Review of SREP Guidelines
Public hearing
31 August 2021
Overview

Agenda

- EBA presentation
  - Introduction and timelines
  - SREP framework
  - Main revisions of SREP Guidelines
  - Questions for consultations

- Questions and comments from participants

House keeping rules

- To avoid background noise please remain muted, unless you take the floor

- To increase audio quality please turn off video streaming, unless you take the floor

- If you would like to intervene:
  - please indicate that on Webex chat, or
  - write your question / comment in Webex chat

- Whenever intervening please identify yourself by providing:
  - your full name (unless already used on Webex)
  - name of your organisation
Introduction and timelines
Revision of SREP Guidelines – introduction

- Revision set out in **Pillar 2 Roadmap** published as part of the EBA risk reduction measures package in November 2019

- **Main objectives** of the current review of the SREP Guidelines are to:
  - reflect the changes in the revised CRD-CRR framework
  - update the Guidelines where necessary in view of other regulatory developments, including other EBA guidelines and technical standards
  - improve the Guidelines considering practical application experience and with a view to enhancing the application of the principle of proportionality

Further amendments may be necessary in the future:

- Potential further streamlining of the Guidelines
- Further clarifications on IRRBB and CSRBB
- Further consideration of ESG factors
Developments of the SREP Guidelines

**Implementation**
- **2014**
  - First publication of SREP GL applicable
- **2016**
  - First SREP GL applicable
- **2018**
  - First revision of SREP GL applicable
- **2019**
  - Revised SREP GL applicable
- **2021/2022**
  - Second revision of SREP GL applicable
- **2022/2023**
  - Revised SREP GL applicable
- **Implementation of future revisions**

**Development**
- **2014**
  - Updates on governance
  - Clarifications on scoring
  - New chapter on supervisory stress-testing
- **2016**
  - First SREP GL applicable
- **2018**
  - First revision of SREP GL applicable
- **2019**
  - Revised SREP GL applicable
- **2021/2022**
  - Second revision of SREP GL applicable
  - Comprehensive review (see next slides)
- **2022/2023**
  - Revised SREP GL applicable
- Future revisions
  - Further streamlining
  - IRRBB and CSRBB
  - ESG
  - ....
Timelines for the revision of SREP Guidelines

- Publication of the CP on revised SREP GLs: 26 June 2021
- Public hearing: 31 August 2021
- Deadline for providing consultation responses: 28 September 2021
- Publication of final revised SREP GLs: By March 2022
SREP framework
Mandate – Article 107(3) CRD

- Article 107(3) of Directive 2013/36/EU mandates the EBA to issue guidelines on the SREP:

CRD Articles:
76 – Treatment of risks
77 – Internal Approaches for calculating own funds requirements
78 – Supervisory benchmarking
79 – Credit and counterparty risk
80 – Residual risk
81 – Concentration risk
82 – Securitisation risk
83 – Market risk
84 – IRRBB
85 – Operational risk
86 – Liquidity risk
87 – Risk of excessive leverage

EBA shall issue guidelines addressed to the competent authorities in accordance with Article 16 of Regulation (EU) No 1093/2010 to further specify, in a manner that is appropriate to the size, the structure and the internal organisation of institutions and the nature, scope and complexity of their activities, the common procedures and methodologies for the supervisory review and evaluation process referred to in paragraph 1 of this Article and in Article 97 and for the assessment of the organisation and treatment of the risks referred to in Articles 76 to 87, in particular relating to concentration risk in accordance with Article 81.
Overview of the common SREP framework

Supervisory review and evaluation process (SREP):

- at the core of supervision bringing together outcomes of all other supervisory activities into a comprehensive supervisory overview
- to ensure that institutions have sound management and coverage of risks they are or might be exposed to:
  - adequate arrangements, processes and mechanisms
  - adequate capital and liquidity
- applied in line with the principle of proportionality
Overview of the common SREP framework

<table>
<thead>
<tr>
<th>Categorisation of institutions</th>
<th>Monitoring of key indicators</th>
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<tbody>
<tr>
<td>Business Model Analysis</td>
<td>Assessed of internal governance and institution-wide controls</td>
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<td>Assessment of internal governance and institution-wide controls</td>
<td>Assessment of inherent risks and controls</td>
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<td>Determination of own funds requirements &amp; stress testing</td>
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<td>Capital adequacy assessment</td>
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<td>Assessment of inherent risks and controls</td>
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<td>Determination of liquidity requirements &amp; stress testing</td>
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<td>Liquidity adequacy assessment</td>
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**Proportionality** (frequency and intensity of assessment)

