

EBA/CP/2017/18

31 October 2017

Consultation Paper

Draft Guidelines

on the revised common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing

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Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in the “Overview of questions for consultation” section.

Comments are most helpful if they:

- respond to the questions stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the ‘send your comments’ button on the consultation page by 31 January 2018. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA’s rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA’s Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

Executive Summary

The comprehensive common EU SREP framework is well established since 2014 and has been applied in practice since 2016. While the framework remains robust and serves the purpose of ensuring convergence of supervisory practices, certain changes are deemed necessary to reinforce the framework in light of the recent developments in the EU and international fora. Furthermore, revisions to the framework are necessary in order to reflect EBA findings from the ongoing monitoring and assessment of convergence of supervisory practices.

In accordance with the EBA Pillar 2 Roadmap¹, where the EBA's multi-stage approach to the update of the EU SREP framework in 2017- 2018 and beyond is outlined, the EBA has developed and is now publishing for consultation the first revisions of the SREP framework. The revisions of the SREP Guidelines reflect the ongoing policy initiatives related to Pillar 2/SREP, which include amongst other things, the introduction of Pillar 2 Capital Guidance (P2G), the integration of supervisory stress testing requirements and supervisory assessment of banks' stress testing from the EBA Consultation paper on Guidelines on stress testing and supervisory stress testing², clarification of certain aspects on scoring, further details on the articulation of TSCR and OCR and various consistency checks with relevant EBA standards and guidelines that came into force after the publication of the original SREP Guidelines in 2014.

These revised Guidelines, which now also cover supervisory stress testing, aim at achieving convergence of practices followed by competent authorities in supervisory stress testing across the EU. They provide guidance with a view to ensuring convergence for supervisory stress testing in the context of SREP performed by competent authorities in accordance with Article 100 of Directive 2013/36/EU. These revised Guidelines are issued partially to cover and update the CEBS Guidelines on stress testing³, which will be repealed and replaced by these Guidelines, and partially on the basis of Article 100(2) of Directive 2013/36/EU to cover supervisory stress testing. It is noted that supervisory stress testing is established in Article 100 of Directive 2013/36/EU as an obligation of competent authorities independent and distinct from the official sector Union-wide stress test already foreseen since 2010 in the Article 22 of Regulation (EU) 1093/2010.

Next steps

The EBA will finalise these revisions following the public consultation. These revisions will amend, where relevant, and supplement the existing SREP Guidelines, published on 19 December 2014, once they enter into force. The EBA is updating in parallel its Guidelines on IRRBB in the context of the supervisory review process and finalising the draft Guidelines on institution's stress testing after the public consultation.

¹ <https://www.eba.europa.eu/documents/10180/1814098/EBA+Pillar+2+roadmap.pdf>

² [Consultation Paper: Draft Guidelines on stress testing and supervisory stress testing \(EBA/CP/2015/28\)](#)

³ https://www.eba.europa.eu/documents/10180/16094/ST_Guidelines.pdf

These revisions, which are introduced in the initial SREP Guidelines, will apply from 1 January 2019 and should therefore be applied in the 2019 cycle of SREP and joint decisions on institutions-specific prudential requirements.

Background and rationale

1. In EBA's continuous efforts to maintain the SREP Guidelines, published on 19 December 2014 and in force since January 2016, updated with the EU and international standards and promote best supervisory practices as well as address issues identified in its ongoing work on assessment of supervisory convergence, revisions of the SREP framework are considered essential.
2. Since the publication and first application of the SREP Guidelines there have been also a significant number of external developments affecting the SREP framework, needed to be reflected in the revised Guidelines. In particular, these relate, for example, to the use of supervisory stress testing in SREP and wider introduction of P2G in the 2016 EU-wide stress test⁴, the revision by the Basel Committee on Banking Supervision of its IRRBB framework⁵, which needs to be implemented in the EU legislation, and the clarification of the European framework for the application of maximum distributable amount (MDA)⁶.
3. Furthermore, during EBA's ongoing work on the monitoring and assessment of supervisory convergence, a number of significant observations⁷ have been noted with respect to the practical application of supervisory practices as well as specific areas have been identified that need to be reflected in the SREP framework and factored in the revised SREP Guidelines.
4. To this end, the revisions in the existing SREP Guidelines aim to refine and introduce the following: (1) Pillar 2 capital guidance and supervisory stress testing, (2) supervisory assessment of institution's stress testing, (3) alignment of supervisory assessment of IRRBB with the revision of the EBA Guidelines on IRRBB Guidelines, (4) scoring framework, (5) interaction between SREP elements, (6) articulation of total SREP capital requirements (TSCR) and overall capital requirements (OCR) and communication of supervisory capital expectations to the institutions, and (7) consistency with recently published legislation on internal governance.
5. As part of the assessment of capital adequacy, competent authorities should also determine whether applicable own funds requirements can be met in stressed conditions. Where the quantitative outcomes of relevant stress tests suggest that an institution may not be able to meet the applicable own funds requirements in stressed conditions, or is excessively sensitive to the assumed scenarios, competent authorities should take appropriate supervisory measures to ensure that the institution is adequately capitalised. These include

⁴ <https://www.eba.europa.eu/-/eba-clarifies-use-of-2016-eu-wide-stress-test-results-in-the-srep-process>

⁵ <http://www.bis.org/bcbs/publ/d368.htm>

⁶ <https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-24+Opinion+on+MDA.pdf>

⁷ <https://www.eba.europa.eu/documents/10180/1360107/EBA+report+on+the+convergence+of+supervisory+practices>

communicating expectations to institutions to have own funds over and above the combined buffer requirement (Pillar 2 capital guidance – “P2G”) and which are not subject to the restrictions on distributions provided for in Article 141 of Directive 2013/36/EU. In particular, these revisions outline how competent authorities should establish and set Pillar 2 capital guidance based on supervisory stress test results.

6. Furthermore, these revisions cover supervisory stress testing for SREP purposes in accordance with Article 100 of Directive 2013/36/EU and supervisory assessment of the institution’ own stress testing. Article 100(2) of Directive 2013/36/EU empowers EBA to issue guidelines to ensure that common methodologies are used by competent authorities when conducting annual supervisory stress tests for SREP purposes.
7. The newly added supervisory stress testing section focuses on different forms of supervisory stress testing and objectives, the respective use for SREP purposes, the aspects related to the organisation, resources and communication, and possible methodologies. In particular, the supervisory stress testing section complements Section 7.7 by further clarifying and operationalising procedures for dealing with instances, where the results of stress tests would suggest than an institution will not be able to meet its applicable capital requirements.
8. Article 107 of Directive 2013/36/EU also mandates the EBA with monitoring and assessment of convergence of supervisory practices with particular emphasis on SREP practices and methodologies. Such convergence monitoring and assessment activities should also lead to the EBA keeping SREP Guidelines updated, therefore the EBA findings from the convergence monitoring and assessment are also reflected in these revisions.
9. To help facilitating communication within the competent authorities and colleges of supervisors, fostering comparability and level playing field between institutions as well as to prioritise supervisory resources and measures, further clarifications have been included in the assessment of SREP elements where competent authorities should score from a range of ‘1’ (low risk) to ‘4’ (high risk) to reflect the ‘supervisory view’ for each element-specific title of the Guidelines. These revisions further clarify the two types of scores introduced in the initial version of the SREP Guidelines: (1) risk scores to be applied to individual risks to capital, liquidity and funding that indicate likelihood that the risk will have a significant prudential impact on the institution (e.g. potential loss) and (2) viability scores to be applied to the four SREP elements and Overall SREP score that indicate the magnitude to risk to the institution’s viability stemming from a SREP element assessed.
10. Considering the fact that since the publication of the SREP Guidelines in 2014, the EBA has issued two guidelines explaining how SREP outcomes can be used for the purposes of early intervention and recovery and resolution (Guidelines on triggers for use of early intervention measures, EBA/GL2015/03⁸) and Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail

⁸ <https://www.eba.europa.eu/-/eba-publishes-its-final-guidelines-on-triggers-for-the-use-of-early-intervention-measures>

(EBA/GL/2015/07⁹) as well as progress with enhancing framework for the assessment of the institutions' recovery plans in the EBA Supervisory Handbook, it was important to better clarify the interaction between SREP and the supervisory processes covered in the above guidelines and Supervisory Handbook.

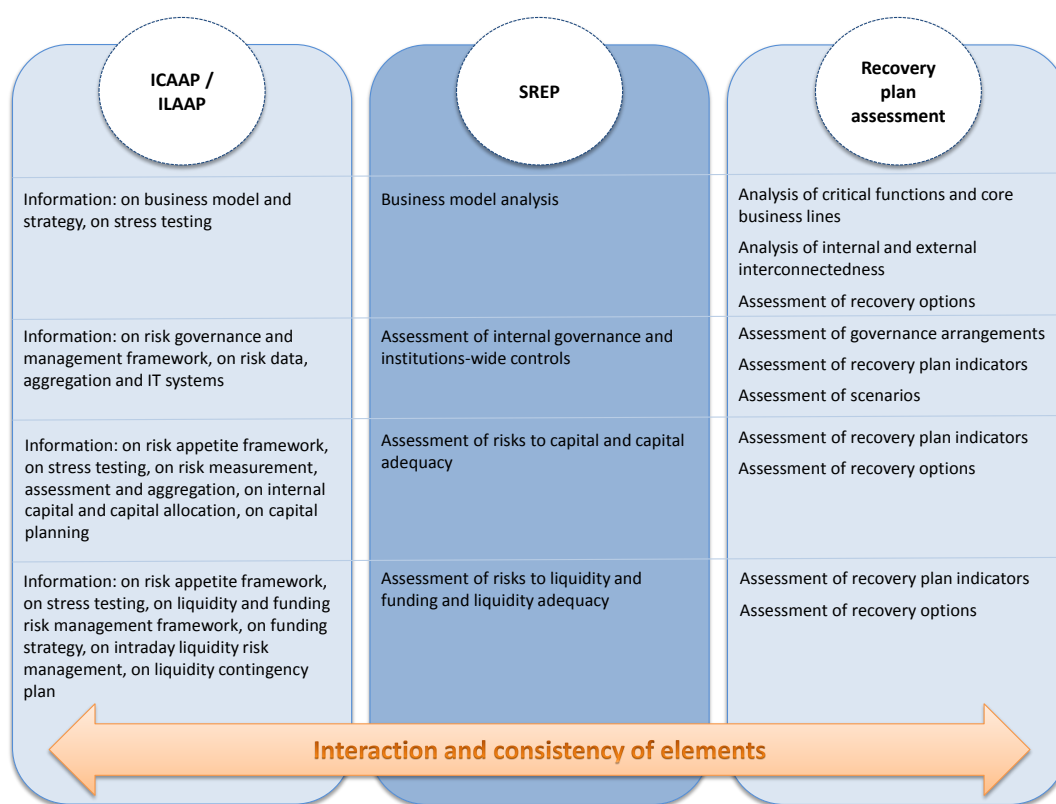
Interaction between SREP and other supervisory processes, in particular assessment of recovery plans

