

### 3. Using a common scoring framework

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# Outline

## 1. Types of scores

- Risk scores
- Viability scores
- Overall SREP Score

## 2. Objectives of the scoring

## 3. Considerations for assigning the scores

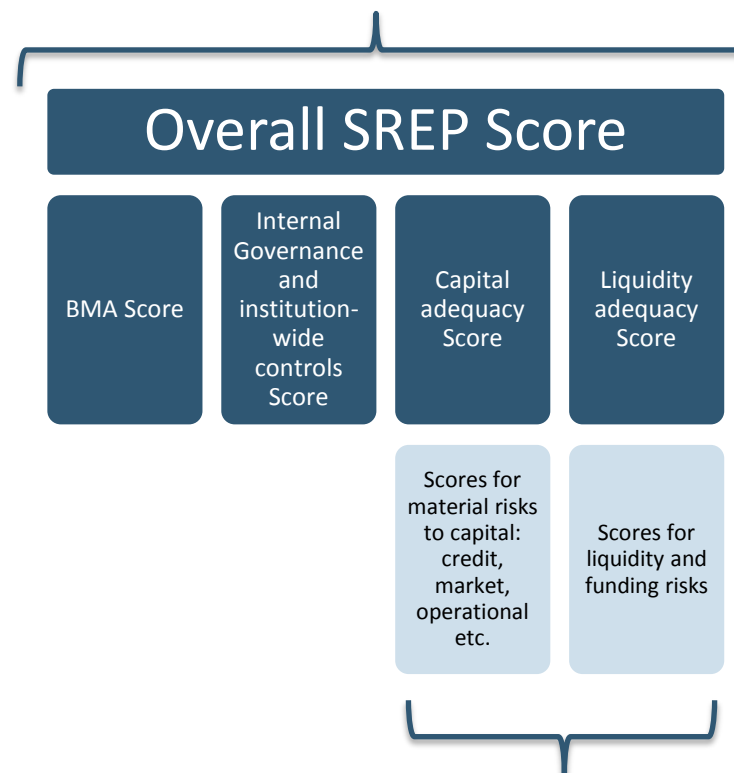
## 4. Using the scores

# Types of scores: risk and viability

Competent authorities should score:

- business model and strategy
- internal governance and institution-wide controls
- individual risks to capital
- capital adequacy
- individual risks to liquidity and funding;
- liquidity adequacy
- overall SREP assessment

Viability scores. Focus on the magnitude of risk to the viability of an institution



Risk scores. Focus on the magnitude of risk of significant prudential impact having considered the level of inherent risk and the management and controls

# General principles applied to scoring

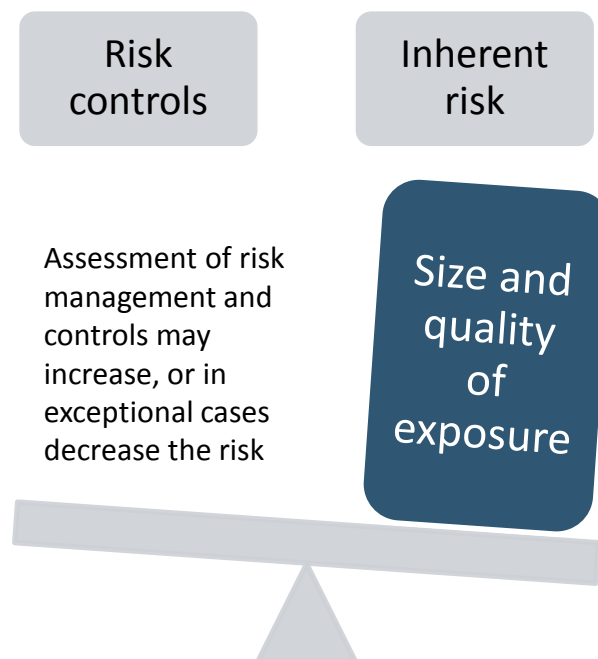
- All scores use the same grades '1' (no discernible risk) to '4' (high risk) scale
- All scores are defined and supported by 'supervisory consideration', although there are no matrixes or formulas
  - aim of 'supervisory consideration' is to support supervisory judgement
  - it is not necessary for the institution to fulfil all the 'considerations' linked to a score of '1' to achieve a score of '1'
  - score of '4' should be assigned to reflect the worst possible assessment (i.e. even if the institution's position is worse than that envisaged by the 'considerations' for a score of '4', a score of '4' should still be assigned)
- Aggregation is judgement based
  - However, in the national implementation CAs may introduce aggregation methodologies and more granular scoring for internal purposes (e.g. planning of resources) → all college interaction and communication with institutions should use EBA scale
- Communication of scores to institution is left for CAs to decide → need to consider potential disclosure obligations by institutions