**Sources of information:**
- Supervisory reporting
- Inspections and off-site reviews
- Information from the institutions (ICAAP & ILAAP)
- Benchmark calculations and comparisons to peers
- Supervisory judgement
- Any other relevant inputs
Main changes introduced by the CRD V

**Institution-specific character of Pillar 2:**
- Impossibility to use P2R for macro-prudential purposes, systemic risk taken out of Pillar 2

**More specific conditions for setting P2R,** more prominent requirement for risk-by-risk assessment and the use of ICAAP:
- Elements explicitly excluded or not explicitly addressed or likely to be underestimated despite compliance with Pillar 1 requirements
- Obligation to first consider other supervisory measures (governance, ICAAP, large exposures)
- Supervisory flexibility – P2R where institution-specific situation raises material concern

**Minimum requirements for the quality of capital,** but possibility to increase in institution-specific situation

**Pillar 2 Guidance:**
- Forward-looking guidance based on stress-tests
- Failure to meet P2G will not trigger restrictions but possibility to transfer into P2R if repeatedly failed

**Risk of excessive leverage:**
- Introduced as a parallel requirement
- P2G on top of 3% LR, additional requirement for risk of excessive leverage and LR buffer requirement

**Amendments to supervisory powers,** including specific mention of outsourced activities and stricter conditions for additional reporting

**Increased accountability:**
- Decisions duly justified to institutions in writing, providing a clear account on all elements
## Stacks of own funds requirements

### TREA-based stack of own funds requirements

<table>
<thead>
<tr>
<th>Combined buffer requirement</th>
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<tr>
<td></td>
<td>Pillar 1 minimum requirements</td>
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<td></td>
<td>Capital conservation buffer (CCB)</td>
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<td>Systemic risk buffer (SRB)</td>
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<td></td>
<td>G-SII / O-SII buffer</td>
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<td>Pillar 2 guidance for risks other than the risk of excessive leverage (P2G)</td>
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<tr>
<td>TSCR&lt;sup&gt;1&lt;/sup&gt;</td>
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### LR-based stack of own funds requirements

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<tr>
<td></td>
<td>Leverage ratio (LR) minimum requirement</td>
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<td>Pillar 2 requirements for the risk of excessive leverage (P2R-LR)</td>
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<tr>
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<td>G-SII leverage ratio buffer</td>
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<tr>
<td>OCR&lt;sup&gt;2&lt;/sup&gt;</td>
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<td></td>
<td>TSLRR&lt;sup&gt;3&lt;/sup&gt;</td>
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### Notes

1. TSCR – total SREP capital requirement
2. OCR – overall capital requirement
3. TSLRR – total SREP leverage ratio requirement
4. OLRR – overall leverage ratio requirement

*Scale not meaningful*
Main revisions of SREP Guidelines
Title 1: Subject matter, definitions, level of application and implementation

- **Update of definitions**, including:
  - definition of money laundering and terrorist financing (ML/TF) risks
  - definition of AML / CFT supervisor
  - definitions related to the leverage ratio based stack of requirements

- **Date of application**: implementation needed as soon as possible considering that CRD V is already in force

- **Definition of risk appetite unchanged** – wording aligned across the text of the GL (no longer referring to risk tolerance)

*References to ML / TF risk included across the text in line with the EBA Opinion of November 2020*
Title 2: The common SREP

- **Review of categorisation:** to enhance proportionality:
  - Category 1: reflecting CRR definition of large institutions
  - Category 4: reflecting CRR definition of small and non-complex institutions
  - Flexibility in categorisation

- **Streamlined drafting**

- **Minimum engagement model:**
  - Category 4: tailored scope and depth of review
  - All categories:
    - tailored methodologies for institutions with similar risk profiles
    - possibility to determine specific focus of SREP (but sufficient scrutiny for all SREP elements)
    - granularity appropriate for the size and business model if the institution and the nature, scale and complexity of its activities
Title 3: Monitoring of key indicators

- Indicators used for monitoring should include **indicators that may point to ML/TF risk** (where available)

Title 4: Business model analysis

- BMA should include **assessment of prudential implications of ML/TF risks** linked to the business model of the institution, including analysis of specific indicators