11. Competent authorities should reflect in the SREP assessments information and outcomes from all other supervisory activities, including on-site inspections, approvals of internal models, fit & proper and other authorisation approvals, assessment of recovery plans market conduct and consumer protection activities, AML/CTF activities, etc. Likewise, the findings from the assessment of SREP elements should inform other supervisory processes. Such integration of supervisory activities and cross-utilisation of findings from various activities to inform each other allows for truly integrated analysis and supervision of institutions enhancing overall supervisory view on institutions, their viability and risks, as well as maximises synergies in various (as sometimes overlapping) areas of assessment.
12. An important example of such synergies and complementarity of the analysis, is the interaction between SREP and the assessment of recovery plans, where the outcomes of the assessment of the recovery plans feed into the SREP assessment of institution's internal governance and institution-wide controls, and information from the recovery plan itself would support supervisors in their business model analysis, assessment of internal governance and controls as an additional source of information. On the other hand, findings from the assessment of SREP elements, including internal governance and institution-wide controls, business model analysis, capital and liquidity adequacy assessment, including setting additional capital and liquidity requirements, should feed into the assessment of recovery plans.
13. Such interaction between the SREP and recovery plan assessments also aligns with the principle that institutions' own recovery planning activities should be embedded into their risk management framework. Furthermore, competent authorities should expect from institutions that such integration be also noticeable in relation to ICAAP/ILAAP and various aspects of recovery planning, in particular governance arrangements, recovery plan indicators, analysis of recovery options, and post-recovery strategy, and scenario testing used in recovery planning (see Figure 3 for more details).
14. With respect to the stress testing, it should be noted that although the ICAAP/ILAAP stress testing and scenario testing in recovery plans have different objectives compared to stress testing used in ICAAP and ILAAP, this does not preclude that some elements of the stress tests, especially the methodologies and models are the same. In particular, should institutions when identifying their 'severe, but plausible' scenarios for ICAAP and ILAAP stress

⁹ <https://www.eba.europa.eu/documents/10180/1085517/EBA-GL-2015-07+GL+on+failing+or+likely+to+fail.pdf>

testing¹⁰ already meet the requirements for the recovery planning scenario testing¹¹, in particular in terms of severity and choice of scenarios, they can use such scenarios as one element in the scenario testing in recovery planning. On the supervisory assessment side, competent authorities should use the outcomes of the assessment of the institutions’ stress testing programmes and capabilities under SREP also to help their assessment of scenario testing when assessing recovery plans.

Figure 1. Interaction between the elements of ICAAP/ILAAP, SREP and recovery plan assessment



Link between SREP and early intervention and resolution

15. The assessment through the SREP of the viability of an institution and its compliance with the requirements of Regulation (EU) 575/2013 and Directive 2013/36/EU allows for the use of the outcomes of the assessment in setting triggers for early intervention measures, as provided in Article 27 of Directive 2014/59/EU. It also allows for the determination of whether an institution can be considered to be ‘failing or likely to fail’ pursuant to Article 32 of Directive 2014/59/EU (when such a determination is made by a competent authority), which activates the formal interaction procedure with resolution authorities as provided in

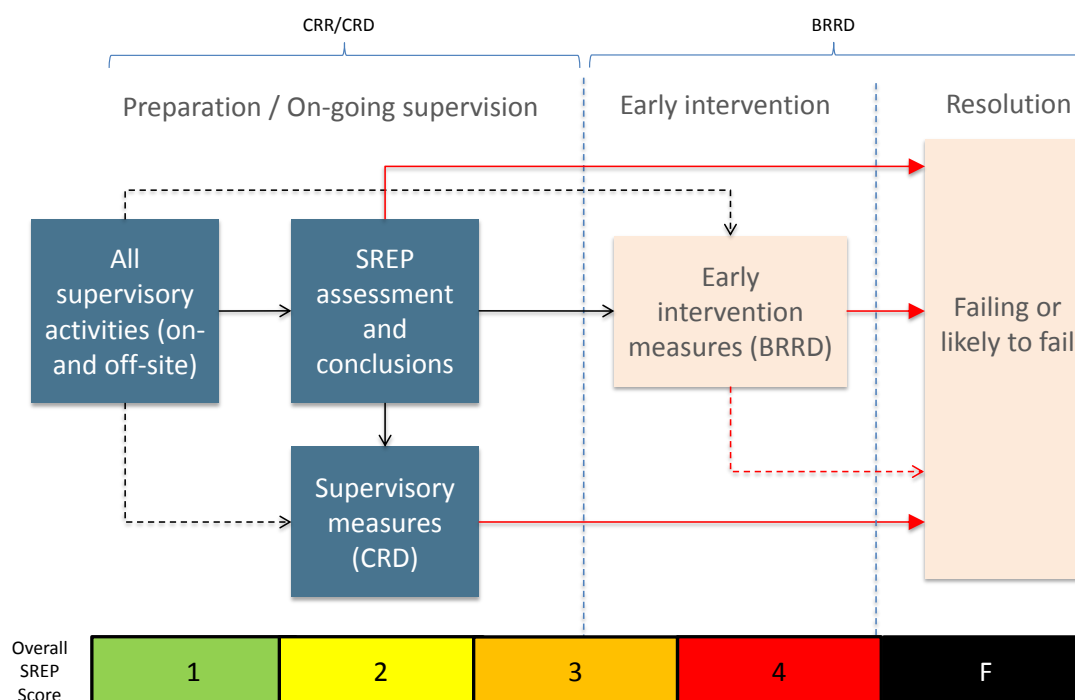
¹⁰ Add reference to stress testing GL

¹¹ EBA Guidelines on scenarios to be used in recovery plans ([EBA/GL/2014/06](#))

Article 32 of Directive 2014/59/EU. The link between the ongoing supervision under SREP and application of early intervention measures and determination whether an institution is 'failing or likely to fail' is based on the viability focus of the Overall SREP assessment and assessment of individual SREP elements as expressed by viability scores and considering that outcomes of all supervisory activities are taken into account in the SREP assessments (see Figure 3 below).

16. In particular, the outcomes of the SREP assessments as expressed by the Overall SREP score acts as a trigger for the decision on whether to apply early intervention measures (Overall SREP score of '4' or combination of the Overall SREP score of '3' and SREP elements score of '4'). Furthermore, should the competent authority assess an institution as not being viable (as expressed in an Overall SREP score 'F'), competent authorities would consider that institution as 'failing or likely to fail'.

Figure 2. Link between on-going supervision, early intervention and resolution



17. To this end these guidelines should be read together with the EBA Guidelines on triggers for use of early intervention measures¹² and Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail¹³.

¹² EBA Guidelines on triggers for use of early intervention measures ([EBA/GL/2015/03](#))

¹³ EBA Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail ([EBA/GL/2015/07](#))

Revisions to the Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP)

- (1). The phrase 'and supervisory stress testing' is added to the title of the Guidelines.
- (2). At the end of paragraph 1 the following sentence is added:

"In addition, these guidelines aim at providing common methodologies to be used by competent authorities when conducting supervisory stress tests in the context of their SREP as referred to in Article 100(2) of Directive 2013/36/EU."
- (3). The following paragraph is added as paragraph 2:

"These guidelines do not set methodologies for the stress tests conducted by the EBA in cooperation with other competent authorities in accordance with Article 22 of Regulation (EU) No 1093/2010, however they do describe the range of stress tests help to set the appropriate context for the consideration of future EBA stress tests as one part of the suite supervisory stress tests."
- (4). Paragraph 3 is amended as follows:
 - a. The following is inserted before the first phrase:

"Unless otherwise specified, terms used and defined in Regulation (EU) No 575/2013, Directive 2013/36/EU, Directive 2014/59/EU, or EBA Guidelines on institution's stress testing, have the same meaning in the guidelines"
 - b. After the definition of 'capital buffer requirements', the following definition is inserted:

"'Consolidating institution' means an institution which is required to abide by the prudential requirements on the basis of the consolidated situation in accordance with Part 1, Title 2, Chapter 2 of Regulation (EU) 575/2013."
 - c. The definition of 'information and communication (ICT) risk' is replaced by the following:

"'Information and communication technology (ICT) risk' means risk of loss due to breach of confidentiality, failure of integrity of systems and data, inappropriateness or unavailability of systems and data or inability to change IT within reasonable time and costs when the environment or business requirements change (i.e. agility)."
 - d. After the definition of 'overall SREP score', the following two definitions are inserted:



- i. "Pillar 2 capital guidance (P2G)' means the level and quality of own funds the institution is expected to hold in excess of the OCR, determined in accordance with the criteria specified in these guidelines."
 - ii. "Pillar 2 capital requirement (P2R)' or 'additional own funds requirements' means the additional own funds requirements imposed in accordance with Article 104(1)(a) of Directive 2013/36/EU."
- e. After the definition of 'risk appetite', the following definition is inserted:
- "Risk score' means numerical expression summarising supervisory assessment of individual risks to capital, liquidity and funding representing the likelihood that the risk will have a significant prudential impact on the institution (e.g. potential loss) after considering risk management and controls and before consideration of the institution's ability to mitigate the risk through available capital or liquidity resources."
- f. After the definition of 'unhedged borrowers', the following definition is inserted:
- "Viability score' means numerical expression summarising supervisory assessment of SREP elements and representing an indication of the risk to the institution's viability stemming from a SREP element assessed."
- (5). In paragraph 9 the phrase 'which are also summarised in Figure 1' is deleted and Figure 1 is removed.
- (6). Paragraph 26 is replaced by:
- "Competent authorities should assign risk and viability scores to summarise the outcomes of the assessment of various risk categories and elements in the SREP framework. The following paragraphs describe the general approach to scoring that is further detailed in the element-specific Titles."
- (7). The following paragraphs are inserted after paragraph 26:
- "28. Competent authorities should assign risk scores to individual risks to capital in accordance with the criteria specified in Title 6, and scores to risks to liquidity and funding in accordance with the criteria specified in Title 8. These scores represent the likelihood that the risk will have a significant prudential impact on the institution (e.g. potential loss), before consideration of the institution's ability to mitigate the risk through available capital or liquidity resources.
29. Competent authorities should separately assign scores to summarise the level of risk posed to the viability of the institution based on the outcomes of the assessment of the four SREP elements:
- i. business model and strategy, in accordance with the criteria specified in Title 4;
 - ii. internal governance and institution-wide controls, in accordance with the criteria specified in Title 5;
 - iii. capital adequacy, in accordance with the criteria specified in Title 7; and
 - iv. liquidity adequacy, in accordance with the criteria specified in Title 9.



26c. For capital adequacy and liquidity adequacy, these scores represent the supervisory view on the capacity of the institution's capital and liquidity resources to mitigate/cover the individual risks to capital and liquidity and funding, as set out in Titles 6 and 8, respectively.

27d. Competent authorities should also assign an Overall SREP score in accordance with the criteria specified in Title 10. This score should be assigned based on the supervisory judgement and represent the supervisory view on the overall viability of the institution on the basis of the aggregate view of the threats to the viability from the four SREP elements (business model and strategy, internal governance and institution-wide controls, capital adequacy, and liquidity adequacy), taking into account the outcomes of the assessment of individual risks to capital, liquidity and funding."

(8). The first sentence of paragraph 28 is replaced by:

"In the assessment of the individual SREP elements, competent authorities should use a range of '1' (low risk), '2' (medium-low risk), '3' (medium-high risk), and '4' (high risk), reflecting the 'supervisory view' based on the relevant scoring tables in each element-specific title."

(9). Paragraph 29 is replaced by:

"In their implementation of the guidelines, competent authorities may introduce aggregation methodologies for aggregating individual risks to capital and liquidity and funding scores. Competent authorities may also introduce more granular scoring for their internal purposes, such as planning of resources, provided that the overall scoring framework provided in these guidelines is respected."

(10). After paragraph 29, the following sub title is added:

"2.2.1 Risk scores"

(11). Paragraph 30 is replaced by:

"Competent authorities should ensure that through the scoring of individual risks to capital, liquidity and funding they provide an indication of the potential prudential impact (e.g. potential loss) of the risk to the institution after considering the quality of risk controls to mitigate this impact (i.e. residual risk) but before considering capital or liquidity resources."

(12). The following paragraphs are inserted after paragraph 30:

"36. Competent authorities should determine the risk score predominantly through the assessment of the inherent risk, but they should also reflect considerations about risk management and controls. In particular, the adequacy of management and controls may increase or – in some cases – reduce the risk of significant prudential impact (i.e. considerations for inherent risk may under- or overestimate the level of risk depending on



the adequacy of management and controls). The assessment of inherent risk and the adequacy of management and controls should be made with reference to the considerations specified in Tables 4 to 7 and 9 to 10.”

“37. Under the implementation of these guidelines, competent authorities may use different methods to decide on individual risk scores. Inherent risk levels and the quality of risk management and controls may be scored separately (in this case resulting in an intermediate and final scores) or in aggregate.”

(13). Before paragraph 31, the following sub title is added:

“2.2.2. Viability scores”

(14). Paragraph 31 is replaced by the following:

“Competent authorities should ensure that the scoring of the business model, internal governance and institution-wide controls, capital adequacy and liquidity adequacy achieves the following objectives:

- i. provide an indication of the risks to the institution’s viability stemming from the SREP elements assessed, given their individual assessments as described in Titles 4, 5, 7 and 9;
- ii. indicate the likelihood that supervisory measures may need to be taken to address concerns in accordance with the criteria specified in Title 10¹⁴;
- iii. act as a trigger for the decision on whether to apply early intervention measures¹⁵, in accordance with the EBA Guidelines on triggers for use of early intervention measures; and
- iv. help with the prioritisation and planning of supervisory resources and setting priorities in the SEP.”

(15). After paragraph 31 is added the following sub title:

“2.2.3 Overall SREP scores”

(16). Paragraph 32 is replaced by the following:

“Competent authorities should ensure that the Overall SREP score assigned on the basis of the aggregate view of the threats from the four SREP elements achieves the following objectives:

- i. provide an indication of the institution’s overall viability;
- ii. and whether the institution is ‘failing or likely to fail’ in the meaning of Article 32 of Directive 2014/59/EU;
- iii. indicate the likelihood that supervisory measures may need to be taken to address concerns in accordance with the criteria specified in Title 10;

¹⁴ Irrespective of the score for capital adequacy, additional own funds requirements should be imposed as specified in Title 7 and Title 10.3

¹⁵ EBA Guidelines on triggers for use of early intervention measures ([EBA/GL/2015/03](https://www.eba.europa.eu/media/1000000/2015/03/eba_guidelines_on_triggers_for_use_of_early_intervention_measures.pdf))

- iv. act as a trigger for the decision on whether to apply early intervention measures in accordance with the *EBA Guidelines on triggers for use of early intervention measures*;
and
- v. help with the prioritisation and planning of supervisory resources and setting priorities in the SEP.”

(17). In paragraph 33 the word ‘overall’ is capitalised.

(18). In paragraph 37 the word ‘particualry’ is replaced by ‘particularly’.

(19). In paragraph 80 the word ‘viability’ is added before the word ‘score’.

(20). Table 2 is amended as follows:

- a. In the first row the words ‘no discernible’ are replaced by ‘low level of’.
- b. In the second row the word ‘medium-’ is added before ‘low’.
- c. In the third row the word ‘-high’ is added after ‘medium’.

(21). Title 5 is replaced by the following:

Title 5. Assessing internal governance and institution-wide controls

5.1 General considerations

- 88. Competent authorities should assess whether or not institutions’ internal governance, are adequate and commensurate to the institution’s risk profile, business model, nature, size and complexity. They should identify the extent to which the institution complies with the applicable EU requirements and international standards regarding sound internal governance arrangements. Competent authorities should evaluate in particular whether or not the internal governance arrangements ensure a sound management of risks and include appropriate internal controls. Competent authorities should establish if there are material risks posed by poor internal governance arrangements and their potential effect on the sustainability of the institution.
- 89. For the SREP, the assessment of internal governance and institution-wide controls should include the assessment of the following areas:
 - a. the overall internal governance framework;



- b. composition, organisation and functioning of the management body and its committees;
 - c. corporate and risk culture;
 - d. remuneration policies and practices;
 - e. internal control framework, including controls at the level of the business units and internal risk management, compliance and internal audit function;
 - f. risk management framework, including ICAAP, ILAAP and new product approval process;
 - g. administrative and accounting procedures;
 - h. outsourcing arrangements;
 - i. information systems and business continuity; and
 - j. consistency of recovery planning.
90. The assessment of internal governance should inform the assessment of risk management and controls as provided for in Titles 6 and 8, as well as the assessment of ICAAP and ILAAP in the SREP capital assessment (Title 7) and SREP liquidity assessment (Title 9). Likewise, risk-by-risk analysis of ICAAP calculations/capital estimates reviewed under Title 7, and any deficiencies identified there, should inform the assessment of the overall ICAAP framework assessed under this title.

5.2 Overall internal governance framework

91. In line with the EBA Guidelines on internal governance¹⁶, this assessment of the internal governance framework by competent authorities should include an assessment of whether the institution demonstrates at least that:
- a. if the duties of the management body are clearly defined, distinguishing between the duties of the management (executive) function and of the supervisory (non-executive) function and that appropriate governance arrangements have been implemented;
 - b. a robust and transparent organisational structure with clearly defined responsibilities, including the management body and its committees has been set up;

¹⁶ EBA Guidelines on internal governance ([EBA/GL/2017/11](#))



- c. the management body has set and implemented a business and a risk strategy, including the setting of its risk appetite, on an individual and group wide basis under the appropriate involvement of the management body in its supervisory function;
- d. risk policies and their implementation, including communication and training, are appropriate;
- e. a selection and suitability assessment process for key function holders have been implemented;
- f. an adequate and effective internal governance and internal control framework have been implemented that includes a clear organisational structure and well-functioning independent internal risk management, compliance and audit functions that have sufficient authority, stature and resources to perform their functions;
- g. a remuneration policy and remuneration practices that are in line with the remuneration principles set out in Articles 92 to 95 of Directive 2013/36/EU and the EBA guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU¹⁷ have been implemented;
- h. arrangements aimed at ensuring the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards are implemented;
- i. an outsourcing policy and strategy that considers the impact of the outsourcing on the institution's business and the risks it faces has been implemented¹⁸;
- j. the internal governance framework is set, overseen and regularly assessed by the management body; and
- k. that the internal governance framework is transparent to stakeholders, including shareholders.

