBA SREP Guidelines, which entered into force on 1 January 2016, has required wide-scale efforts from CAs to review and adapt existing methodologies and also on the side of the EBA for its monitoring, implementation support and training.
76. In order to understand the status of the supervisory methodologies after the 12-month implementation period, the on-site bilateral visits conducted by the EBA staff in Q1 2016 were focused on the general understanding of the changes applied in supervisory methodologies and on the following components of the EBA SREP framework:
- The SREP assessment process;
  - Categorisation of institutions and supervisory engagement model;
  - Use of key risk indicators in the SREP;
  - Scoring;
  - Capital adequacy assessment;
  - Link between the SREP, early intervention and the determination of a failing or likely to fail institution.
77. The outcome of these visits suggests that the SREP processes and overall methodologies are broadly in line with the EBA SREP Guidelines and that all authorities have moved towards the new common framework, though to different extents.
78. In particular, the EBA can distinguish the following broad groups of authorities in their implementation of the EBA SREP Guidelines:

- Authorities that have largely implemented the EBA SREP Guidelines. These authorities made significant efforts with the implementation of the EBA SREP Guidelines and have developed complex methodologies aiming to be in-line with the EBA SREP Guidelines. These authorities have also developed/updated and formalised their internal manuals and methodologies accordingly.
- Authorities that have implemented the EBA SREP Guidelines only partially. These authorities have dedicated resources into changing their existing methodologies and adjusted these based on the provisions in the EBA SREP Guidelines, but still have material differences on some aspects and will need to continue their implementation work based on the feedback provided by the EBA.
- Authorities that have not implemented the Guidelines. These authorities have: not started the implementation as yet; continue with their past practices and methodologies, introducing some tweaks in the methodology and claiming that these are broadly compliant or 'in spirit' with the EBA SREP Guidelines; or believe that their existing approaches are already in line with the Guidelines and no specific activity is required.

#### 4.2.1 Main findings

79. The SREP assessment process, as a system of supervisory activities and decision-making processes established, has been assessed as satisfactory in order to enable CAs to have a comprehensive view on the risk profile and viability of the supervised institutions.
80. The categorisation and minimum supervisory engagement model introduced in the EBA SREP Guidelines for the application of the principle of proportionality was also received and implemented in a very positive way.
81. The framework of indicators for the regular monitoring of risks and identifying potential weaknesses at an early stage has been well established by the majority of CAs. A need for slight improvements were identified in the case of some authorities, particularly in embedding suitable thresholds into the framework of indicators to ensure appropriate investigation of anomalies and escalation procedures.
82. On the other hand, the EBA has identified that the new approach to scoring in the SREP introduced by the EBA SREP Guidelines (risk scores and viability scores), the capital adequacy assessment and the linking of the SREP outcome to the BRRD concepts seem to be challenging in the implementation process. While some problematic areas stem from differences in the understanding and interpretation of the common framework (which require further clarifications from the EBA), others are more the omission of selected aspects of the EBA SREP Guidelines.
83. Regarding the capital adequacy assessment and related determination of additional own funds requirements, the findings are identical with those covered extensively in the previous chapter. In addition to these findings, the EBA also observed that while ICAAP (i.e. Internal

Capital Adequacy Assessment Process) is generally used as one of the inputs to this determination, there are some important examples where it is disregarded and capital requirements are solely set on the basis of supervisory benchmarks and supervisory judgement, regardless of the reliability of the ICAAP.

84. As for the determinants of the additional own funds, the risk underestimation by internal models is only taken into consideration in a few cases, the preferred option being to directly address relevant issues by requiring changes to the models. A similar approach is adopted with regard to governance, where the most common approach is fixing the problems rather than imposing capital requirements. When it comes to governance issues, one authority's approach further differs from the rest as, instead of imposing binding capital requirements, it foresees the set-up of a capital buffer. Finally, the EBA also observed cases where the analysis of the business model is taken into account in a holistic way for the determination of capital requirements. The EBA SREP Guidelines suggests reviewing business or capital plans and limiting the imposition of add-ons to only temporary measures when identified concerns are not addressed.
85. The observations of such diverging practices, particularly the possibility of addressing identified issues either within Pillar 1 (for example, requiring conservative increase of risk parameters) or Pillar 2, can have broader effects on the overall capital requirements (as the combined buffer is calibrated on the RWAs which refer to Pillar 1 only) as well as on stress testing (generally, Pillar 2 risks are not sensitive to the adverse scenarios).
86. In terms of scoring, the EBA found that, in most of the cases, CAs score the elements expected by the EBA SREP Guidelines and the concept of risk scores is well understood by majority of the CAs. However, the new concept of viability scores for the four main SREP elements and for the overall SREP score has not been understood or applied correctly in many cases. The overall SREP score as an indicator of the overall viability of an institution then consequently may create difficulties for using the outcomes of the SREP as triggers for the decision on early intervention measures and the determination of whether institutions can be considered as failing or likely to fail.<sup>6</sup>
87. The EBA also noted that some authorities did not score material risks to capital, liquidity and funding on an individual basis, instead only applying the scores for the main four SREP elements.

The findings have been clearly highlighted and detailed to the relevant CAs, guiding them in terms of compliance, the consistent application of the Guidelines and the broader EU capital framework. It is reasonable to expect that the efforts put into these bilateral interactions will already deliver positive results in the 2016 SREP assessment, and generally improve the link between policy setting and practical application.

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<sup>6</sup> Misuse of the viability focus in the overall SREP assessment, or not using viability scores at all, also hampers the implementation of the EBA Guidelines on triggers for early intervention measures (EBA/GL/03/2015) and dialing or Likely to Fail (FOLTF) (EBA/GL/2015/07), which relied on the viability focus of the SREP.

## 4.3 Practices in the assessment of material risks

- 88. In order to reach consistency in the SREP outcomes, it is key that risk assessment is conducted according to common definitions of risks and comparable methodologies. While the EBA SREP Guidelines provide a comprehensive framework, the level of detail and the scope of risks covered cannot cater for all situations and it is necessarily limited to the most common material risks and the key aspects of the supervisory review.<sup>7</sup>
- 89. With a view to identifying best practices and evaluating the degree of convergence, the EBA has therefore performed targeted assessments of risk taxonomies in use, supervisory benchmarks applied for the determination of capital requirements, and supervisory practices for reviewing some of the most material emerging risks, notably conduct risk and ICT risks.
- 90. The latter in particular were part of the key topics that the EBA identified as supervisory priorities in 2016, along with non-performing loans, balance sheet cleaning and the business model sustainability in challenging regulatory and macroeconomic environments (see section 6.2).<sup>8</sup>

### a. Risk taxonomies in use and supervisory benchmarks

- 91. The EBA conducted a stocktake of supervisory practices on risk taxonomies and on their practical applications, particularly on the content of ICAAP reporting and on supervisory benchmarks (which are increasingly being used to challenge ICAAP and, in some cases, to determine capital requirements). The analysis conducted on the risks normally covered under the SREP showed that the scope of Pillar 2 risks materially differs across CAs, although there is a bulk of risks that are considered by a fair number of CAs.<sup>9</sup>
- 92. The degree of divergence is further accentuated by differences in risks' definitions, risk exposures considered, and the inclusion of sub-risk categories, with some cases where no definitions are provided at all. In general, however, risk definitions are quite high level and do not include specific risk sub-categories or risk factors, while risk exposures are seldom defined.
- 93. As for supervisory benchmarks, the majority of CAs developed specific methods and tools mostly used to assist supervisors in forming a view on possible additional capital

<sup>7</sup> As highlighted by the EBA Board of Supervisors at the time of their approval, the EBA SREP Guidelines need to be complemented with a comprehensive risk taxonomy which would also allow for a correct application of the risk by risk capital requirements determination, of the inter-risks diversification limit and would provide the common ground for their assessment and quantification, including for challenging the ICAAP.

<sup>8</sup> See "Report on the functioning of supervisory colleges in 2015" available on the EBA website: <http://www.eba.europa.eu/documents/10180/1390624/Report+on+the+functioning+of+supervisory+colleges+in+2015.pdf/eafde612-f85d-4ec4-baaf-14db0b03fccd>.

<sup>9</sup> The most common Pillar 2 risks considered are the credit concentration risk and the IRRBB.

requirements to be imposed under the SREP. In several cases, the experience of using the benchmarks is at a very early stage.

94. The construction and the scope of risks covered differ, with the exception of interest rate risk in the banking book (IRRBB) and credit concentration risk, which are the most commonly addressed (although the findings on the risk taxonomy in this regard apply as well).
95. The EBA notes that different definitions of risks or different scope of exposures—considered to be affected by or generating those risks—have potential disruptive effects on convergence and consistency of outcomes, which eventually hamper the single market.