- Key vulnerabilities to which the business model may expose the institution include:
  - excessive concentrations or volatility of high risk customers and countries (related to ML/TF risks)
  - impact of ESG risks
Title 5: Assessment of governance

- **Alignment with other regulatory developments** (GL on internal governance, GL on sound remuneration, GL on fit and proper, GL on outsourcing arrangements), including:
  - diversity policy, gender neutrality
  - conflicts of interest resulting from transactions with related parties
  - appropriate remuneration policies and practices

- **Internal control function**: dedicated sections on risk management and compliance functions

- **Information and communication technologies**: enhanced guidance on aggregated risk data

- Governance arrangements and mechanisms to ensure **compliance with AML / CFT requirements**

- **ML/TF risks and prudential concerns**:  
  - exchange of information with AML/CFT supervisors
  - ML/TF risk management framework
  - suitability of management body and key function holders, their competencies and responsibilities

- **Code of conduct**: principles and examples of acceptable and unacceptable behaviours linked to financial misreporting, misconduct, economic and financial crime

- **Assessment of institutions’ stress testing**:  
  - alignment with GL on institutions’ stress testing
  - drafting streamlined
Title 6: Assessment of risks to capital

<table>
<thead>
<tr>
<th>Type of risk</th>
<th>Main revisions</th>
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<tbody>
<tr>
<td>Credit risk</td>
<td>• References to GL on loan origination and monitoring and GL on management of non-performing and forborne exposures</td>
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<td></td>
<td>• Policies and processes to manage ML/TF risks resulting from credit granting process</td>
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<td></td>
<td>• Proportion of transactions to third country CCPs (especially UK)</td>
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<tr>
<td>Market risk</td>
<td>• Limited changes, correction of wording and references</td>
</tr>
<tr>
<td>Operational risk (including ICT risk)</td>
<td>• Increased prominence of ICT risk (references to GL on ICT risk assessment under SREP and GL on ICT and security risk)</td>
</tr>
<tr>
<td></td>
<td>• Analysis of institution’s exposure to ML/TF risk</td>
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<tr>
<td></td>
<td>• Reputational risk to also include ML/TF considerations</td>
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<td>• Alignment with GL on outsourcing arrangements</td>
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<tr>
<td>IRRBB / CSRBB</td>
<td>• Alignment with CRD requirements and references to future RTS and GL (without preempting policy decisions)</td>
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<td>• CSRBB to be assessed separately from IRRBB</td>
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Title 7: SREP capital assessment (P2R and P2R-LR setting)

**P2R for risks other than the risk of excessive leverage:**
- Institution-specific character of Pillar 2 add-ons
- Clarifications on the risk-by-risk approach, incl. application of Pillar 1 floor on a risk-by-risk basis
- Clarifications on the use of ICAAP:
  - for identification and assessment of risks – ICAAP information and results of assessment
  - for quantification of P2R – ICAAP calculations if the figures are reliable
- Clarifications on setting P2R for deficiencies in internal governance, business model and internal models (after considering other supervisory measures)
- Minimum capital composition and possibility to require higher quality of capital based on institution-specific circumstances

**Assessment of risk of excessive leverage:**
- Taking into account the leverage ratio and its dynamics, as well as any hidden leverage due to arbitrage / optimisation practices
- Specific question for consultations on the relevance of the methodology used in 2016 leverage ratio calibration report (stability of profitability, funding and business activity, and degree of concentration)

**P2R-LR for the risk of excessive leverage:**
- Similarly as for other risks, reference to the same sources of information and the use of ICAAP
- To consider exclusions in Article 429a CRR and elements of REL not sufficiently covered by LR
- P2R-LR to be covered by Tier 1 capital, with a possibility to require higher quality of capital if justified
Title 7: SREP capital assessment (articulation and communication of own funds requirements)

Specification of metrics

- Highlighting two separate stacks of requirements
- Presenting the composition of capital
- In line with revised COREP

\[
\begin{align*}
TSCR & = \frac{TSCR}{TREA} \\
TSLRR & = \frac{TSLRR}{LRE} \\
OCR & = TSCR + \text{combined buffer requirement} \\
OLRR & = TSLRR + \text{G-SII LR buffer under Article 92(1a) CRR}
\end{align*}
\]