5.3 Organisation and functioning of the management body

92. In accordance with Article 91(12) of Directive 2013/36/EU and with the EBA Guidelines on internal governance and Joint EBA and ESMA Guidelines on the

¹⁷ EBA guidelines on sound remuneration policies([EBA/GL/2015/22](#))

¹⁸ [CEBS Guidelines on outsourcing](#) published 14.12.2006; the CEBS GL is due to be updated and replaced by EBA Guidelines on Outsourcing.



assessment of the suitability of members of the management body and key function holders, competent authorities should assess whether:

- a. arrangements aimed at ensuring that the individual and collective suitability of the management body and key function holders are implemented and carried out effectively upon appointment, when material changes happen and on an ongoing basis including application of notification to the relevant competent authorities¹⁹;
- b. the composition and succession planning of the management body are appropriate and that the number of members of the body is adequate, including that diversity has been taken into account when recruiting members¹⁹;
- c. whether or not effective interaction exists between the management and the supervisory functions of the management body;
- d. whether or not the management body in its management function appropriately directs the business and the supervisor function oversees and monitors the management decision-making and actions;
- e. members act with independence of mind;
- f. there is sufficient time commitment by the members of the management body to perform their functions;
- g. the limitation of the number of directorship for significant institutions as set out in Article 91(3) of Directive 2013/36/EU is complied with
- h. appropriate internal governance practices and procedures are in place for the management body and its committees, where established; and
- i. the management body, in its management function and in its supervisory function, and the risk committee, where established, have appropriate access to information on the risk situation of the institution.

5.4 Corporate and risk culture

93. Competent authorities should assess whether the institution has an appropriate and transparent corporate structure that is 'fit for purpose' and has a sound corporate and risk culture that is comprehensive and proportionate to the nature,

¹⁹ See also the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders ([ESMA/2016/1529](#))



scale and complexity of the risks inherent within the business model and the institution's activities and is consistent with the institution's risk appetite.

94. In line with the EBA Guidelines on internal governance, competent authorities should assess whether:
- a. the management body knows and understands the legal, organisational and operational structure of the institution ('know your structure') and ensure that it is consistent with its approved business and risk strategy and risk appetite;
 - b. institutions have not set up opaque or unnecessarily complex structures which have no clear economic rationale or legal purpose and that when setting up structures the management body understands them, their purpose and the particular risks associated with them and ensure that the internal control functions are appropriately involved;
 - c. institutions have developed an integrated and institution-wide risk culture, based on a full understanding and holistic view of the risks they face and how they are managed, taking into account the institution's risk appetite;
 - d. the institution's ethical corporate and risk culture creates an environment of effective challenge in which decision-making processes promote a range of views (e.g. by including independent members in the management body committees);
 - e. institutions have implemented independent whistle-blowing processes and procedures;
 - f. institutions appropriate manage conflicts of interest at an institutional level and have established a conflict of interest policy for staff to manage conflicts between the personal interest of the staff and the interest of the institution; and
 - g. there is a clear, strong and effective communication of strategies, corporate values, code of conduct, risk and other policies to all relevant staff and that the risk culture is applied across all levels of the institution.

5.5 Remuneration policies and practices

95. Competent authorities should assess whether the institution has a remuneration policy and practices as specified in Articles 92 to 95 of Directive 2013/36/EU for staff whose professional activities have a material impact on the institutions' risk profile and appropriate remuneration policies for all staff members. In line with



the EBA Guidelines on internal governance and EBA Guidelines on sound remuneration policies²⁰, competent authorities should assess whether:

- a. the remuneration policy is consistent with the institution's business and risk strategy, corporate culture and values, long-term interests of the institution and the measures used to avoid conflicts of interest and does not encourage excessive risk taking and is maintained, approved and overseen by the management body;
- b. staff whose professional activities have a material impact on the institution's risk profile (identified staff) are appropriately identified and Regulation (EU) No 604/2014 is properly applied, in particular with regard to:
 - i. the application of the qualitative and quantitative criteria for the identification of staff; and
 - ii. the provisions on exclusion of staff who are identified only under the quantitative criteria specified in Article 4 of Regulation (EU) No 604/2014;
- c. the combination of variable and fixed remuneration is appropriate and the provisions on the limitation of the variable remuneration component to 100% of the fixed remuneration component (200% with shareholders' approval) are complied with and variable remuneration is not paid through vehicles or methods that facilitate non-compliance with Directive 2013/36/EU or Regulation (EU) No 575/2013; and
- d. the variable remuneration for identified staff is based on performance and the requirements on deferral, retention, pay out in instruments and the application of malus and claw back are respected and the institution does not use vehicles or practices to circumvent remuneration requirements.

5.6 Internal control framework

96. Competent authorities should assess whether the institution has an appropriate internal control framework that encourages a positive attitude towards risk management and compliance within the institutions' internal control framework. This assessment should include, at least whether:

²⁰ EBA Guidelines on sound remuneration policies and disclosures [EBA/GL/2015/22](#)



- a. the institution has adequate written internal control policies in place and has implemented an internal control framework within the business units and within independent control functions;
- b. there is a clear decision-making process with a clear allocation of responsibilities for implementation of the internal control framework and its components;
- c. there is an adequate segregation of duties with regard to conflicting activities;
- d. the all independent control functions are effective and have sufficient resources, authority and stature and have direct access to the management body, including to its supervisory function to fulfil their mission;
- e. the internal control framework is implemented in all areas of the institution, with business and support units being responsible in the first instance for establishing and maintaining adequate internal controls and risk management procedures;
- f. there are exchanges of the necessary information in a manner that ensures that management body, business line and internal unit, including each internal control function, is able to carry out its duties;
- g. the institution has a new product approval policy and process, including a process for material changes, with a clearly specified role for the independent risk management and compliance function, approved by the management body;
- h. the institution has the capacity to produce risk reports and uses them for management purposes and whether such risk reports are:
 - i. accurate, comprehensive, clear and useful; and
 - ii. produced and communicated to the relevant parties with the appropriate frequency; and
- i. audit recommendations are subject to a formal follow-up procedure by the appropriate levels of management to ensure and report on their effective and timely resolution.

5.6.1 Internal audit function

97. In line with the EBA Guidelines on internal governance, competent authorities should assess whether the institution has established an effective independent internal audit function that:



- a. is set up in accordance with national and international professional standards;
- b. has its purpose, authority and responsibility defined in a mandate that recognises the professional standards and that is approved by the management body;
- c. has adequate resources and stature to perform their tasks;
- d. has its organisational independence and the internal auditors' objectivity protected, including by an appropriate segregation of duties, having an independent head with sufficient stature and direct reporting lines to the management body;
- e. assesses the appropriateness of the institution's governance framework, including whether existing policies and procedures remain adequate and comply with legal and regulatory requirements, with decisions of the management body and the risk appetite and strategy of the institution;
- f. assesses whether procedures are correctly and effectively implemented (e.g. compliance with conduct requirements of transactions, the compliance of the level of risk effectively incurred with the risk appetite and limits, etc.);
- g. assess the adequacy, quality and effectiveness of the controls performed and the reporting done by the business units and the internal risk management and compliance functions;
- h. that adequately covers all areas in a risk-based audit plan, including ICAAP, ILAAP and new product approval process (NPAP); and
- i. determines if the institution adheres to internal policies and relevant EU and national implementing legislation and addresses any deviations from either.

5.7 Risk management framework

98. Competent authorities should assess whether the management body of the institution has established an appropriate risk management framework and risk management processes. As a minimum competent authorities should review :
 - a. whether the risk strategy, risk appetite and risk management framework are appropriate and implemented on an individual and group wide basis;
 - b. the ICAAP and ILAAP frameworks;
 - c. the stress testing capabilities and results;



- d. whether the institution has established an independent risk management function covering the whole institution, that is actively involved in drawing up the institution's risk strategy and all material risk management decisions, and that provides the management body and business units with all relevant risk-related information;
- e. whether the institution has a head of the risk management function with sufficient expertise, independence and seniority, and, where necessary, direct access to the management body in the supervisory function;
- f. whether the independent risk management function ensures that the institution's risk measurement, assessment and monitoring processes are appropriate; and
- g. whether the institution has put in place policies and procedures to identify, measure, monitor, mitigate and report risk and associated risk concentrations and whether these are in line with risk limits, the risk appetite or are approved by the management body.

5.7.1 Risk appetite framework and strategy

- 99. When assessing the risk management framework, competent authorities should consider the extent to which it is embedded in, and how it influences, the overall strategy of the institution. Competent authorities should, in particular, assess if there is an appropriate and consistent link between the business strategy, risk strategy, risk appetite and risk management framework, capital and liquidity management frameworks.
- 100. When reviewing the risk strategy, risk appetite and risk management framework of an institution, competent authorities should assess whether:
 - a. the responsibility of the management body in respect of the risk strategy, risk appetite and risk management framework is exercised in practice by providing appropriate direction and oversight;
 - b. the risk strategy and risk appetite considers all material risks to which the institution is exposed and contains risk limits, tolerances and thresholds;
 - c. the risk strategy and risk appetite are consistent and implemented;
 - d. the risk appetite framework is forward-looking and in line with the strategic planning horizon set out in the business strategy and is regularly reviewed;
 - e. the risk strategy and appetite appropriately considers the risk tolerance and financial resources of the institution (i.e. risk appetite should be consistent



with supervisory own funds and liquidity requirements and other supervisory measures and requirements); and

- f. the risk strategy, risk appetite statement and risk policy is documented in writing and there is evidence that it is communicated to the staff of the institution.

5.7.2 ICAAP and ILAAP frameworks

- 101. Competent authorities should periodically review the institution's ICAAP and ILAAP based on the information collected from the institutions in accordance with the EBA Guidelines on ICAAP and ILAAP information collected for SREP purposes²¹ and determine their (1) soundness, (2) effectiveness and (3) comprehensiveness according to the criteria specified in this section. Competent authorities should also assess how ICAAP and ILAAP are integrated into overall risk management and strategic management practices, including capital and liquidity planning.
- 102. These assessments should contribute to the determination of additional own funds requirements and the assessment of capital adequacy as outlined in Title 7, as well as to the evaluation of liquidity adequacy as outlined in Title 9.