#### b. Conduct risk

96. The topic of conduct risk has been discussed at the EBA table at different levels and on several occasions. The EBA has been encouraging supervisors to pay particular attention to this topic in their supervisory examination programmes. Recognising the emerging materiality of conduct risk in the context of its prudential impact on institutions, the EBA undertook a stocktake exercise of current supervisory practices in this area. This exercise covered the overview of the conduct risk incidents and losses from 2013 to Q2 2015, and supervisory practices and responses this risk.
97. The three main types of conduct incidents that led into the highest settlement costs in the time period covered are related to the mis-selling of financial products, manipulation of benchmark rates accounts, and the breach of financial and trade sanctions across all countries in all 3 years. Mis-selling of financial products counts to the incident types that witnessed the highest aggregate maximum settlement amounts in all 3 years. Fines connected to the manipulation of benchmark rates also appear in the top three maximum settlement amounts. As expected from the total settlement amounts, in 2014, fines connected with the breach of financial trade sanctions dominate the largest single settlement amounts. Violation of anti-money laundering and counter-terrorism financing rules became part of the top three largest single settlement amounts in 2014.
98. The overview of supervisory approaches towards the assessment, monitoring and management of conduct risk suggests that this risk is assessed by supervisors mostly as part of operational risk, in line with the EBA SREP Guidelines. Less than a quarter of CAs established dedicated teams or units on conduct risk, while slightly more than half of the CAs included the conduct risk in their supervisory examination programmes. However, the nature, scope and frequency of relevant supervisory activities and the underlying reasons leading into dedicating resources to conduct risk vary.
99. For some CAs, it seems that considering conduct risk as a material risk with a prudential impact on institutions is a relatively new concept. Many supervisors have limited experience in considering conduct risk events in the supervisory stress testing. In this area, the supervisory practices are progressing along the practices being developed by the institutions.

100. Overall, the analysis confirms a raised attention of CAs towards conduct risk. The relatively limited experience and diversity of measures (more details on supervisory measures are presented in section 5.3.2) suggest the need for sharing experiences and exchanging information, particularly around the conditions driving the nature and type of supervisory measures chosen to mitigate the prudential impact of conduct risk incidents and the timing of exercising those measures. Moreover, further convergence should be reached with regard to the inclusion of conduct risk and more in general operational risk in supervisory stress testing.

#### c. ICT

101. ICT is an intrinsic component of banks' operational functioning; it is a key resource in developing and supporting banking services, enabling institutions' strategies, and it forms the backbone of almost all banking processes and distribution channels, making ICT indispensable for an institution. Accordingly, ICT risks are an important component of operational risk and supervisors have been gradually paying more attention to them.

102. In 2014, the EBA conducted a stocktake of supervisory practices on ICT assessment, which drew attention to the very heterogeneous European ICT supervisory landscape. In this landscape, there are significant differences among Members States in, *inter alia*, the available ICT supervisory resources, the adopted supervisory approaches, the regulatory reporting expectations and, last but not least, the produced ICT supervisory outputs.

103. As such, concerns were raised on the prudential impact on banks due to the lack of a supervisory framework for the supervision of ICT risks in light of the rising frequency of adverse events related to ICT. Taking heed of growing supervisory concerns for ICT risk, the EBA initiated work with CAs on developing a framework for assessing ICT risk in banks.

## 4.4 Practices in the assessment of governance elements

104. The assessment of governance and internal controls is generally a well-established practice in all CAs. Over time, this has gained importance and drawn more supervisory scrutiny. The functioning of the management body, risk appetite, risk management and internal controls framework are key elements assessed by all authorities. These elements have been, in the last years, complemented with specific focus on remuneration policies and fit and proper requirements for the members of the management body and key function holders. In this regard, the EBA has drafted specific regulatory technical standards (RTS), Guidelines and Opinions with the purpose of building a common framework for relevant supervisory assessment.

105. Overall, the practices observed suggest that supervisors are familiar with the key aspects of the evaluation of internal governance, which has been incorporated in the ongoing SREP assessment. A new aspect that needs to be further assessed by the EBA with respect to

convergence is the translation of supervisory assessment outcomes into viability scores, as well as the inclusion of all the elements for this determination.

#### 4.4.1 Remuneration practices

106. As part of the SREP, and particularly within the assessment of overall internal governance and institution-wide controls, CAs also assess the adequacy of institutions' remuneration policies and the compliance with requirements of Articles 92-95 of the CRD and the relevant EBA Guidelines<sup>10</sup> and RTS.<sup>11</sup>
107. Since the publication of the above EBA Guidelines and the EBA Opinion on remuneration and allowances,<sup>12</sup> the EBA has been monitoring the development of remuneration practices and trends and the supervisory reviews and measures in this area. In 2015, the EBA followed-up on the actions taken by CAs in the EU and summarised the outcome in a report published in November.
108. In the first finding, the analysis showed that all 30 CAs participating in the stocktake had included the review of remuneration practices in the SREP. Moreover, in several cases, measures were taken by CAs to ensure that institutions apply the criteria set out in the EBA Guidelines and EBA Opinion in their remuneration policies and practices and, where necessary, implement necessary changes (an overview of the measures is in section 5.3.3).
109. The EBA annually performs a benchmarking of staff remunerations of EUR 1 million or more in the previous financial year, and publishes a detailed report on the remuneration of identified staff<sup>13</sup> based on data provided by CAs from over hundred banking groups and institutions. The publication aims at ensuring a high level of transparency regarding the remuneration practices within the EU, which should help the harmonisation of remuneration frameworks. The data shows that, after the entry into force of the RTS on identified staff, there was a significant increase of high earners classified as identified staff (from 59% in 2013 to 87% in 2014), leading to a better alignment of remuneration and risk across the EU.
110. However, there emerged a low correlation between the performance of many institutions and the variable remuneration that would require further analysis by CAs particularly to determine the coherence of relevant remuneration policies. The EBA notes that the existence of differences in the application of waivers at national levels in terms of deferral and pay out in instruments has been a significant determinant of these findings.

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<sup>10</sup> The EBA Guidelines on sound remuneration policies under Article 74(3) and Article 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013.

<sup>11</sup> RTS with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile (Commission Delegated Regulation (EU) No 604/2014); RTS specifying the classes of instruments that adequately reflect the credit quality of an institution as a ongoing concern and are appropriate to be used for the purposes of variable remuneration (Commission Delegated Regulation (EU) No 527/2014).

<sup>12</sup> <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-10+Opinion+on+remuneration+and+allowances.pdf>.

<sup>13</sup> Categories of staff having a material impact on the institution's risk profile.

#### 4.4.2 Assessment of the suitability of members of the management body and key function holders

111. From October 2014 to June 2015, the EBA conducted a peer review focused on the assessment of the suitability of members of the management bodies and key function holders, in accordance with the EBA's Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2012/06).
112. Overall, the peer review results indicated that CAs 'largely' or 'fully applied' the relevant EBA Guidelines. However, the EBA noted that the EBA Guidelines have not led to convergent EU supervisory practice in many areas. In spite of the transposition of common provisions of Directive 2013/36/EU, these have not prevented further divergence arising from national laws. It was also identified that the cooperation between CAs regarding suitability assessments should be enhanced.
113. Differences in actual practices include the definition of 'suitability', the criteria used by CAs and institutions to assess candidate suitability, the approach regarding the suitability of key function holders, and the notion of independence of members of the management body.
114. Accordingly, the EBA concluded that, in order to foster enhanced convergence of supervisory practices in these observed areas, a list of minimum criteria/requirements to increase the quality and effectiveness of the general provisions set out in Directive 2013/36/EU should be established. More detailed guidance for CAs on the assessment of the suitability of key function holders and to improve cooperation between CAs, following the best practices observed, should be also considered for the revision of the EBA Guidelines on the assessment of the suitability of members of the management body and key function holders.

### 4.5 Practices in BMA

115. The EBA SREP Guidelines have introduced BMA as one of the main SREP elements pursuing CAs to form supervisory views on business and strategic risks through the assessment of the institution's business model viability and sustainability. This component of the SREP is important for embedding a forward-looking perspective in supervisory work, linking together all the other components from the assessment of risks and governance to capital and liquidity adequacy and stretching beyond the SREP to the determination of the likelihood to fail and the adequacy of recovery plans.
116. Based on the practices observed in the framework of the colleges of supervisors and information received from CAs, BMA has been generally incorporated in the SREP practices. While, in some cases, BMA represents an additional activity under the responsibility of line supervisors, other authorities set up ad hoc or permanent dedicated teams performing this assessment.
117. Overall, the practices observed suggest that the supervisors understand the key aspects of the evaluation of banks' current business models and challenge their strategic plans in the

context of the markets in which they operate. As highlighted in section 4.1 on the implementation of the EBA SREP Guidelines, the EBA has noticed different approaches in terms of elements covered under BMA and in its role within the SREP. However, a deeper review of this SREP element needs to be performed by the EBA in order to evaluate supervisory convergence in this area.

