

SSM approach to supervisory proxies

Agenda Item 10 - Role of supervisory benchmarks in the assessment of capital adequacy

Overview

- 1 SSM overall SREP approach
- 2 The role of the supervisory proxies
- 3 The SSM proxies so far developed

SSM Overall SREP Approach

■ Context

- 123 JSTs conduct SREP for institutions in 19 different SSM countries with different national supervisory background

■ Key objective of the SSM:

- Overcome traditional Pillar 2 differences by developing common SSM SREP methodology that is applied in practice
 - EBA SREP GLs form basis of SSM SREP
 - In this initial stage, SSM focuses on establishing a common SREP approach

SSM proxies (common methodology for estimating risk levels)
are key for fostering consistency across institutions

SSM Overall SREP Approach

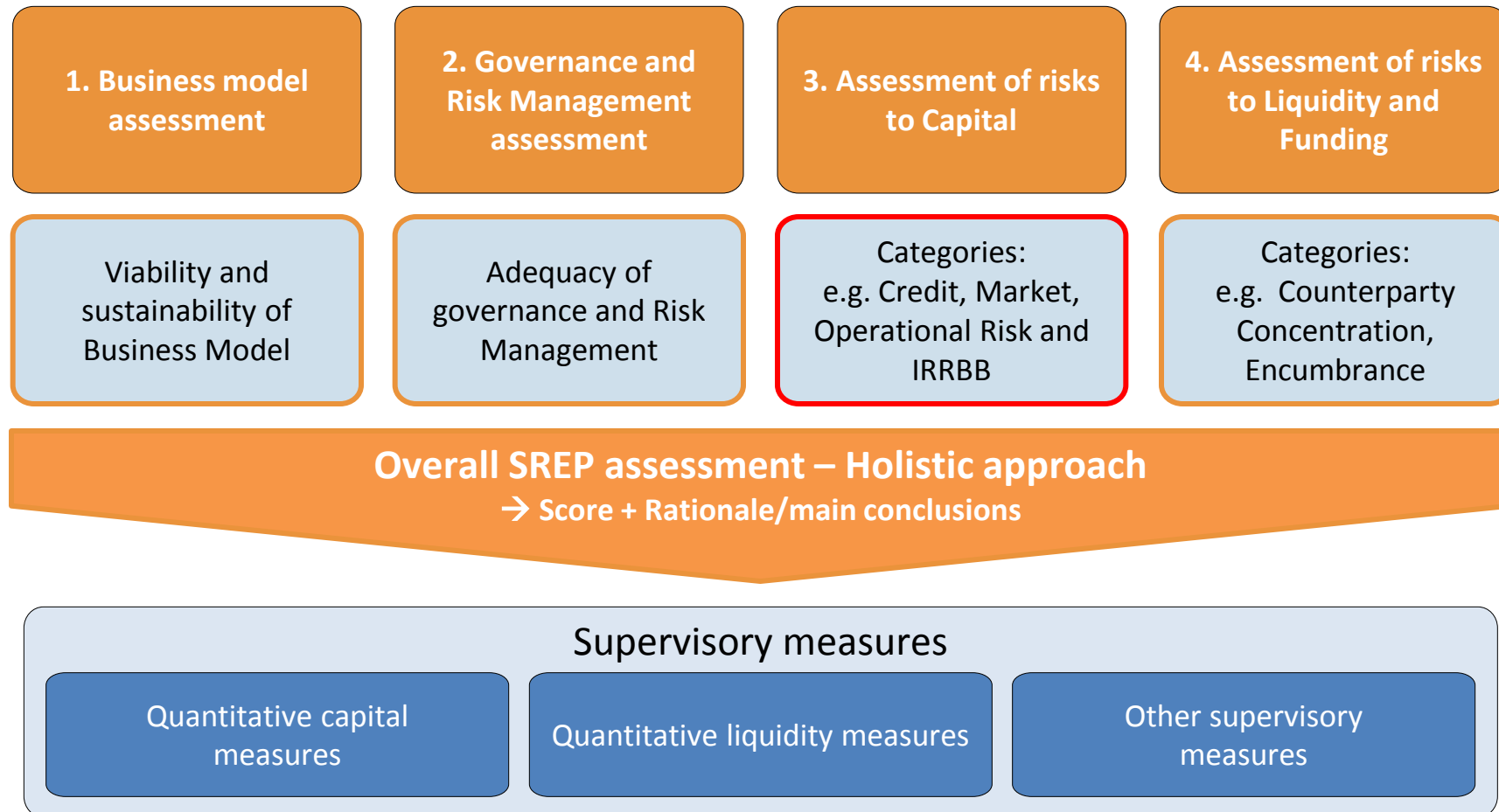
The right balance between Anchoring and Judgment

- **SSM SREP serves two main outcomes:**
 - A decision on the capital/liquidity requirements and other corrective measures
 - An input for determining the minimum supervisory level of engagement and the related Supervisory Examination Programme (SEP)
- **SSM SREP strikes a balance between:**
 - Quantitative and qualitative information
 - Past data and forward-looking elements
 - Anchor points and flexibility (“constrained judgment”)