Soundness of the ICAAP and ILAAP

- 103. To evaluate the soundness of the ICAAP and ILAAP, competent authorities should consider whether the policies, processes, inputs and models constituting the ICAAP and ILAAP are proportionate to the nature, scale and complexity of the activities of the institution. To do so, competent authorities should assess the appropriateness of the ICAAP and ILAAP for assessing and maintaining an adequate level of internal capital and liquidity to cover risks to which the institution is or might be exposed and to make business decisions (e.g. for allocating capital under the business plan), including under stressed conditions in line with the EBA Guidelines on institution's stress testing²².
- 104. In the assessment of the soundness of the ICAAP and ILAAP, competent authorities should consider, where relevant:
 - a. whether methodologies and assumptions applied by institutions are appropriate and consistent across risks, are grounded in solid empirical input data, use robustly calibrated parameters and are applied equally for risk measurement and capital and liquidity management;

²¹ EBA Guidelines on ICAAP and ILAAP information collected for SREP purposes([EBA/GL/2016/10](#))

²² CEBS Guidelines on Stress Testing ([GL 32](#))



- b. whether the confidence level is consistent with the risk appetite and whether the internal diversification assumptions reflect the business model and the risk strategies;
- c. whether the definition and composition of available internal capital or liquidity resources considered by the institution for the ICAAP and ILAAP are consistent with the risks measured by the institution and are eligible for the calculation of own funds and liquidity buffers; and
- d. whether the distribution/allocation of available internal capital and liquidity resources amongst business lines or legal entities properly reflects the risk to which each of them is or may be exposed, and properly takes into account any legal or operational constraints on transferability of these resources.

Effectiveness of the ICAAP and ILAAP

- 105. When assessing the effectiveness of the ICAAP and ILAAP, competent authorities should examine their use in the decision-making and management process at all levels in the institution (e.g. limit setting, performance measurement, etc.). Competent authorities should assess how the institution uses the ICAAP and ILAAP in its risk, capital and liquidity management (use test). The assessment should consider the interconnections and interrelated functioning of the ICAAP and ILAAP with the risk appetite framework, risk management, liquidity and capital management, including forward-looking funding strategies, and whether this is appropriate for the business model and complexity of the institution.
- 106. To this end, competent authorities should assess whether the institution has policies, procedures and tools to facilitate:
 - a. clear identification of the functions and/or management committees responsible for the different elements of the ICAAP and ILAAP (e.g. modelling and quantification, internal auditing and validation, monitoring and reporting, issue escalation, etc.);
 - b. capital and liquidity planning: the calculation of capital and liquidity resources on a forward-looking basis (including in assumed stress scenarios) in connection with the overall strategy or significant transactions;
 - c. the allocation and monitoring of capital and liquidity resources amongst business lines and risk types (e.g. risk limits defined for business lines, entities or individual risks are consistent with the objective of ensuring the overall adequacy of the institution's internal capital and liquidity resources);
 - d. the regular and prompt reporting of capital and liquidity adequacy to senior management and to the management body. In particular, the frequency of



reporting should be adequate with respect to risks and business-volume development, existing internal buffers and the internal decision-making process to allow the institution's management to put in place remedial actions before capital or liquidity adequacy is jeopardised; and

- e. senior management or management body awareness and actions where business strategy and/or significant individual transactions may be inconsistent with the ICAAP and available internal capital (e.g. senior-management approval of a significant transaction where the transaction is likely to have a material impact on available internal capital) and ILAAP.

- 107. Competent authorities should assess whether the management body demonstrates appropriate commitment to and knowledge of the ICAAP and ILAAP and their outcomes. In particular, they should assess whether the management body approves the ICAAP and ILAAP frameworks and outcomes and, where relevant, the outcomes of internal validation of the ICAAP and ILAAP.
- 108. Competent authorities should assess the extent to which the ICAAP and ILAAP are forward-looking in nature. Competent authorities should do this by assessing the consistency of the ICAAP and ILAAP with capital and liquidity plans and strategic plans.

Comprehensiveness of the ICAAP and ILAAP

- 109. Competent authorities should assess the ICAAP and ILAAP's coverage of business lines, legal entities and risks to which the institution is or might be exposed, and the ICAAP and ILAAP's compliance with legal requirements. In particular, they should assess:
 - a. whether the ICAAP and ILAAP are implemented homogeneously and proportionally for all the relevant institution's business lines and legal entities with respect to risk identification and assessment;
 - b. whether the ICAAP and ILAAP cover all material risks regardless of whether the risk arises from entities not subject to consolidation (special-purpose vehicles (SPVs), special-purpose entities (SPEs)); and
 - c. where any entity has different internal governance arrangements or processes from the other entities of the group, whether these deviations are justified (e.g. adoption of advanced models by only part of the group may be justified by a lack of sufficient data to estimate parameters for some business lines or legal entities, provided that these business lines or legal entities do not represent a source of risk concentration for the rest of the portfolio).

5.7.3 Assessment of institutions' stress testing



110. Competent authorities should review and assess the institutions' stress testing programmes and their compliance with the requirements of the EBA Guidelines on institution's stress testing in particular in relation to the assessment of the stress testing programmes, governance arrangements, data infrastructure, use of stress testing in ICAAP and ILAAP and management actions as referred to in Section 4 of that guidelines.
111. Competent authorities should perform a qualitative assessment of stress testing programmes, as well as a quantitative assessment of the results of stress tests. Competent authorities should consider the outcomes of qualitative and quantitative assessments together with the results of supervisory stress tests (see Title 12) for the purposes of the assessment of the institutions' capital and liquidity adequacy and determining appropriate supervisory response to the identified deficiencies.
112. Furthermore, supervisory assessment of the institutions' stress testing programmes, and outcomes of various stress tests performed by an institution as part of its stress testing programme could inform the assessment of various SREP elements and, in particular:
 - a. the identification of possible vulnerabilities or weaknesses in risk management and controls of individual risk areas. This should be used as an additional source of information to be taken into account by the competent authorities when assessing individual risks to capital as referred to in Section 6 of these Guidelines, or risks to liquidity and funding as referred to in Section 8 of these Guidelines. For example, sensitivity analyses and scenario analyses performed by an institution can be used to assess the sensitivity and adequacy of the models used and the quantifications of the individual risks;
 - b. the identification of possible deficiencies in the overall governance arrangements or institution-wide controls. This should be considered by competent authorities as an additional source of information for the purposes of the SREP assessment of internal governance and institution-wide controls. Furthermore the results of the institution's stress tests can be used for the assessment of capital planning, and, in particular its time dimension;
 - c. quantification of specific quantitative liquidity requirements in the context of the assessment of liquidity adequacy, especially in the case when a competent authority has not developed specific supervisory benchmarks for liquidity requirements, or does not apply liquidity supervisory stress testing.

Qualitative assessment of the institutions' stress testing programmes

113. To facilitate the qualitative assessment, competent authorities should require institutions to submit information regarding the organisation of their stress



testing programme in all the aspects specified above. Information submitted by institutions should cover data architecture and IT infrastructure, governance arrangements, methodologies, scenarios, key assumptions, results and planned management actions.

114. Competent authorities should consider all relevant sources of information about stress testing programmes and methodologies, including the institutions' own internal assessments and validation or reviews undertaken by independent control functions, as well as information and estimations provided by third parties, where available.
115. Competent authorities should also engage in dialogue with the management body and senior management of institutions in relation to major macro-economic and financial market vulnerabilities, as well as institution-specific threats to institutions' ongoing business, to assess how institutions manage their stress testing programmes.
116. When assessing stress-testing programmes, and the results of stress tests, competent authorities should pay specific attention to the appropriateness of the selection of the relevant scenarios, and the underlying assumptions, methodologies, as well as of the use of stress tests' results in the institutions' risk and strategic management. In particular, competent authorities should assess:
 - a. the extent to which stress testing is embedded in an institution's risk management framework;
 - b. the involvement of senior management and of the management body in the stress-testing programmes;
 - c. the integration of stress testing and its outcomes into decision-making throughout the institution; and
 - d. the institution's ability and infrastructure, including data, to implement the stress testing programme in individual business lines and entities and across the group, where relevant.
117. When assessing stress testing programmes, the results of stress tests and proposed management actions competent authorities should consider both idiosyncratic and system-wide perspectives. In particular, management actions should be primarily assessed from an internal perspective as to their plausibility, considering the specificities of an individual institution. Competent authorities should also consider the management actions from a system-wide perspective as other institutions are likely to consider similar actions, which in a system-wide context may make those actions implausible.



118. When assessing the management actions with an effect on the institution's capital or general financial position, competent authorities should consider the timelines for implementation of action. In particular, the management actions should be completed and implemented during the time horizon of the stress test. Competent authorities may, also consider, where relevant, management actions with the completion later than the time horizon of the stress test.
119. Competent authorities should take into account the effectiveness of institutions' stress testing programmes in identifying relevant business vulnerabilities and take this into consideration when assessing institutions business model viability and sustainability of strategy (see Section 4).
120. When assessing stress testing programmes and respective results in the case of cross-border groups, competent authorities should consider the transferability of capital and liquidity between the legal entities or business units during stressed conditions, as well as the functioning of any established intra-group financial support arrangements, taking into account funding difficulties expected in stressed conditions.