## 4.6 Review of internal models

118. In the last 3 years, the EBA has conducted several benchmarking exercises in the context of the RWAs comparability, mainly on Internal Ratings Based (IRB) models pursuant to Article 502 of Regulation (EU) No 575/2013, with the broader objective of identifying banks' supervisory practices underneath the observed divergences and suggesting possible solutions to increase convergence. The outcomes, summarised in last year's supervisory convergence report, prompted the definition of a mid-term project aimed at a repair of internal models for credit risk, further referred to in section 6.1.4.
119. Since 2015, the objective of the EBA benchmarking has mostly moved towards assisting CAs in the authorisation and review of internal models, in accordance with the mandate from Article 78 of the CRD.
120. The benchmarking of internal models is indeed an important assessment tool and a key component of validation for supervisors and institutions, helping to understand divergences and comparability in capital requirements. The EBA focused its work on calculating and delivering benchmarks to support the work of CAs on the assessment of the internal approaches applied by the institutions, and to identify internal models that show significant dispersion of RWAs from peers and potential significant underestimations.
121. The reports published in 2015 present the results of the first supervisory benchmarking study pursuant to Article 78 of the CRD on the outcomes of internal models and related minimum capital requirements for counterparty credit risk (CCR) and credit valuation adjustment (CVA) risk on a subset of EU banks<sup>14</sup> who participated on a voluntary basis.<sup>15</sup>
122. The analyses have been performed on predefined portfolios designed to be consistent with the draft ITS on benchmarks with the objective of identifying main divergences, investigating the causes, and providing CAs with useful inputs for their internal model reviews.

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<sup>14</sup> The complete reports are available on the EBA website at the following address:  
<http://www.eba.europa.eu/documents/10180/950548/EBA+results+from+the+2014+Low+Default+portfolio+%28LDP%29%20exercise.pdf/b3adc4f7-653d-408d-b950-da2e4229e294> and  
<http://www.eba.europa.eu/documents/10180/950548/EBA+report+on+CCR+benchmarking+2014/3166f371-22b5-4021-b50a-ebd6d0047b72>.

<sup>15</sup> From 2016 onwards, the exercises will cover all EU institutions permitted to use internal approaches for the calculation of risk-weighted exposure amounts or own funds requirements except for operational risk.

#### 4.6.1 Main findings on the outcome of internal models

123. For the credit risk, the analysis of the most recent report regarded, in particular, the internal models used for estimating the credit risk parameters (PD, LGD and EAD) of exposures in the sovereign, institutions and corporate asset classes, which are characterised by low default rates (collectively referred to as low default portfolios (LDP)). For the CCR and the CVA, the analysis focused on the estimation of the expected exposure and leveraged on the data used for a similar study conducted by the Basel Committee on Banking Supervision (BCBS).
124. The results on the benchmark portfolio used for credit risk showed an increased standard deviation in terms of capital requirements compared to the previous exercise conducted in 2013 (c.a. 36% vs 25% in terms of global charge). Most of the observed differences across institutions' real portfolios could be explained by two factors: the proportion of defaulted exposures in the portfolio and the portfolio mix between large corporate, sovereign and institution exposures. For defaulted exposures in the large corporate portfolio, the discrepancy in terms of risk weights (RW) is very high among institutions. As highlighted in previous reports and confirmed in interviews with several banks, there is a wide range of practices with regard to the definition of 'default' and the treatment of defaulted assets. These differences are particularly important when comparing Foundation-IRB institutions, where RW should be zero, with Advanced-IRB institutions, where LGD best estimates are used. These factors should, however, gradually disappear with the implementation of the RTS on the assessment of internal approaches and on default definition (see more details in section 6.1.4).
125. Moreover, and among the reasons underlying these differences, the study identified the imposition of add-ons and floors to risk parameters by CAs, in addition to banks' risk management and methodologies factors, as well as some regulatory differences that are addressed in more detail in the EBA report on the future of the IRB approach.<sup>16</sup>
126. Similarly, the study on the CCR indicated add-ons and floors (on risk parameters or trade-specific) among others elements responsible for the differences in the banks analysed; however, the study covered only a small sample of banks. For the CVA, the choice of the stressed period and of the reference market curves for credit spread seemed the most relevant factors.

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<sup>16</sup> The paper is available on the EBA website at the following address:  
<https://www.eba.europa.eu/documents/10180/1003460/EBA-DP-2015-01+DP+on+the+future+of+IRB+approach.pdf>.

#### 4.6.2 Main findings on the use of benchmarking by CAs

127. The EBA also assessed (through a questionnaire) the CAs' follow-up to the outcome of the supervisory benchmarking analyses, pursuant to Article 78(4).<sup>17</sup>
128. From this perspective, the answers were encouraging—particularly for the benchmarking on the internal models for credit risk, although the use of this tool is not an established practice as yet. In the majority of cases, CAs used the outcome of the EBA benchmark for regular monitoring and the review of internal models and, to a lesser extent, for the approval of internal models. While the 2015 LDP exercise was not used to identify issues for NCAs' actions, it nevertheless helped to confirm issues already known.
129. With regard to the CCR and the CVA, the limited sample considered was not deemed robust enough to prompt specific supervisory actions, with the exception of a few authorities considering the review of the criteria under the selection of the stress test period. On a positive note for supervisory convergence, the majority of the relevant CAs declared the use of the EBA proxy spread methodology<sup>18</sup> when comparing banks that adopt different proxies, which helps to narrow the gaps among possible supervisory outcomes.
130. Overall, the benchmarking showed that there are still differences in internal estimates of risk and that, in some cases, these can materially affect the comparability of RWAs and therefore the capital requirements. The use of benchmarking in the review and authorisation process is gaining pace, but its input is still not a significant discriminant for the supervisory decisions and measures. With the extension of the benchmarking coverage of banks and models, the EBA expects a wider use and higher importance of the tool for supervisory review and measures in this area.

#### 4.7 Recovery plans assessment

131. With the implementation of the BRRD 2014/59/EU in January 2015, recovery planning has become a crucial aspect in crisis prevention by ensuring that an institution has appropriate processes and measures in place should it come under stress. Accordingly, the assessment of recovery plans and the decision regarding relevant remediation measures has now become a significant part of the regular supervisory activities.
132. In addition to the regulatory work,<sup>19</sup> the EBA is carrying out ongoing work in identifying and promoting better and more consistent practices, both through dedicated assistance and support to supervisory colleges and through appropriate benchmarking analysis,<sup>20</sup> (which

<sup>17</sup> Overall, 15 CAs answered the questionnaire.

<sup>18</sup> Defined in the Commission Delegated Regulation (EU) No 526/2014.

<sup>19</sup> Module on the assessment of recovery plans of the single supervisory handbook; RTS on the content of recovery plans (EBA/RTS/2014/11).

<sup>20</sup> See Comparative report on the approach to determining critical functions and core business lines in recovery plans (<http://www.eba.europa.eu/documents/10180/950548/EBA+Report+-+CFs+and+CBLs+benchmarking.pdf>) and Comparative report on the approach taken on recovery plan scenarios (<http://www.eba.europa.eu/documents/10180/950548/Report+on+benchmarking+scenarios+in+recovery+plans.pdf>).

provides the supervisors with complementary information for the assessment of recovery plans). The two EBA benchmarking reports published in 2015 covered the determination of critical functions and core business lines and the approaches taken on recovery plan scenarios.

133. Over the past year, the supervisory colleges underwent the first cycle of assessment in terms of group recovery plans for cross-border institutions under the new regulatory framework. With this in mind, the overall approach undertaken by the EU supervisors showed a fair degree of convergence in identifying the main deficiencies in the group recovery plans, although some differences emerged and need to be addressed properly in the coming months.
134. The EBA's involvement as part of the college activity has revealed that the EBA single supervisory handbook was extensively used and was helpful when assessing recovery plans. On the other hand, there were a couple of areas where the process of assessment of recovery plans still showed some divergence in the practices.
135. The first one of these areas refers to the appropriate sharing of the document among relevant authorities in accordance with Article 7(2) of the BRRD. In fact, while (in general) the decision regarding the assessment of recovery plan needs to be taken within 6 months from the submission of the plan, for group recovery plans, Article 8(2) of the BRRD further provides that a joint decision should be reached within 4 months of the date of sharing the group recovery plan by the consolidating supervisor with the college.
136. These two overlapping deadlines imply that the consolidating supervisor has some time, up to 2 months, between the submission of the recovery plan by the bank and the transmission to the other CAs that form part of the college. Experience shows that the majority of recovery plans were shared with the supervisory colleges within the 2-month time frame from their submission by institutions (most of the time, plans were also accompanied by a preliminary assessment by the consolidating supervisor). Nevertheless, in some cases, consolidating supervisors experienced some difficulties in transmitting the group recovery plans to the other college members as a result of confidentiality related administrative provisions.
137. This led to a late transmission of the documents, thus leaving host CAs less than the 4 months envisaged by the BRRD to assess the group plans. This, in turn, made reaching a timely joint decision more challenging.
138. A second area where full convergence of practices is yet to come is the definition of fully integrated group recovery plans covering sufficiently information on parent companies and subsidiaries for cross-border groups. In fact, at the time of entry into force of the BRRD, some Member States had already implemented specific provisions at the national level requiring some or all credit institutions under their jurisdiction to submit recovery plans on an individual basis, without full coordination with the parent undertaking. This clearly posed the

challenge, both from the home and the host perspective, of having a group recovery plan able to identify measures to be implemented both at the level of the parent and of each individual subsidiary. More convergence in this area would contribute to a smooth joint decision process between competent authorities on group recovery plans.