# Risk scores

- Risk scores should be assigned to all material risks to capital, and risks to liquidity and funding
- Risk scores provide an indication of the level of risk of significant impact on the institution after considering the level of inherent risk and the quality of risk controls

Risk score	Supervisory view
<b>1</b>	There is no discernible risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.
<b>2</b>	There is a low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.
<b>3</b>	There is a medium risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.
<b>4</b>	There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.

Risk scores are exposure driven assuming that the controls are adequate



## Viability scores (1/2)

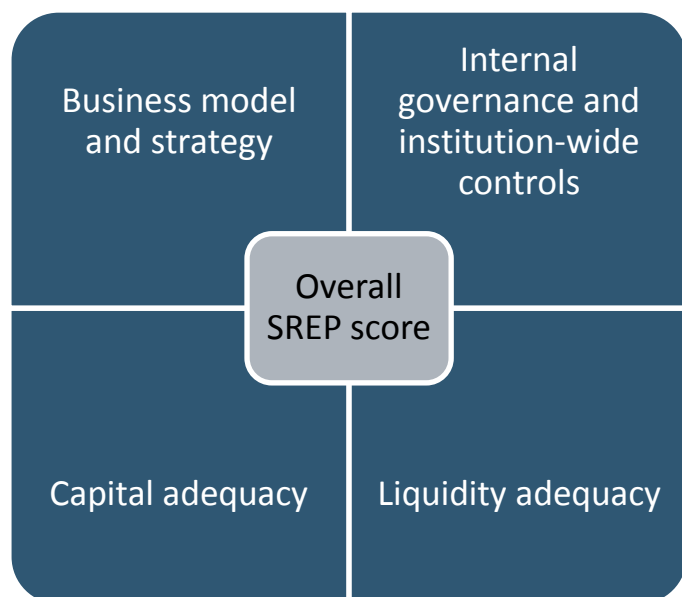
- Provide an indication of the threat posed to the institution's viability by the SREP elements assessed, given the individual risk assessments
- Indicate the likelihood that supervisory measures should be taken to address concerns
- Indicate the likelihood that early intervention measures should be taken, and act as a trigger for them
- Assigned on the basis of supervisory judgement

## Viability scores (2/2)

Score	Business model and strategy	Internal governance and controls	Capital adequacy	Liquidity adequacy
1	The business model and strategy pose no discernible risk to the viability of the institution.	Deficiencies in internal governance and institution-wide control arrangements pose no discernible risk to the viability of the institution.	The quantity and composition of own funds held pose no discernible risk to the viability of the institution.	The institution's liquidity position and funding profile pose no discernible risk to the viability of the institution.
2	The business model and strategy pose a low level of risk to the viability of the institution.	Deficiencies in internal governance and institution-wide control arrangements pose a low level of risk to the viability of the institution.	The quantity and composition of own funds held pose a low level of risk to the viability of the institution.	The institution's liquidity position and/or funding profile pose a low level of risk to the viability of the institution.
3	The business model and strategy pose a medium level of risk to the viability of the institution.	Deficiencies in internal governance and institution-wide control arrangements pose a medium level of risk to the viability of the institution.	The quantity and composition of own funds held pose a medium level of risk to the viability of the institution.	The institution's liquidity position and/or funding profile pose a medium level of risk to the viability of the institution.
4	The business model and strategy pose a high level of risk to the viability of the institution.	Deficiencies in internal governance and institution-wide control arrangements pose a high level of risk to the viability of the institution.	The quantity and composition of own funds held pose a high level of risk to the viability of the institution.	The institution's liquidity position and/or funding profile pose a high level of risk to the viability of the institution.