Quantitative assessment of institutions' stress tests done for ICAAP and ILAAP purposes

121. Competent authorities in addition to the qualitative assessment specified above should assess and challenge the choice and use of scenarios and assumptions, their severity, relevance to the business model of an institution as well as the results of such stress tests, in particular for stress tests performed for ICAAP and ILAAP purposes (see also Section 5.6.2).
122. Competent authorities should ensure that in a stressed scenario used for ICAAP purposes capital is negatively affected as the result, e.g., of credit rating migrations, reduction of net interest margins, or trading losses. Competent authorities should have access to the details of the institution's main assumptions and risk drivers and should challenge these, also based on supervisory stress tests, as specified in Title 12 of these Guidelines.
123. In their reviews of stress tests for ICAAP and ILAAP purposes competent authorities should made a combined assessment of impact of stress tests outcomes on capital and liquidity needs, as well as on other relevant regulatory requirements. To that end, competent authorities should assess whether the institution is able to maintain the applicable TSCR, at all times, in an adverse scenario and has identified a set of management actions to address any potential breaches of TSCR.
124. Competent authorities should duly challenge the scenarios, assumptions, and methodologies used by an institution. When challenging scenarios, assumptions,



and outcomes of institutions' stress tests done for ICAAP and ILAAP purposes, competent authorities should use, where appropriate, the outcomes, scenarios and assumptions used in the supervisory stress tests, including relevant regional stress test exercises done by various authorities, including the EBA, IMF, and ESCB/ESRB, as well the qualitative assessment as specified above, to determine the extent to which reliance can be placed on the institution's stress testing programme and respective outcomes.

125. If competent authorities identify deficiencies in the design of the scenarios or assumptions used by institutions, competent authorities may require from institutions to re-run stress tests, or some specific parts of the stress testing programme, based on the supervisory prescribed or anchor scenario or assumptions.
126. Competent authorities should also consider the impact of stress tests on the institution's leverage ratio as well as eligible liabilities held for the purposes of minimum requirements for eligible liabilities (MREL) as referred to in Directive 2014/59/EU.
127. In the assessment of stress testing results, competent authorities should also consider all known future regulatory changes affecting institutions within the scope and time horizon of the stress test exercise. Likewise competent authorities should also consider all known changes in future capital requirements (e.g. fully loaded assessments) when assessing the stress-test results and business model viability.

5.7.4 New product and significant changes

128. Competent authorities should assess whether the institution should have in place a well-documented new product approval policy (NPAP), approved by the management body, that addresses the development of new markets, products and services, and significant changes to existing ones, as well as exceptional transactions.
129. Competent authorities should assess whether the internal risk management function and compliance function is appropriately involved in approving new products or significant changes to existing products, processes and systems.

5.8 Information systems and business continuity

130. In line with the EBA Guidelines on internal governance, competent authorities should assess whether the institution has effective and reliable information and communication systems and whether these systems fully support risk data



aggregation capabilities at normal times as well as during times of stress. In particular, competent authorities should assess whether the institution is at least able to:

- a. generate accurate and reliable risk data for business units and the entire institution;
 - b. capture and aggregate all material risk data across the institution;
 - c. generate aggregate and up-to-date risk data in a timely manner; and
 - d. generate aggregate risk data to meet a broad range of on-demand requests from the management body or competent authorities.
131. Competent authorities should assess whether the institution has established effective business continuity management with tested contingency and business continuity plans as well whether all its critical functions and resources have been identified in the recovery plan and whether that plan can credibly recover these.

5.9 Recovery planning

132. To assess internal governance and institution-wide controls, competent authorities should consider any findings and deficiencies identified in the assessment of recovery plans and recovery planning arrangements conducted in accordance with Articles 6 and 8 of Directive 2014/59/EU.
133. Similarly, findings from the assessment of SREP elements, including internal governance and institution-wide control arrangements, should inform the assessment of recovery plans.

5.10 Application at the consolidated level and implications for the group entities

134. At the consolidated level, in addition to the elements covered in the sections above, competent authorities should assess whether:
- a. the management body of the consolidating institution understands both the organisation of the group and the roles of its different entities, and the links and relationships amongst them;



- b. the organisational and legal structure of the group – where relevant – is clear and transparent and suitable for the size and the complexity of the business and operations;
 - c. the institution has established an effective group-wide management information and reporting system applicable to all business units and legal entities, and whether this is available to the management body of the institution’s parent undertaking on a timely basis;
 - d. the management body of the consolidating institution has established consistent group-wide strategies, including a group wide risk strategy and appetite framework;
 - e. group risk management covers all material risks regardless of whether the risk arises from entities not subject to consolidation (including SPVs, SPEs, property firms) and establishes a comprehensive view on all risks;
 - f. the institution carries out regular stress testing covering all material risks and entities in accordance with the EBA Guidelines on institution’s stress testing; and
 - g. the group-wide internal audit function is independent, has a group-wide risk based auditing plan, is appropriately staffed and resourced, has appropriate stature and has a direct reporting line to the management body of the consolidating institution.
135. When conducting the assessment of internal governance and institution-wide controls at subsidiary level, in addition to the elements listed in this title, competent authorities should assess whether group-wide policies and procedures are implemented consistently at subsidiary level and whether group entities have taken steps to ensure that their operations are compliant with all applicable laws and regulations.

5.11 Summary of findings and scoring

136. Following the above assessment, competent authorities should form a view on the adequacy of the institution’s internal governance arrangements and institution-wide controls. This view should be reflected in a summary of findings, accompanied by a viability score based on the considerations specified in Table 3.



Table 1. Supervisory considerations for assigning an internal governance and institution-wide controls score

Score	Supervisory view	Considerations
1	Deficiencies in internal governance and institution-wide control arrangements pose low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution has a robust and transparent organisational structure with clear responsibilities and separation of risk taking from risk management and other control functions. • There is a sound corporate culture, management of conflicts of interest and whistleblowing processes. • The composition and functioning of the management body are appropriate. • The time commitment of members of the management body is appropriate and they comply with the number of directorships. • The institution has adopted a diversity policy that fosters a diverse board composition and complies with the targets set. • The remuneration policy is in line with risk strategy and long-term interests. • The risk management framework and risk management processes, including the ICAAP, ILAAP, NPAP, stress testing framework, capital planning and liquidity planning, are appropriate. • The internal control framework and internal controls are appropriate. • The internal risk management, compliance and audit function is independent and has sufficient resources and the internal audit function operates effectively in accordance with established international standards and requirements. • Information systems and business continuity arrangements are appropriate. • The recovery plan is credible and recovery planning arrangements are appropriate.



2	<p>Deficiencies in internal governance and institution-wide control arrangements pose a medium-low level of risk to the viability of the institution.</p>	<ul style="list-style-type: none"> • The institution has a largely robust and transparent organisational structure with clear responsibilities and separation of risk taking from risk management and control functions. • There is a largely sound corporate culture, management of conflicts of interest and whistleblowing processes. • The composition and functioning of the management body are largely appropriate. • The time commitment of members of the management body is largely appropriate, but they comply with the limitation of the number of directorships. • The institution has adopted a diversity policy that fosters a diverse board composition, and largely complies with the targets set. • The remuneration policy is largely in line with risk strategy and long-term interests. • The risk management framework and risk management processes, including the ICAAP, ILAAP, NPAP, stress testing framework, capital planning and liquidity planning, are largely appropriate. • The internal control framework and internal controls are largely appropriate. • The internal risk management, compliance and audit function is independent and its operations are largely effective. • Information systems and business continuity arrangements are largely appropriate. • The recovery plan is largely credible. The recovery planning arrangements are largely appropriate.
3	<p>Deficiencies in internal governance and institution-wide control arrangements pose a medium-high level of risk to the viability of the</p>	<ul style="list-style-type: none"> • The institution's organisational structure and responsibilities are not fully transparent and risk taking is not fully separated from risk management and



	<p>institution.</p>	<p>control functions.</p> <ul style="list-style-type: none"> • There are doubts about the appropriateness of the corporate culture, management of conflicts of interest and/or whistleblowing processes. • There are doubts about the appropriateness of the composition and functioning of the management body. • There are doubts about the appropriate time commitment of members of the management body or they do not comply with the limitation of the number of directorships. • The institution has not adopted a diversity policy or has not put measures in place to aim for an appropriate diversity. • There are concerns that the remuneration policy may conflict with risk strategy and long-term interests. • There are doubts about the appropriateness of the risk management framework and risk management processes, including the ICAAP, ILAAP, NPAP, stress testing framework, capital planning and liquidity planning. • There are doubts about the appropriateness of the internal control framework and internal controls. • There are doubts about the independence and effective operation of the internal risk management, compliance and audit function. • There are doubts about the appropriateness of information systems and business continuity arrangements. • The recovery plan was potentially assessed as having material deficiencies and/or having material impediments to its implementation and supervisory concerns have not been fully addressed. There are
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		doubts about the appropriateness of arrangements for recovery planning.
4	Deficiencies in internal governance and institution-wide control arrangements pose a high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution's organisational structure and responsibilities are not transparent and risk-taking is not separated from risk management and control functions. • The corporate culture management of conflicts of interest and/ or whistleblowing processes are inappropriate. • The composition and functioning of the management body are inappropriate. • There time commitment of members of the management body is insufficient or they do not comply with the limitation of the number of directorships. • The institution has not adopted a diversity policy, the management body is not diverse and the institution has not put measures in place to aim for an appropriate diversity. • The remuneration policy conflicts with risk strategy and long-term interests. • The risk management framework and the risk management processes, including the ICAAP, ILAAP, NPAP, stress-testing framework, capital planning and liquidity planning, are inappropriate. • The internal risk management, compliance and/or audit function is not independent and/or the internal audit function is not operating in accordance with established international standards and requirements; operations are not effective. • The internal control framework and internal controls are inappropriate. • The information systems and business continuity arrangements are inappropriate. • The recovery plan was assessed as having material deficiencies and/or having material impediments to its implementation and supervisory concerns have not been fully



		addressed. The recovery planning arrangements are inappropriate.
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(22). Paragraph 129 is replaced by the following:

“The outcome of the assessment of each material risk should be reflected in a summary of findings that provides an explanation of the main risk drivers, and a risk score, as specified in the following sections.”

(23). Contents of Paragraphs 130 and 131 are deleted.

(24). In paragraph 196 the word ‘risk’ is added before the words ‘score based’.