139. Although there are no known cases (as 2016 is the first year of application of the BRRD), the EBA deems that requesting individual recovery plans outside the joint decision process risks leading to uncoordinated recovery actions by the institutions, which, in turn, may yield inconsistent recovery measures at the group and at the individual levels.

## 5. Supervisory measures

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140. Adoption of different practices and methodologies for scoring, risk assessment, nature of capital requirements and the use of benchmarks have a direct impact on the consistency of supervisory outcomes and measures. Consequently, the divergences highlighted in section 4 were at the basis of different supervisory responses described in the following paragraphs.
141. While some degree of variability in supervisory outcomes and measures is inherent to the application of supervisory judgement and may also be justified by the specific situations at stake, it is reasonable to not expect significant differences when supervisory review and evaluation practices are aligned. In some situations, however, different outcomes are not just a reflection of supervisory review and evaluation practices, but rather depend on diverse approaches to address specific issues (for example, in the case of risk underestimation by internal models or internal governance deficiencies, as highlighted before).
142. Nonetheless, the EBA acknowledges that wider divergence in qualitative measures—for example, in areas such as governance or the use of benchmarks on internal models, can be expected as, in these cases, supervisory judgement plays a major role and the issues can be more specific.

### 5.1 Measures taken in the context of joint decisions on capital and liquidity adequacy

143. In accordance with the powers and mandates contained in Article 8 and Article 21 of its founding regulation, the EBA has been monitoring and promoting the efficient, effective and consistent functioning of the colleges of supervisors set up for the most significant cross-border banking groups,<sup>21</sup> fostering the consistent application of EU law across these supervisory settings.
144. The work in supervisory colleges is also an important source of information for the assessment of consistency of supervisory measures. Supervisory convergence in measures—particularly the capital and liquidity measures taken as part of joint decisions on institution-specific prudential requirements, and the measures to address deficiencies identified in group recovery plans—is crucial for ensuring a level playing field for cross-border institutions. By participating in colleges of supervisors, the EBA has been able to monitor the degree of convergence of these supervisory measures and promote harmonisation in this area.

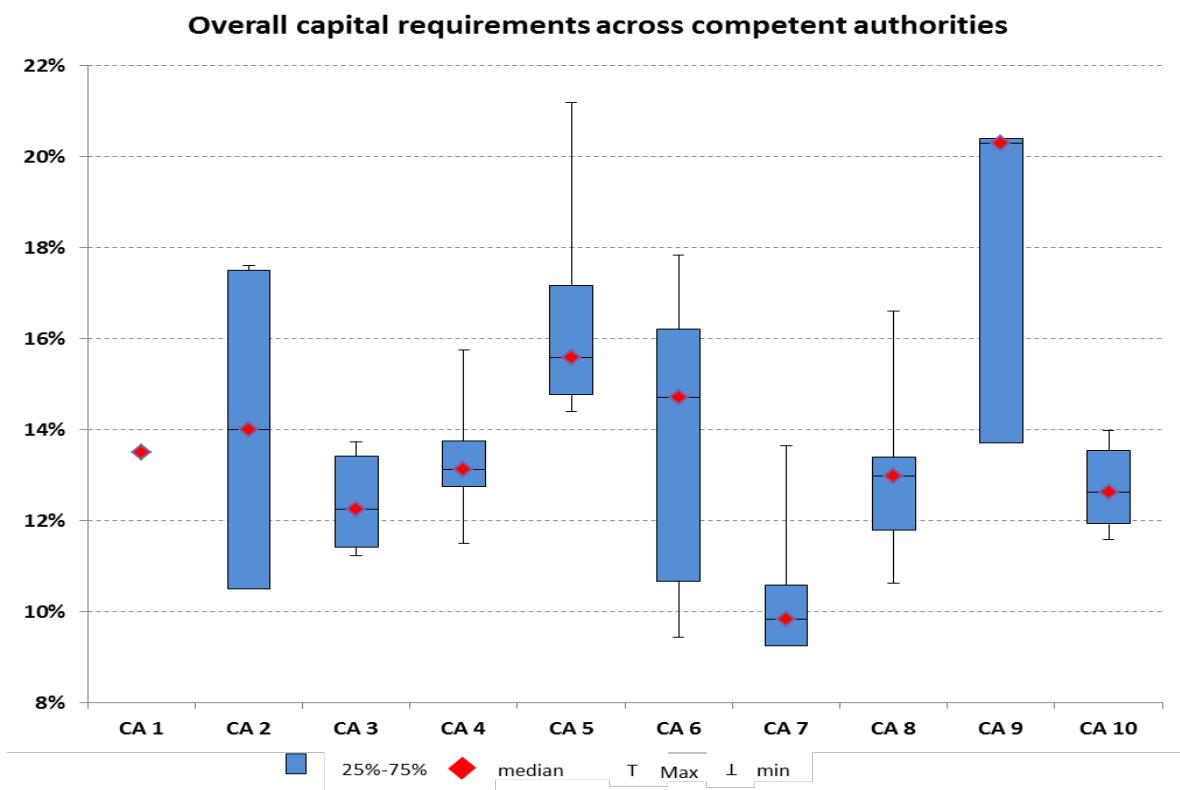
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<sup>21</sup> Article 115 of Directive 2013/36/EU requires that, for cross-border banking groups with the parent undertaking established in one Member State and at least one subsidiary in another Member State, the consolidating supervisor establishes a college of supervisors to reach a joint decision on the capital and liquidity adequacy of the supervised institution.

### a. Capital measures

145. The publication of the EBA SREP Guidelines in December 2014 had a positive impact on the general understanding of the basis for setting the additional capital requirements. It particularly ensured clarity on the steps and the binding nature of the additional capital requirements, which are set on top of the minimum capital requirements laid down by the CRR and under the combined buffer requirements.
146. While the implementation of the common EBA SREP Guidelines is on a good track, several divergences across supervisory practices for the imposition of additional capital requirements have been observed in the 2015 SREP, and these are described in detail in section 4.1 of this report.
147. The chart below, based on data of 20 closely monitored banking groups (covering around 150 entities), suggests that CAs tend to impose very different levels of requirements (including macroprudential buffers),<sup>22</sup> which conversely tend to converge within each jurisdiction, a sign that differences in the SREP approaches seem to materialise in different outcomes.

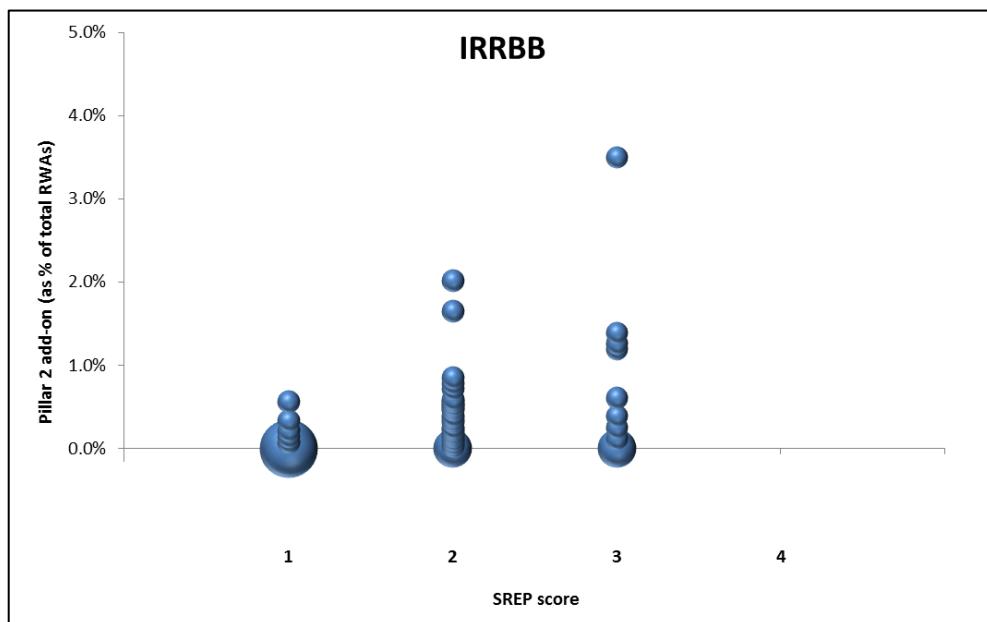
**Figure 3: Distribution of overall capital requirements (OCR) across the EU**



<sup>22</sup> The overall capital requirements levels in the figure are approximate, under the assumption that, in the case of applicable Global Systemically Important Institutions (G-SII), Other Systemically Important Institutions (O-SII) and Systemic Risk (SRB) buffers, the combined buffer is determined based on the maximum of the three.