# Overall SREP score (1/2)

- Overall SREP score supports the Overall SREP assessments → summary/synthesis of the findings from the assessment of all SREP elements, considering:
  - the risks to which the institution is or may be exposed
  - the likelihood that the institution's governance, control deficiencies and/or business model or strategy are likely to exacerbate or mitigate these risks, or expose the institution to new sources of risk
  - whether the institution's own funds and liquidity resources provide sound coverage of these risks



## Important to consider:

- SREP elements combine each other and can play as a mitigation or as an amplification of other elements' weaknesses/strengths
- The potential for positive and negative interaction between the elements:
  - strong capital position may be a potential mitigating factor for certain concerns identified in the area of liquidity and funding, or by contrast, that a weak capital position may exacerbate concerns in that area



# Overall SREP score (2/2)

- Provide an indication of the institution's overall viability → proximity to the point of non-viability
- Indicate the likelihood that early intervention measures should be taken, and act as a trigger for them
- Determine, through the assessment of the overall viability of the institution, whether that institution is failing or likely to fail
- Assigned on the basis of supervisory judgement

Score	Supervisory view
1	The risks identified pose no discernible risk to the viability of the institution.
2	The risks identified pose a low level of risk to the viability of the institution.
3	The risks identified pose a medium level of risk to the viability of the institution.
4	The risks identified pose a high level of risk to the viability of the institution.
F	The institution is considered to be 'failing or likely to fail'.

- There is an immediate risk to the viability of the institution
- The institution meets the conditions for 'failing or likely to fail', as specified in Article 32(4) of Directive 2014/59/EU
- CA enters into interaction with resolution authority (consultation on determination FOLF)

# Scores and supervisory measures

There is no mechanistic link between the scores and supervisory measures, but...

## Risk scores

- Do not necessarily mean that supervisory measures are needed, but provide an indication for that → risk might be already covered by own funds
- Do not necessarily imply that there is a need for additional own funds requirements as they do not consider capital → risk might be already covered by own funds

## Viability scores

- Provide an indication that supervisory measures are needed
- In certain instances require decision on the application of early intervention measures

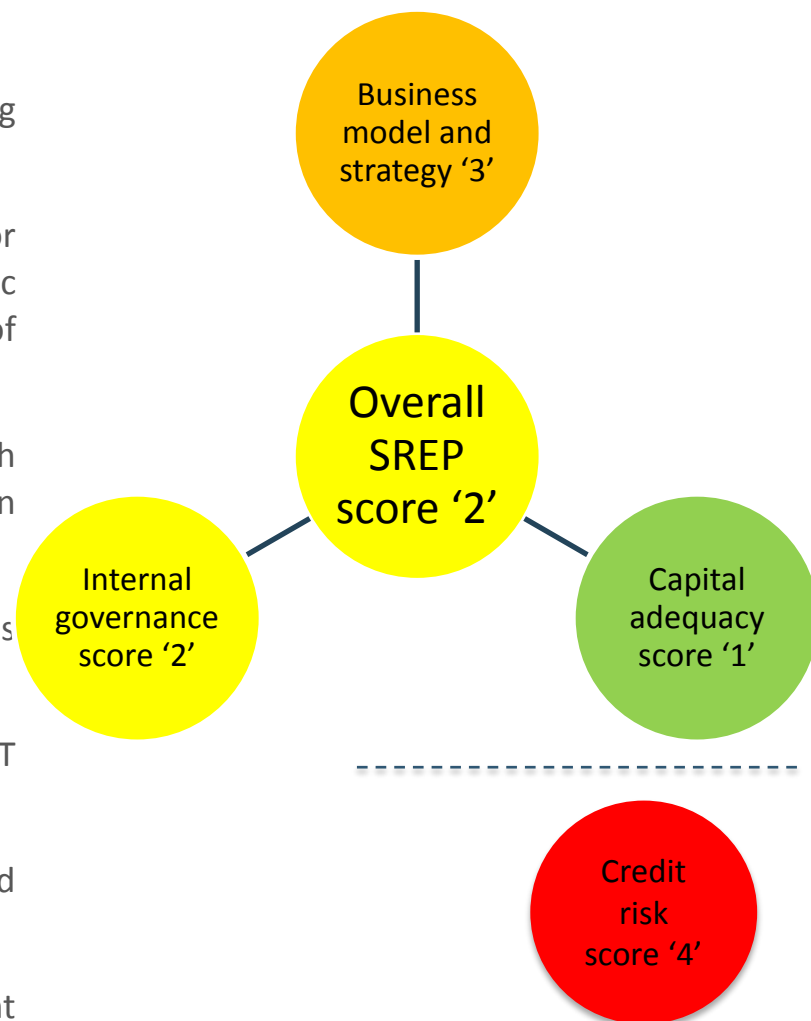
**NB!** There is no direct link between the capital adequacy score (and Overall SREP score) and level of TSCR:

- TSCR is determined based on the risk unexpected losses and other considerations
- Capital adequacy score considers adequacy of existing own funds to meet TSCR

# Application of scoring: Example (1/2)

## Situation:

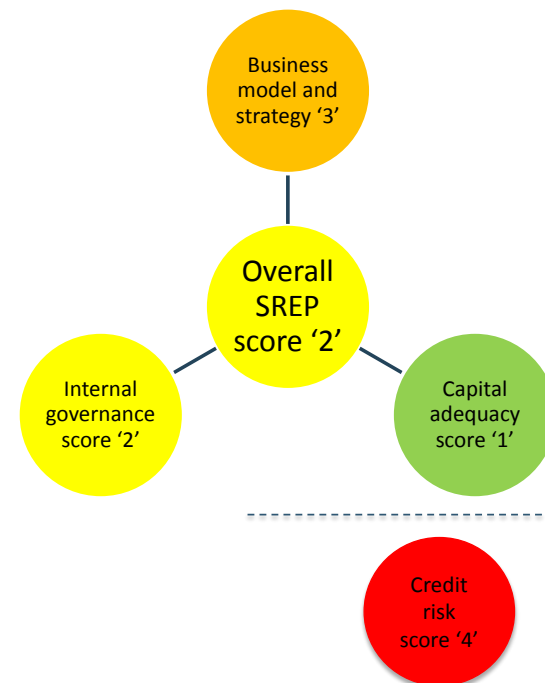
- Institution is concentrating on high-margin consumer lending and buy-to-let property lending
- The model so far has proved profitable and there is room for further expansion, however overall macro-economic conditions in the country have started showing signs of deterioration
- Institutions considers expansion to other EU markets with the similar offering, but choses markets on potential return rather than cultural or business experience
- Governance model is overall good, but remuneration policies encourage aggressive sales
- Risk management and controls are best in class, especially IT infrastructure
- Despite high levels of NPLs, the profits are still there and capital position is 35% CET1
- Very strong investor base willing to support the management and institution long-term



## Application of scoring: Example (2/2)

### SREP conclusions:

- Credit risks are high due to high concentrations in risk exposures and poor quality of assets even despite the fact that controls and risk management systems are best in class  
→ **Credit risk score '4'**
- Due to high credit concentration risk, poor credit quality and risk asset composition supervisors require institutions to hold additional own funds for credit risk and concentration risk  
→ **TSCR is set to 19% CET1**
- Institution has high capital base, profitability and strong investor base. Stress tests reveal no breaches of TSCR  
→ **Capital adequacy score is '1'**
- Governance and institution-wide controls are of good quality, but problems with remuneration policies raise concerns and the bank is required to fix them  
→ **Internal governance score is '2'**
- Business model is viable, but concerns over sustainability of strategy given the choice of markets for expansion, and future deterioration of macro conditions  
→ **BMA score is '3'**



Overall there are no major concerns regarding the viability of this institution, but credit risk as well as business model changes will need to be followed



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