(25). Table 4 is replaced by the following:

Risk score	Supervisory view	Considerations for inherent risk
1	There is low level of risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies non-material risk/very low risk. • Exposure to complex products and transactions is not material/very low. • The level of credit concentration risk is not material/very low. • The level of forborne and non-performing exposures is not material/very low. • The credit risk from performing exposures is not material/very low. • The coverage of provisions and of credit valuation adjustments is very high. • The coverage and quality of guarantees and collateral are very high.
2	There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies low to medium risk. • Exposure to complex products and transactions is low to medium. • The level of credit concentration risk is low to medium. • The level of forborne and non-performing exposures is low to medium. • The credit risk from performing exposures is low to medium. • The coverage of provisions and of credit valuation adjustments is high. • The coverage and quality of guarantees and collateral are high.
3	There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the	<ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies medium to high risk. • Exposure to complex products and transactions is medium to high.

	management and controls.	<ul style="list-style-type: none"> • The level of credit concentration risk is medium to high. • The level of forborne and non-performing exposures is medium to high. • The credit risk from performing exposures is medium to high and subject to further deterioration under stress conditions. • The coverage of provisions and of credit valuation adjustments is medium. • The coverage and quality of guarantees and collateral are medium.
4	There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies high risk. • Exposure to complex products and transactions is high. • The level of credit concentration risk is high. • The level of forborne and non-performing exposures is high. • The credit risk from performing exposures is high. • The coverage of provisions and of credit valuation adjustments is low. • The coverage and quality of guarantees and collateral are low.

(26). In paragraph 231 the word 'risk' is added before the words 'score based'.

(27). Table 5 is replaced by the following:

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is low level of risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The nature and composition of exposures imply that market risk is not material/very low. • The institution's exposures to market risk are non-complex. • The level of market risk concentration is not material/very low. • The institution's market risk exposures generate non-volatile returns. 	<ul style="list-style-type: none"> • There is consistency between the institution's market risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for market risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions.
2	There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and	<ul style="list-style-type: none"> • The nature and composition of market risk exposures imply low to medium risk. • The complexity of the institution's market risk exposures is low to medium. • The level of market risk 	<ul style="list-style-type: none"> • Market risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the

	controls.	<p>concentration is low to medium.</p> <ul style="list-style-type: none"> • The institution’s market risk exposures generate a low to medium volatility of returns. 	<p>control framework for market risk are sound and in line with the institution’s risk management strategy and risk appetite.</p>
3	<p>There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.</p>	<ul style="list-style-type: none"> • The nature and composition of market risk exposures imply medium to high risk. • The complexity of the institution’s market risk exposures is medium to high. • The level of market risk concentration is medium to high. • The institution’s exposures to market risk generate a medium to high volatility of returns. 	
4	<p>There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.</p>	<ul style="list-style-type: none"> • The nature and composition of market risk exposures imply high risk. • The complexity of the institution’s market risk exposures is high. • The level of market risk concentration is high. • The institution’s exposures to market risk generate a high volatility of returns. 	

(28). In paragraph 287 the word ‘risk’ is added before the words ‘score based’.

(29). Table 6 is replaced by the following:

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	<p>There is low level of risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.</p>	<ul style="list-style-type: none"> • The nature of the institution’s operational risk exposures is limited to few high-frequency/low-severity impact categories. • The significance of the institution’s exposure to operational risk is not material/very low, as shown by scenario analysis and compared to the losses of peers. • The level of losses experienced by the institution in recent years has not been material/very low, or has decreased from a higher 	<ul style="list-style-type: none"> • There is consistency between the institution’s operational risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for operational risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. • Operational risk

		level.	
2	There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature of the institution’s operational risk exposures is mainly high-frequency/low-severity impact categories. The significance of the institution’s exposure to operational risk is low to medium, as shown by scenario analysis and compared to the losses of peers. The level of losses experienced by the institution in recent years has been low to medium, or is expected to increase from a lower historic level or decrease from a higher historic level. 	<p>measurement, monitoring and reporting systems are appropriate.</p> <ul style="list-style-type: none"> The control framework for operational risk is sound.
3	There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature of the institution’s operational risk exposures extends to some low-frequency/high-severity impact categories. The significance of the institution’s exposure to operational risk is medium to high, as shown by scenario analysis and compared to the losses of peers. The level of losses experienced by the institution over the last few years has been medium to high, or is expected to increase from a lower historic level or decrease from a higher historic level. 	
4	There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature of the institution’s operational risk exposures extends to all main categories. The significance of the institution’s exposure to operational risk is high and increasing, as shown by scenario analysis and compared to the losses of peers. The level of losses experienced by the institution over the last few years has been high or risk has significantly increased. 	



(30). Section 6.5 is replaced by the following:

6.5 Assessment of interest rate risk from non-trading activities

6.5.1 General considerations

310. Competent authorities should assess interest rate risk arising from interest-rate-sensitive positions from non-trading on and off-balance sheet activities (commonly referred to as interest rate risk in the non-trading book, or IRRBB), including hedges for these positions, irrespective of their recognition and measurement, and irrespective of the recognition and measurement of losses and gains, for accounting purposes (note that credit spread risk arising from some non-trading book positions is covered in the section on market risk).
311. Competent authorities should consider the following sub-categories when assessing IRRBB:
- a. Gap risk – risk resulting from the term structure of interest rate sensitive instruments that arises from differences in the timing of their rate changes, covering changes to the term structure of interest rates occurring consistently across the yield curve (parallel risk) or differentially by period (non-parallel risk);
 - b. Basis risk – risk arising from the impact of relative changes in interest rates on interest rate sensitive instruments that have similar tenors but are priced using different interest rate indices. It arises from the imperfect correlation in the adjustment of the rates earned and paid on different interest rate sensitive instruments with otherwise similar rate change characteristics; and
 - c. Option risk – risk arising from options, including embedded options, where the institution or its customer can alter the level and timing of their cash flows, namely the risk arising from interest rate sensitive instruments where the holder will almost certainly exercise the option if it is in their financial interest to do so (automatic option risk) and the risk arising from flexibility embedded implicitly or within the terms of interest rate sensitive instruments, such that changes in interest rates may affect a change in the behaviour of the client (behavioural option risk).
312. Competent authorities should take into account whether the guidance established in the EBA guidelines issued in accordance with Article 98(5) of Directive 2013/36/EU is implemented prudently by the institution. This is particularly true for the calculation of the supervisory outlier test specified in Article 98(5) of this Directive and any other supervisory outlier test, as well as for the institution's internal interest rate risk identification, measurement, monitoring and control procedures.



6.5.2 Assessment of inherent IRRBB

313. Through the assessment of the inherent level of IRRBB, competent authorities should determine the main drivers of the institution's IRRBB exposure and evaluate the potential prudential impact of this risk on the institution. The assessment of inherent IRRBB should be structured around the following main steps:

- a. preliminary assessment;
- b. assessment of the nature and composition of the institution's interest rate risk profile; and
- c. assessment of the outcome of the supervisory outlier tests and supervisory stress tests, as well as institution's interest rate shocks scenarios and interest rate stress scenarios.

Preliminary assessment

314. To determine the scope of the IRRBB assessment, competent authorities should first identify the sources of IRRBB to which the institution is or might be exposed. To do so, competent authorities should leverage the knowledge gained from ICAAP and ILAAP information collected for SREP purposes, from reporting established on IRRBB, from the assessment of other SREP elements, from the comparison of the institution's position to peers and from any other supervisory activities.

315. As a minimum, competent authorities should consider:

- a. the institution's governance of interest rate risk, including the main IRRBB strategy and the institution's risk appetite in relation to IRRBB;
- b. the impact of a supervisory outlier test as referred to in Article 98(5) of Directive 2013/36/EU, and any other supervisory outlier test, taking into account the EBA guidelines issued in accordance with that Article, on the economic value as a proportion of the institution's regulatory own funds, or Tier 1;
- c. the impact on earnings and economic value from a change in interest rates according to the methodology used by the institution; and
- d. the internal capital – where relevant – allocated to IRRBB, both in total and as a proportion of the institution's total internal capital according to its ICAAP, including the historical trend and forecasts, if available.

316. In their preliminary assessment, competent authorities should also consider significant changes in the institution's exposures to IRRBB. As a minimum, they should assess the following aspects:



- a. significant changes in the institution's overall IRRBB strategy, risk appetite, policy and limit sizes;
- b. the potential impact on the institution's risk profile of those changes;
- c. major changes in institutions' modelling, customer behaviour and use of interest rate derivatives and
- d. major market trends.

Nature and composition of the institution's interest rate risk profile

317. Competent authorities should form a clear view on how changes in interest rates can have an adverse impact on an institution's earnings and economic value (the present value of expected cash flows) to gain both a short-term and a longer-term view on the possible threat to capital adequacy.
318. For this purpose, competent authorities should analyse and form a clear view on the structure of the institution's assets, liabilities and off-balance-sheet exposures. In particular:
 - a. the different positions in the non-trading book, their maturities or re-pricing dates and behavioural assumptions (e.g. assumptions regarding products with uncertain maturity) for these positions;
 - b. the institution's interest cash flows, if available;
 - c. the proportion of products with uncertain maturity, and products with explicit and/or embedded options, paying particular attention to products with embedded customer optionality; and
 - d. the hedging strategy of the institution and the amount and use of derivatives (hedging vs. speculation).
319. To better determine the complexity and the interest rate risk profile of the institution, competent authorities should also understand the main features of the institution's assets, liabilities and off-balance-sheet exposures, in particular:
 - a. loan portfolio (e.g. volume of loans with no maturity, volume of loans with pre-payment options, volume of floating-rate loans with caps and floors, share of floating rate loan contracts that prevent repricing at negative rates, etc.);
 - b. bond portfolio (e.g. volume of investments with options, possible concentrations);