148. Additionally, the level of binding requirements is significantly different across jurisdictions, which means that, from a legal perspective, the trigger of automatic restrictions on distributions pursuant to Article 141 of the CRD applies at different levels and is partially subject to supervisory judgement and intervention.
149. Differences also appear in relation to risk scores and capital add-ons. In particular, in the case of IRRBB (which is a typical Pillar 2 risk and therefore a certain level of correlation is expected to be found between those two variables), the EBA observed significant variance of capital add-ons within each score class, which suggests a very low correlation.

**Figure 4: Relationship between IRRBB risk score and add-ons**



150. This result depends on three main drivers:
- Differences in scoring methodology;
  - Differences in quantification methodology;
  - Application of different supervisory judgement.
151. With the information available, however, the EBA cannot determine which of the three prevails.
152. For other risks, the correlations appear to be even lower. However, in the case of credit, market and operational risk (i.e. Pillar 1 risks), this result is not negative per se in terms of the convergence perspective, as additional own funds should only be imposed in case elements of such risks are not captured by the minimum own funds requirements. However, in this case, the information available does not allow reaching clear-cut conclusions and a deeper analysis would be necessary.

153. The EBA sees room for more convergence, which would help achieve a common language and consistent treatment of risks in all Member States.

b. **Liquidity measures**

154. Institution-specific liquidity requirements can also be imposed on the basis of the SREP assessment. These requirements can be qualitative or quantitative. There is generally a satisfactory convergence in the assessment of liquidity risk, which is also supported by the methodology published by the EBA in draft form at the end of 2013.

155. However, when applying appropriate supervisory measures based on this assessment, the outcome is quite dispersed. Supervisory measures were only proposed for half of the cases where significant shortcomings in the assessment of liquidity were identified in the risk assessment.

156. When looking at the types of supervisory measures, both qualitative and quantitative have been used. Quantitative measures involved either setting a survival period or specifying additional add-ons on risks not captured by the Liquidity Coverage Ratio (LCR). Qualitative measures typically addressed specific issues identified in the assessment of the inherent risk or risk management and control, and vary from requesting stress tests on intraday liquidity, strengthening liquidity monitoring, and improving liquidity risk management to requesting additional reporting.

157. The observation of such different measures does not raise concerns at the moment due to the specificity of the liquidity risk profiles. Moreover, the information available from risk assessments does not allow the EBA to draw specific conclusions on this. Nonetheless, the EBA expects more consistency between conclusions of risk assessment and supervisory responses.

## 5.2 Measures taken in the context of the assessment of group recovery plans

158. Joint decisions on group recovery plans should be taken on three main issues: the assessment of the recovery plan, the need for individual plans, and the application of measures as per Article 6(5) and Article 6(6) of the BRRD. In particular, Article 6(5) states that when ‘there are material deficiencies in the recovery plan, or material impediments to its implementation, it shall notify the institution (...) of its assessment and require it to submit, within 2 months, a revised plan demonstrating how those deficiencies or impediments are addressed’.

159. In the absence of a clear definition in the BRRD of what a material deficiency is, a broad consensus has emerged among supervisors that it refers to a situation that would prevent a swift implementation of the recovery plan, should the need arise. However, a different approach was observed in response to the identification of material deficiencies.

160. On the one hand, because of the late transposition of the BRRD in national legislation and the consequent early stage of development for institutions' recovery plans, some authorities opted for highlighting 'very significant shortcomings' to be remediated in the next submission of their recovery plans rather than requiring a new recovery plan within 2 months (as per the BRRD).
161. A second approach consisted in exploiting the hearing period granted to institutions in the case of material deficiencies to assess the remedial actions and, only in case these were deemed unsatisfactory, competent authorities requested the resubmission of the plan.
162. Due to the recent introduction of the new regulatory framework, these different practices are not deemed significant by the EBA at this stage, although their persistence in the future will affect the level playing field in this area and may also affect the response from the resolution authorities.

### 5.3 Other measures

#### 5.3.1 Internal models

163. As mentioned in section 4.5.1, the EBA also inquired how CAs used the outcome of the supervisory benchmarking analyses of the internal models in term of taking appropriate supervisory response or measures.
164. While the majority of CAs used the outcome of the EBA benchmarking analyses for the regular monitoring and review of internal models, only 30% of CAs also found the outcome helpful to identify issues requiring some supervisory action (i.e. add-ons, inclusion in the SREP assessment, measures on governance).
165. Very few CAs practically reflected the use of the EBA benchmark in the SREP assessment. To an even lesser extent, CAs confirmed that these issues were discussed in the context of the joint decisions for the authorisation of internal models.
166. In some cases, the relative non-materiality of the LDP exposures or the ongoing model changes made the outcome of the benchmarking non-relevant.
167. Finally, CAs highlighted that there were not many actions under way or planned for the first half of 2016 regarding the credit risk models.
168. While these findings require further analysis by the EBA to better understand the reasons of the limited use of the benchmarking results, undoubtedly CAs should have more regard for these results and undertake similar approaches towards the supervisory response in case of model inaccuracies—e.g. upscaling risk parameters or imposing additional own funds.

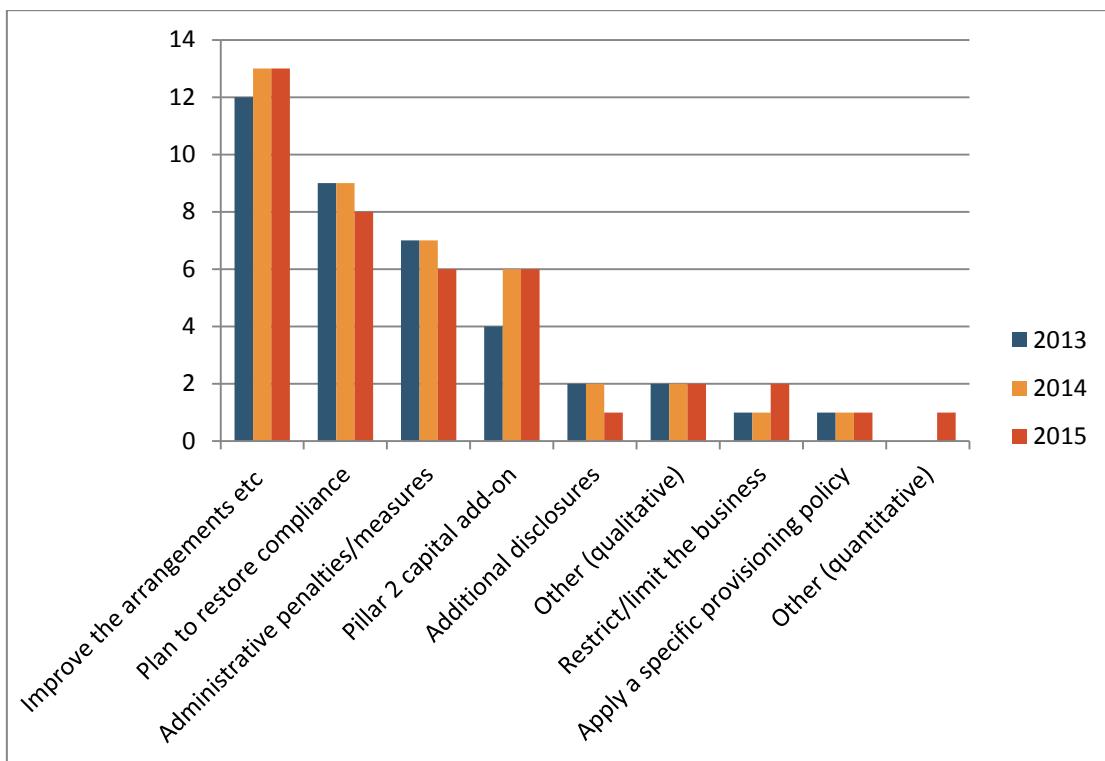
### 5.3.2 Conduct risk

169. Concerning supervisory measures to address the findings from the assessment of conduct risk, the following types of measures were taken most frequently by a number of CAs:

- Requesting improvements/reinforcement of the arrangements, processes, mechanisms and strategies implemented by institutions;
- Requiring institutions to present a plan to restore compliance with supervisory requirements;
- Imposing administrative penalties or other administrative measures;
- Imposing additional own funds requirements for conduct risk.