Structured dialog with institutions

- Justification of additional requirements:
  - Separately for P2R and P2R-LR – providing main drivers underlying the requirement
  - Referring to categories / subcategories of risks
  - Pointing out identified deficiencies in governance, business model or internal models, which contribute to additional requirements, with expected timeline for rectifying them
  - Institution-specific justification in case higher quality of capital required
Title 7: SREP capital assessment (P2G and P2G-LR)

- **Revised methodology for setting P2G and P2G-LR**
  - Possibility to use bucketing approach:
    - Buckets based on P2G starting point, i.e. capital depletion under adverse scenario adjusted by CCB and, where relevant, static BS assumption and different time horizon
    - Buckets may overlap to avoid cliff effects
    - Final P2G to be set within the range of the bucket or exceptionally outside of it
  - Possibility to use simplified forms of stress tests for proportionality purposes
  - Separate P2G-LR based on Tier 1 depletion

- **Composition of capital**
  - **P2G**: to be covered by CET1, in line with current SREP GL
  - **P2G-LR**: specific consultation question on capital instruments that could be used to cover losses

- **Communication**
  - Specific question for consultations to gather views on possible disclosures related to P2G levels and, where used, the ranges of buckets
    - Related to ESMA Consultation Paper: Review of MAR Guidelines on delay in the disclosure of inside information and interactions with prudential supervision
Title 8: Assessment of liquidity and funding risk

- **Alignment with regulatory developments:**
  - Introduction of LCR – references to RTS on liquidity coverage requirement (CDR 2015/61)
  - Introduction of NSFR by CRR 2
  - Best practices in the first and second monitoring reports on LCR implementation

- **Assessing liquidity risk:**
  - Further specification of indicators to assess
    - Internal limits to concentration of liquid assets
    - Internal limits to currency mismatch
    - Concentration of outflows maturities
    - Central bank funding within liquid assets
  - Usage of liquidity buffer under stress in the liquidity contingency plan
  - ML/TF risks affecting liquidity position

Title 9: SREP liquidity assessment

- **Specific quantitative stable funding requirements:**
  - Higher NSFR
  - Higher available stable funding

- **Assessing funding risk:**
  - NSFR as a minimum funding risk metric
  - Funding risk not covered by NSFR
  - Further specification of indicators to assess
    - Internal limits to currency mismatch
    - Concentration of funding
  - Funding characteristics indicating ML/TF risk
Title 10: Application of supervisory measures

- **Measures related to ML/TF risks:**
  - after liaising with AML/CFT supervisors
  - additional own funds requirements only where this is considered more appropriate than other supervisory measures and only as an interim measure

- **Clarifications on possible measures**
  - related eg. to outsourced activities, credit risk, operational risk, IRRBB
  - legal references to supervisory powers related to liquidity and funding risk

- **Interaction with macro-prudential measures:**
  - text streamlined taking into account institution-specific character of Pillar 2

- **Interaction between supervisory and AML/CFT measures:**
  - Assessment of the impact of deficiencies on the prudential situation of the institution
  - Interaction with AML/CFT supervisors when considering the most appropriate measures

Title 11: Cross-border groups

- Consideration of ML/TF risks linked to the cross-border group structure
- Information from AML/CFT supervisors
- Discussions in AML/CFT and prudential colleges
Questions for consultations
Questions for consultation purposes

1) How could the guidelines be further simplified in a way that appropriate focus of assessment is allowed while preserving the comprehensiveness of the assessment and ensuring that all aspects are sufficiently covered?

2) Do you think that the proposed overall framework for setting additional own funds requirements appropriately incorporates the ICAAP information and estimates?

3) Do you agree with the proposed clarifications on the assessment of the risk of excessive leverage?

4) Do you think that the assessment of dimensions and indicators described in the explanatory box would also be relevant for the assessment of the risk of excessive leverage? Are there any other elements / indicators that you are using in the assessment of this risk?

5) Can you provide examples of situations which in your view might require CET1 instead of other capital instruments to cover potential losses in relation to P2R and P2R-LR?

6) Would you consider the introduction of a standardised template for the communication to the supervised institution of the outcome of the SREP to be beneficial?

7) What are your views on the proposed guidance for setting P2G and P2G-LR? Is it sufficiently clear?

8) What are your views on possible disclosures, which may be attached to P2G and/or ranges of buckets in case they are identified?

9) What are your views on the capital instruments potentially used to cover losses in relation to P2G-LR? Please provide the rationale or specific examples for your views.
Thank you!