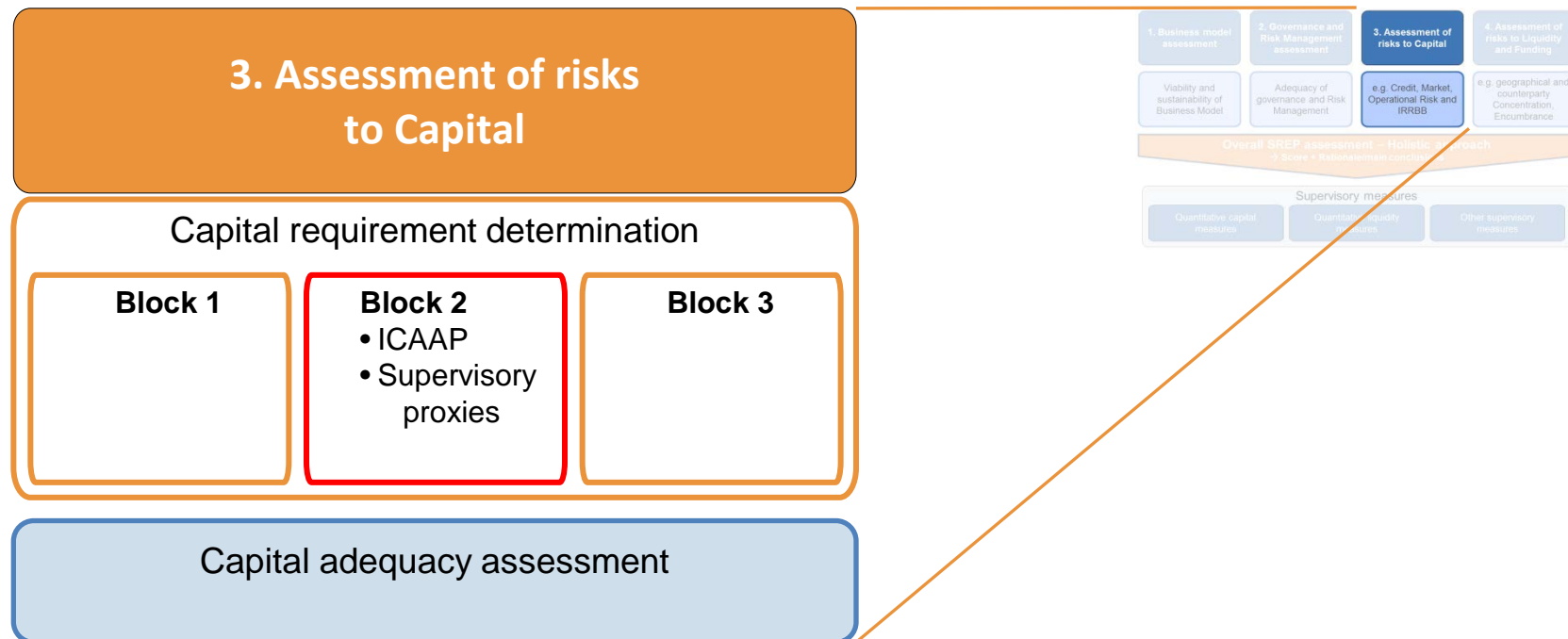
What do SSM proxies stand for?

- Quantitative
- Based on past data
- Forward-looking
- Anchor points

SSM SREP assessment



Block 2 as part of the SSM SREP assessment



SSM combines different complementing angles
→ SSM proxies are one of them

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Role of SSM proxies

■ SSM puts very strong emphasis on ICAAP reliability

- SSM proxies are there to challenge the banks' estimates and to foster convergence by avoiding a too qualitative approach based on judgement
- Give a rough quantification of the capital demand of Pillar 1 and non-Pillar 1 risks
- Allow JST to put institution's estimates in perspective and underpin the supervisory dialogue
- Do not provide a single risk figure, but indicative ranges for JSTs to derive risk-by-risk capital figures based on their judgment

■ SSM Proxy implementation process

- Re-use existing tools from SSM NCAs => align to the best practice and not to the lowest common denominator
- Develop new in-house tools

Role of SSM proxies

■ Development of SSM proxies :

- Proxies for the 4 risk categories are developed and are operational
- **In the end, however, supervisors apply judgment when determining capital add-ons.**
- **Judgment is**
 - Limited by pillar 1 as a floor, risk-by-risk
 - Guided by indicative SSM proxy ranges
 - Limited by the exclusion of intra-risk diversification effects
 - Taking into account peer comparisons
 - justified and documented

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Available SSM proxies

■ Credit Risk

- For some asset classes, the regulatory approaches underestimate capital and for some others they overestimate it.
- We calculate proxies of PD, LGD and RWA for 9 portfolios

■ Concentration Risk

- Concentrations to single names, sectors or geographic regions are not adequately captured under Pillar 1.
- We calculate HHI on single names and apply a granularity adjustment

■ Market Risk

- Market risk is not entirely captured
- We calculate a market risk figure for all positions, regardless of whether they are in the TB or in the BB.

■ Interest Rate Risk in the Banking Book

- Need for a complementary approach to the 200 bp shock
- We calculate a Value at Risk (VaR) on the basis of contractual maturities



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