170. Other types of measures applied in supervisory response to conduct risk included additional disclosure, restriction on business or requesting a specific provisioning policy. Figure 5 provides an overview of measures exercised by CAs between 2013 and Q2 2015.

**Figure 5: Supervisory measures exercised in 2013 to mid-2015 (by number of NCAs indicating the exercise of these measures)**



171. The relatively limited experience and diversity of measures suggest the need for sharing experiences and exchanging information, particularly around the conditions driving the nature and type of supervisory measures chosen to mitigate the prudential impact of conduct risk incidents and the timing of exercising those measures.

### 5.3.3 Remuneration practices

172. In several cases, measures were taken by CAs to ensure that institutions apply the criteria set out in the EBA Guidelines and Opinion for their remuneration policies and practices and, where necessary, implement necessary changes.
173. The actions from CAs ranged from sending general communication to supervised institutions requiring compliance with the EBA Guidelines to requesting changes to the conditions under which role-based allowances were granted in order to comply with the bonus cap.
174. The differences in the measures suggest different levels of supervisory engagement in the review of remuneration policies, rather than different approaches in the form and severity of supervisory measures.

## 6. The EBA policy and colleges' work supporting supervisory convergence

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175. One of the key elements supporting the convergence of supervisory practices is a solid regulatory framework that is consistently implemented and applied across the EU. Since its establishment, the EBA has been working on building this framework and has already developed a number of policy products, in particular:

- Technical standards for the functioning of colleges of supervisors (Commission Delegated Regulation (EU) No 2016/98, and Commission Implementing Regulation (EU) No 2016/99);
- Technical standards for the joint decision on institution-specific prudential requirements (Commission Implementing Regulation (EU) No 710/2014);
- The EBA Guidelines on common procedures and methodologies for the SREP (EBA/GL/2013/14);
- RTS for the definition of material risk-takers for remuneration purposes (Commission Delegated Regulation (EU) No 604/2014);
- Guidelines on the assessment of the suitability of members of the management body and key functions holders (EBA/GL/2012/06).

176. Despite having a solid regulatory background that covers many aspects of supervisory practices and their practical application in the context of cross-border groups and their SREP outcomes, the EBA convergence monitoring and assessment activities in 2015 have highlighted that additional guidance is required to ensure an effective level playing field. Thus, based on the EBA's observations of practices and supervisory outcomes, it was deemed important to strengthen the framework for the (1) application of distributions restrictions, (2) assessment of ICAAP and ILAAP<sup>23</sup>, and (3) stress testing and supervisory stress testing.

177. The EBA has also continued developing a number of regulatory products supporting the convergence of supervisory practices in assessing, approving and benchmarking internal models' approaches for the calculation of the minimum capital requirements. A consultation paper on the EBA's work plan on regulatory products for credit risk was published in 2015, with the objective of spreading the burden on banks in a reasonable time frame, bearing in mind the forthcoming review of the CRR and the discussions on internal models at a global level.

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<sup>23</sup> Internal Liquidity Adequacy Assessment Process.

178. Additionally, following the EBA Opinion regarding the principles of remuneration policies of credit institutions and investment firms and the use of allowances (EBA/Op/2014/10),<sup>24</sup> the EBA revised/updated its Guidelines on remuneration policies.<sup>25</sup>

179. An important vehicle to channel these new policy products, as well as broader guidance on supervisory practices to CAs, has been the participation of the EBA in the colleges of supervisors of main cross-border banking groups. In this context, indeed, the EBA has not only observed and fostered the application of specific provisions regarding risks assessment and joint decisions on capital, liquidity and recovery plans, but has also drawn supervisory attention to key topics and priorities for supervisors in 2016.

## 6.1 Policy work

### 6.1.1 Stacking order of capital requirements and the MDA framework

180. Different supervisory practices in the imposition of additional own funds requirements and different approaches in the implementation of the automatic restrictions on distributions—partly a consequence of the lack of clarity in the provisions of Article 141 of the CRD—raised serious concerns for the level playing field and the stability of the markets of Additional Tier 1 (AT1) debt instruments among banks, investors and supervisors in the last quarter of 2015.

181. With the view of bringing clarity to the framework and removing those concerns, the EBA issued an Opinion at the end of 2015 reaffirming the stacking order of capital requirements, with Pillar 1 and Pillar 2 sitting, at all times, beneath the combined buffer.

182. The EBA Opinion also advised CAs to use their broader supervisory powers and impose measures whenever necessary to ensure that the allocation of the MDA between dividends, share buybacks, and payments on AT1 instruments support timely capital restoration plans while not endangering institutions' funding continuities. The EBA Opinion also notes the importance of the MDA triggers for investors in banks' instruments such as AT1 and, consequently, of the disclosure of additional own funds imposed under the SREP.

183. While the EBA Opinion also contains a recommendation to the European Commission (Commission) for a future review of the CRD, CAs are expected to follow this Opinion starting from the decisions on capital requirements adopted in 2016.

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<sup>24</sup> <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-10+Opinion+on+remuneration+and+allowances.pdf>

<sup>25</sup> <https://www.eba.europa.eu/documents/10180/1314839/EBA-GL-2015-22+Guidelines+on+Sound+Remuneration+Policies.pdf/1b0f3f99-f913-461a-b3e9-fa0064b1946b>

### 6.1.2 **Draft guidelines on ICAAP and ILAAP information for the SREP purposes**

184. As part of its effort to support CAs with consistent implementation of the EBA SREP Guidelines, in December 2015, the EBA launched a consultation on draft guidelines for ICAAP and ILAAP information to be collected for the purposes of the SREP.
185. The draft guidelines aim to facilitate a consistent approach to the supervisory assessment of ICAAP and ILAAP frameworks, as well as the assessment of the reliability of institutions' own capital and liquidity estimates as part of setting the institution-specific capital requirements under the SREP.
186. These draft guidelines focus on the information CAs should collect from institutions in order to perform their assessments, and also set the criteria for CAs to organise the collection of ICAAP and ILAAP information from institutions, taking into account the principle of proportionality in relation to the frequency, reference and remittance dates, scope and level of detail of the information collected.
187. The guidelines will be finalised following the outcomes of the public consultation in the second half of 2016 with the aim of being applicable for the round of ICAAP and ILAAP information collection for the 2017 cycle of the SREP and joint decisions.

### 6.1.3 **Draft guidelines on stress testing and supervisory stress testing**

188. To promote convergent supervisory practices and further clarify the role of stress testing, and particularly supervisory stress testing in the SREP, the EBA has revised its 2010 Guidelines on stress testing and issued for consultation draft guidelines on stress testing and supervisory stress testing.
189. The revised Guidelines also set out expectations for institution's stress testing programmes and seek improvements by drawing on lessons from previous EU-wide stress testing exercises and the outcome of the EBA peer review on the application of the 2010 stress test Guidelines.
190. The draft guidelines cover institutions' stress testing programmes, supervisory assessment of institutions' stress testing, supervisory stress testing and, particularly, the use of the outcomes of stress testing when assessing capital and liquidity adequacy under the SREP.
191. The draft guidelines will be finalised following the public consultation and will also reflect the outcomes of the debate on establishing capital guidance as a supervisory tool to address concerns regarding institutions' capital planning (revealed by stress testing). The guidelines will apply for the 2017 cycle of the SREP and joint decisions.

### 6.1.4 Assessment and benchmarking of internal models

192. In the application of the mandates specified in the Regulation (EU) No 2013/575, the EBA has been developing technical standards to specify the methodology CAs must follow in assessing the compliance of institutions with the requirements to use internal model approaches, both in the case of authorisation of new models, and in the case of material changes or ongoing review of existing authorised models.
193. The RTS on the IRB assessment methodology are addressed to CAs and will affect supervisory practices and criteria used by CAs in assessing an institution's compliance with minimum IRB requirements. The consultation paper for the RTS on the assessment methodology for the IRB approach<sup>26</sup> was already drafted in 2014. The final draft RTS will be submitted to the Commission by mid-2016.
194. In December 2015, the EBA published the RTS that specify the conditions under which CAs should assess the significance of positions included in the scope of market risk internal models, as well as the methodology that CAs shall apply to assess an institution's compliance with the requirements to use an internal model approach for market risk.
195. The EBA also drafted specific RTS on assessment methodologies for the use of Advanced Measurement Approaches (AMAs) for operational risk in 2015. These RTS were targeted at CAs in relation to institutions that want to use or are already using AMAs for regulatory purposes, setting out both qualitative and quantitative requirements to check compliance with.
196. Pursuant to the mandate in Article 78 of the CRD, in March 2015, the EBA published draft RTS and ITS to provide definitions and templates with data requirements for benchmarking portfolios. These technical standards specify, in detail, the framework for EU institutions and CAs to carry out the annual supervisory benchmarking foreseen by Directive 2013/36/EU; they also define the benchmarking portfolios, as well as the methodology that CAs across the EU shall use in order to assess the quality of institutions' internal approaches for capital calculation purposes and concerning credit and market risks.
197. It is expected that the above-mentioned technical standards will significantly increase harmonisation of the supervisory assessment methodologies across all EU Member States, thereby rectifying some of the issues identified in the assessment of comparability of internal models in the past years.
198. In 2015, the EBA also published and consulted on its work plan on regulatory products for credit risk with the objective of spreading the burden on banks in a reasonable time frame, bearing in mind the forthcoming review of the CRR and the discussions on internal models at a global level (in this regard, refer to the discussion paper,<sup>27</sup> the report<sup>28</sup> and the EBA

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<sup>27</sup> <http://www.eba.europa.eu/documents/10180/1003460/EBA-DP-2015-01+DP+on+the+future+of+IRB+approach.pdf>

Opinion).<sup>29</sup> While the work plan mainly covers products addressed to institutions (e.g. the estimation of risk parameters, treatment of defaulted assets, credit risk mitigation techniques and disclosure), the criteria for defining the materiality of a past due exposure and the annual benchmarking exercises are directly addressed to CAs and aim at increasing supervisory convergence. This is the same for the specification of the criteria based on which CAs can impose higher risk weights (Article 124 of the CRR) or LGD floor (Article 164 of the CRR) for exposures related to real estate when this is justified by financial stability considerations.

#### 6.1.5 Guidelines on sound remuneration policies and disclosures

199. With the primary objective to update the former Committee of European Banking Supervisors' (CEBS) guidelines on remuneration practices following the changes introduced by CRD IV, end last year, the EBA issued comprehensive Guidelines that also complement the EBA Opinion on the treatment of allowances.
200. The Guidelines set out criteria for the allocation of remuneration to its fixed and variable component, which is crucial for the calculation of the ratio between the variable and the fixed component and to ensure that the limitation of this ratio is complied with. The Guidelines clarify the requirements of the CRD regarding variable remuneration and how remuneration should be aligned to the risks of the institution. They provide additional details on disclosures required in this area under the CRR.

## 6.2 Identification and promotion of key topics and priorities for supervisors

201. In the context of monitoring the colleges' functioning, the EBA has also provided guidance to supervisors on the main risks and topics that require attention in 2016. This has been done both through dedicated discussion among the EBA Board of Supervisors and, on a more direct basis, by addressing specific presentations to those colleges of supervisors that were closely monitored by the EBA.

202. For 2016, the EBA has drawn CAs' attention to three main categories of topics, particularly:
- a. Topics linked to risks faced by EU banks;
  - i. Non-performing loans and balance sheet cleaning;
  - ii. Business model sustainability in challenging regulatory and macroeconomic environments.

<sup>28</sup>

<http://www.eba.europa.eu/documents/10180/1360107/EBA+Report+on+the+regulatory+review+of+the+IRB+Approach.pdf>

<sup>29</sup> <http://www.eba.europa.eu/documents/10180/1359456/EBA-Op-2016-01+Opinion+on+IRB+implementation.pdf>

- b. Topics linked to specific policy products
    - i. The EBA SREP Guidelines implementation;
    - ii. IRB models – Review and cross-border cooperation;
    - iii. **International Financial Reporting Standard (IFRS) 9 impact;**
    - iv. Remuneration – Bonus cap.
  - c. Topics linked to supervisory initiatives
    - i. EU-wide stress test – Home-host cooperation and communication to the market.
203. By shedding light on these topics, the EBA reached two objectives. On one hand, it prompted discussion among colleges, helping the exchange of views and approaches. On the other hand, it promoted the inclusion of specific topics in individual and consolidated supervisory programmes. Both cases provided further input to supervisory convergence.

## 7. Training activities

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204. An important element in building the common supervisory culture is the training provided by the EBA to national CAs. A common training curriculum for European supervisors can contribute to consistent training across the single market. As in the previous years, the training activities in 2015 were focused on the implementation of new parts of the single rulebook addressed to the supervisors and, particularly, on the implementation of the EBA Guidelines on common procedures and methodologies for the SREP and the assessment of recovery plans.

205. In 2015, based on a surge in demand by individual CAs for its technical training, the EBA enlarged its training programme and delivered 24 training sessions in total, of which two were joint events with the other European Supervisory Authorities (ESAs), and three were joint events with other training partners, namely the European Supervisor Education Initiative (ESE),<sup>30</sup> the BCBS/Bank of International Settlement's Financial Stability Institute (FSI) and the European University Institute (EUI).

206. The table below provides details on the number of training sessions provided in 2015, where the EBA training reached over a thousand participants.

**Table 1: Overview of the training events the EBA provided to CAs in 2015**

Title	Attendees
Seminar on supervisory colleges functioning	36
Supervisory assessment of recovery plans – Introduction to the module of the EBA supervisory handbook	43
Supervisory assessment of recovery plans – Introduction to the module of the EBA supervisory handbook ( <i>for ECB SSM staff only</i> )	70
Data analysis systems in supervision	63
EBA-FSI joint training on CRD IV-CRR/Basel 3 – Latest developments and implementation challenges	55
Importance of liquidity risk management for the stability of individual banks and the financial system	20
Cross-sector training – Group supervision under SII and colleges of supervisors	44
Common European supervisory review and examination process (SREP) framework – The EBA Guidelines on the SREP	59

<sup>30</sup> ESE is an alliance of some EU central banks and supervisory authorities. Its members are the Bank of Slovenia, Banque centrale du Luxembourg, Czech National Bank, De Nederlandsche Bank, Deutsche Bundesbank, German Federal Financial Supervisory Authority and Oesterreichische Nationalbank.

Title	Attendees
Workshop on mediation	18
Data needs for risk analysis purposes	69
Data point model and XBRL	42
Supervisory assessment of recovery plans and joint decision on group recovery plans ( <i>hosted by Bank of Slovenia</i> )	58
EBA-EUI joint seminar on market risk	68
Common European supervisory review and examination process (SREP) framework – The EBA Guidelines on the SREP ( <i>for ECB SSM staff only</i> )	50
EBA Guidelines on the security of internet payments	70
Seminar on supervisory colleges functioning and capital and liquidity joint decisions ( <i>for ECB SSM staff only</i> )	50
XBRL/DPM for developers and technical support staff	33
Cross-sector training – Supervisory handbooks in insurance and banking	71
Common European supervisory review and examination process (SREP) framework – The EBA Guidelines on the SREP	51
Soft skills training – Structural analysis and writing (course run five times in 2015)	48 <i>(around 10 attendees per course)</i>
<b>Total</b>	<b>1 018</b>

207. Given the increase in demand from CAs for training provided by the EBA, the EBA Board of Supervisors agreed that the EBA should enhance its training role and further promote supervisory convergence across the EU by building on its unique position to develop a common training foundation for supervisors and resolution experts. The EBA proposed creating a core curriculum and web-based training as a more cost-effective manner of availing its training sessions to a wider audience who could eventually train their own staff using the EBA's material.

208. Accordingly, since autumn 2015, the EBA has been trialling web-based training in cooperation with the technical expertise of the EUI, and has had positive feedback on its pilot online training course on 'Assessment of bank recovery plans'. Accordingly, the EBA has launched web-based training on 'Bank recovery planning' and on 'The SREP process and methodology' for 2016.

209. With regard to intended extension of the EBA training activities, several budgetary constraints appeared to be challenging (e.g. charging fees) for the planned extension of training activities. The EBA is in close contact with EU budgetary structures to address these issues. The EBA is also constrained in terms of human resources to support the training extension.

## 8. Ongoing activities in 2016 and going forward

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211. The EBA will continue to monitor and promote supervisory convergence through the usual sources and tools, and will report the results of its activity to the EBA Board of Supervisors, the EU Parliament and the EU Council.
212. Achieving convergence in supervision requires an iterative process (monitoring practices, setting standards, etc.) that enables rules and practices to be adjusted in the face of a rapidly changing environment and to new best practices.
213. In terms of the participation of colleges of supervisors, the EBA will leverage on peer reviews and staff reviews to gather a broader and deeper overview of supervisory practices, convergence of methodologies, and assessment techniques underlying supervisory outcomes and measures. The outcome of these analyses will then be used either to require more adherences to the rules or identify areas where further, as well as new, guidance is necessary.
214. The delivery of specialised training on the main EBA products for supervisory practices will help promote a common supervisory culture and understanding of guidelines and standards by supervisors.

### 8.1 Supervisory review and evaluation practices

215. Monitoring the implementation of the EBA SREP Guidelines by CAs and consistency of the SREP outcomes will be one of the key activities in 2016. The focus of the EBA will be on the most material elements and on areas that have shown a lesser degree of convergence; this will extend gradually in scope and depth. The EBA SREP Guidelines have indeed brought in a common framework that, if applied consistently, would help establish a truly level playing field and ensure compliance with the EU capital and liquidity requirements framework.
216. This monitoring will employ active bilateral interactions with CAs on supervisory methodologies and the SREP outcomes, multilateral interaction in the respective EBA working structures, and continuous promoting of consistent approaches in the context of supervisory colleges for cross-border institutions.
217. Looking forward, the EBA will focus more on the consistency of practices and of outcomes, both across and within CAs' jurisdictions, possibly including domestic institutions in the scope to monitor issues surrounding a level playing field across the EU.
218. The EBA will also continue its work on developing methodologies and procedures for supervisors on emerging risks or areas where the monitoring of practices shows a need for

additional guidance or where international standards have been updated (e.g. interest rate risk in the banking book). The work already identified in this context is on ICT risk, common risk taxonomy for the SREP and methods for supervisory benchmarks for capital adequacy assessment, and recovery planning, an outline of which is provided in the following.

a. **ICT risk**

- 219. The aim of the EBA's work related to the ICT risks is to create a common understanding of ICT risks and bring consistency to the specific supervisory assessment. The focus of the EBA's work to date has been on risks associated with outsourcing to cloud service providers and on developing a methodology for assessing the prudential impact of ICT risks on banks.
- 220. In terms of outsourcing to cloud service providers, the EBA has been working to promote a common EU approach to address the main supervisory concerns regarding data security, contracts with the providers and audit rights, acknowledging the peculiarity of ICT compared to other activities and services that can be subject to outsourcing.
- 221. In parallel, based on the observations of the lack of structured supervisory approaches, the EBA is developing guidelines for the assessment of ICT risks that will complement the existing content in the EBA SREP Guidelines under the operational risk assessment. Additionally, these guidelines will cover other aspects of ICT more related to governance, institution-wide controls and business strategy. The guidelines are expected to be published for public consultation in 2016.

c. **Benchmarking of internal models**

- 222. Concerning the ongoing review of the internal model approach, the EBA will continue to analyse the comparability of RWAs and will gradually extend its assessment to supervisory practices, methodologies and measures adopted in the ongoing review of the internal model approach, including—but not limited to—the use of supervisory benchmarks.
- 223. The EBA will run its 2016 benchmarking exercise pursuant to Article 78 of the CRD on all institutions in the EU that use internal approaches to calculate own funds requirements. The focus will be on credit risk for the so-called high-default portfolios (small and medium-sized enterprises and retail obligors) and market risk portfolios.
- 224. In preparation for the 2017 exercise, the EBA is already considering changes to the relevant portfolios, which will be transmitted to the Commission and published after its adoption by the EBA Board of Supervisors.

d. **Recovery planning**

- 225. The EBA staff will continue to focus on promoting convergence in supervisory practices in this area through sharing practices in assessing the recovery plans and additional policy work in areas identified as important for achieving a consistent supervisory outcome (e.g. appropriate coverage of entities in group recovery plans).

226. Since the BRRD is based on the principle of proportionality and envisages the possibility of applying simplified obligations for recovery and resolution planning for institutions meeting special criteria, the EBA will also compare practices in applying the simplified obligations, assessing the simplified recovery plans and work on the relevant report and technical standards mandated by the BRRD.

e. **European supervisory handbook**

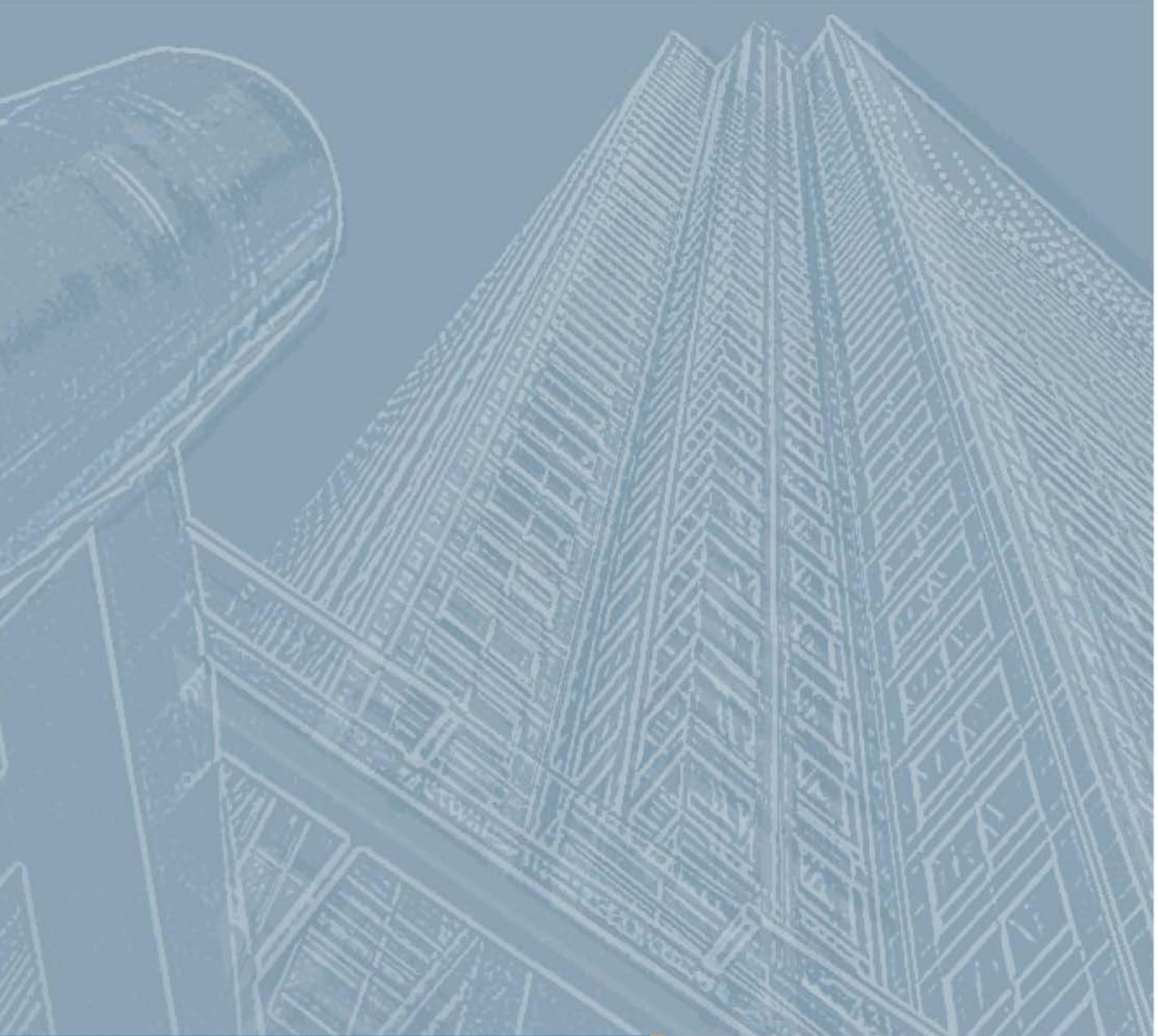
227. In the amendment to the EBA's founding regulation (Regulation (EU) No 1022/2013) following the establishment of the SSM, the EBA was assigned the responsibility of drawing up a European supervisory handbook on the supervision of financial institutions. While the handbook does not take the form of legally binding acts and does not restrict judgement-led supervision, it identifies best practices across the EU with regard to supervisory methodologies and processes that CAs should use in conducting supervisory activities.

228. Experience with using the first two chapters of the handbook covering (1) the supervisory assessment of institutions' business models and (2) the assessment of recovery plans suggests that this tool is very effective in achieving convergence of supervisory practices in new areas of supervisory work. However, due to limited resources, there has not been significant progress achieved in 2015 with additional chapters of the handbook.

229. Going forward, the EBA plans to continue the development of the handbook. A possible area to be covered is represented by supervisory benchmarks, for which the EBA intends developing common criteria that will be used to define and apply these tools in the context of the determination of capital requirements.

f. **The EBA's plans to enhance its training activities**

230. The EBA seeks to extend its training programme for CAs across the single market, provided budgetary constraints can be removed, in order to set the foundations for a common approach, ensure consistent interpretation of the single rulebook and contribute to the building of a common supervisory culture.



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