- c. non-performing exposures;
 - d. deposit accounts (e.g. rate sensitivity of the institution's deposit base to changes in interest rates including core deposits, possible concentrations);
 - e. derivatives (e.g. complexity of the derivatives used either for hedging or for speculative purposes, considerations about sold or bought interest rate options, impact of derivatives on the duration of non-trading book positions);and
 - f. nature of IRRBB embedded in the fair value instruments, including less liquid instruments such as Level 3 assets and liabilities.
320. When analysing the impact on the institution's earnings, competent authorities should consider the institution's different sources of income and expenses and their relative weights to total revenues. They should be aware of how much the institution's returns depend on interest-rate-sensitive positions, and they should determine how different changes in interest rates affect the institution's net interest income and determine the effects of the market value changes of instruments – depending on accounting treatment – either shown in the profit and loss account or directly in equity (e.g. via other comprehensive income).
321. When analysing the impact on the institution's economic value and earnings, competent authorities should first consider the results of a supervisory outlier test, as referred to in Article 98(5) of Directive 2013/36/EU, and any other supervisory outlier test, to get an initial benchmark against which to compare how interest rate changes affect the institution. To ensure compliance, competent authorities should take into account the EBA guidelines issued in accordance with that Article. When performing this assessment, competent authorities should pay particular attention to the sensitivity of cash flows repricing, both their timing and amount, to changes in the underlying key assumptions (particularly for customer accounts without specific re-pricing dates, customer accounts with embedded customer optionality and/or equity capital).
322. Competent authorities should seek to understand the impact of those assumptions and then isolating the economic value and earnings risks arising from the institution's behavioural adjustments.
323. Competent authorities should pay attention to the sensitivity of the cash flows to changes in the valuation of fair value instruments including interest rate derivatives in connection to interest rate changes (e.g. impact of mark-to-market changes in fair value instruments on P&L, hedge account effectiveness).
324. In addition to using the supervisory outlier test, as referred to in Article 98(5) of Directive 2013/36/EU, and any other supervisory outlier test, competent authorities should consider using their own designated shock scenarios (e.g. larger



or smaller, for all or some currencies, allowing for non-parallel shifts in rates, considering basis risk, etc.). When deciding the level at which to set these additional shock scenarios, competent authorities should take into account factors such as the general level of interest rates, the shape of the yield curve and any relevant national characteristics in their financial systems. The institution's internal systems should therefore be flexible enough to compute its sensitivity to any shock that is prescribed by the competent authority.

325. In their quantitative assessment, competent authorities should also consider the results of the institution's internal methodologies for measuring IRRBB, where appropriate. Through the analysis of these methodologies, competent authorities should gain a deeper understanding of the main risk factors underlying the institution's IRRBB profile.
326. Competent authorities should assess whether those institutions operating in different currencies perform an analysis of the interest rate risk in each currency in which they have a significant position. Competent authorities should also assess the approaches that the institutions use for the purpose of aggregating results of economic value and earnings measures in individual currencies.
327. When analysing the results of both the impact of the supervisory outlier tests and the institution's internal methodologies, competent authorities should consider 'point in time' figures as well as historical trends. These rates should be compared to peers and to the global market situation.

Shocks scenarios and stress testing

328. Competent authorities should assess and take into account the results of the interest rate shocks scenarios and stress tests (other than those for the supervisory outlier tests) performed by the institution as part of its ongoing internal management process. In that context, competent authorities should be aware of the main sources of IRRBB for the institution.
329. If, when the outcome of the institution's shock scenarios and stress tests is reviewed, particular accumulations of re-pricing/maturity at different points on the curve are revealed or suspected, competent authorities may require additional analysis.

6.5.3 Assessment of IRRBB management and controls (both risk management and compliance, and internal audit control functions)

330. To achieve a comprehensive understanding of the institution's interest rate risk profile in the non-trading book, competent authorities should review the governance and framework underlying its interest rate exposures.



331. Competent authorities should assess the following elements:
- a. IRRBB strategy and appetite (as distinct elements or as part of broader market risk strategy and appetite);
 - b. organisational framework and responsibilities;
 - c. policies and procedures;
 - d. risk identification, measurement including internal models, monitoring and reporting; and
 - e. internal control framework.

IRRBB strategy and appetite

332. Competent authorities should assess whether the institution has a sound, clearly formulated and documented IRRBB strategy, approved by the management body. For this assessment, competent authorities should take into account:
- a. whether the management body clearly expresses the IRRBB strategy and appetite and the process for the review thereof (e.g. in the event of an overall review of risk strategy, or concerns about profitability or capital adequacy), and whether senior management properly implements the IRRBB strategy approved by the management body, ensuring that the institution's activities are consistent with the established strategy, written procedures are drawn up and implemented, and responsibilities are clearly and properly assigned;
 - b. whether the institution's IRRBB strategy properly reflects the institution's appetite for IRRBB and whether it is consistent with the overall risk appetite;
 - c. whether the institution's IRRBB strategy and appetite are appropriate for the institution considering:
 - its business model;
 - its overall risk strategy and appetite;
 - its market environment and role in the financial system; and
 - its capital adequacy;
 - d. whether the institution's IRRBB strategy broadly covers all the activities of the institution where IRRBB is significant;
 - e. whether the institution's IRRBB strategy takes into account the cyclical aspects of the economy and the resulting shifts in the composition of IRRBB activities; and



- f. whether the institution has an appropriate framework in place to ensure that the IRRBB strategy is effectively communicated to relevant staff.

Organisational framework and responsibilities

333. Competent authorities should assess whether the institution has an appropriate organisational framework and clearly assigned responsibilities for IRRBB management, measurement, monitoring and control functions with adequate human and technical resources. They should take into account whether:
- a. there are clear lines of responsibility for the overall management of IRRBB, and for taking, monitoring, controlling and reporting IRRBB;
 - b. the IRRBB management and control area is subject to independent review and is clearly identified in the organisation and functionally and hierarchically independent of the business area; and
 - c. the staff dealing with interest rate risk (both in the business area and in the management and control areas) have appropriate skills and experience.

Policies and procedures

334. Competent authorities should assess whether the institution has clearly defined policies and procedures for the management of IRRBB that are consistent with its IRRBB strategy and appetite. They should take into account whether:
- a. the management body approves the policies for managing, measuring and controlling IRRBB and discusses and reviews them regularly in line with risk strategies;
 - b. senior management is responsible for developing them and ensuring adequate implementation of the management body's decisions;
 - c. IRRBB policies are compliant with relevant regulations and adequate for the nature and complexity of the institution's activities, enabling a clear understanding of the inherent IRRBB;
 - d. such policies are clearly formalised, communicated and applied consistently across the institution;
 - e. these policies are applied consistently across banking groups and allow proper management of IRRBB;
 - f. IRRBB policies define the procedures for new product development, major hedging or risk management initiatives and whether such policies have been



approved by the management body or its appropriate delegated committee. In particular, competent authorities should ensure that:

- new products, new major hedging and risk management initiatives are subject to adequate procedures and controls before being introduced or undertaken; and
- the institution has undertaken an analysis of their possible impact in its overall risk profile.

Risk identification, measurement including internal models, monitoring and reporting

335. Competent authorities should assess whether the institution has an appropriate framework for identifying, understanding, measuring and monitoring IRRBB, in line with the level, complexity and riskiness of the non-trading book positions and the institution's size and complexity. The assessment should encompass internal models, such as those related to customer behaviour (e.g. models of deposit stability and loan early repayment). They should consider:

- a. whether the information systems and measurement techniques enable management to measure the inherent IRRBB in all its material on- and off-balance-sheet exposures (where relevant at group level), including internal hedges, in the non-trading book portfolio;
- b. whether the institution has adequate staff and methodologies to measure IRRBB (in accordance with the requirements of the EBA Guidelines on the management of interest rate risk arising from non-trading activities – EBA guidelines on IRRBB), taking into account the size, form and complexity of their interest rate risk exposure;
- c. whether the assumptions underlying internal models and methodologies take into account the guidance established by the EBA guidelines on IRRBB. In particular, competent authorities should assess whether the institution's assumptions for positions with no contractual maturity and embedded customer options are prudent. Competent authorities should also assess whether institutions include equity in the calculation of economic value and, if they do, analyse the impact of removing equity from that calculation;
- d. whether the institution's risk measurement systems take into account all material forms of interest rate risk to which the institution is exposed (e.g. gap risk, basis risk and option risk). If some instruments and/or factors are excluded from the risk measurement systems, institutions should be able to explain why to supervisors and to quantify the materiality of the exclusions;



- e. whether institution's internal models used for the measurement of IRRBB have been properly developed, independently validated (including whether any expert opinions and judgments employed in the internal models have been thoroughly assessed), and reviewed regularly;
 - f. the quality, detail and timeliness of the information provided by the information systems and whether the systems are able to aggregate the risk figures for all the portfolios, activities and entities included in the consolidation perimeter. Information systems should comply with the guidance established by the EBA guidelines on IRRBB;
 - g. the integrity and timeliness of the data that feed the risk measurement process, which should also comply with the guidance established by the EBA guidelines on IRRBB;
 - h. whether the institution's risk measurement systems are able to identify possible IRRBB concentrations (e.g. in certain time buckets);
 - i. whether risk managers and the institution's senior management understand the assumptions underlying the measurement systems, especially with regard to positions with uncertain contractual maturity and those with implicit or explicit options, as well as the institution's assumptions for equity capital;
 - j. whether risk managers and the institution's senior management are aware of the degree of model risk that prevails in the institution's risk measurement techniques; and
 - k. whether the use of IR derivatives is compliant with the IRRBB risk strategy and whether those activities are performed within the risk appetite framework and with adequate internal governance arrangements in place.
336. Competent authorities should assess whether the institution has implemented adequate stress test scenarios that complement its risk measurement system. In their assessment, they should evaluate compliance with the relevant guidance established in the EBA guidelines issued in accordance with Article 98(5) of Directive 2013/36/EU.
337. Competent authorities should assess whether the institution has an appropriate monitoring and internal reporting framework for IRRBB that ensures there is prompt action at the appropriate level of the institution's senior management or management body, where necessary. The monitoring system should include specific indicators and relevant triggers to provide effective early warning alerts. Competent authorities should take into account whether the management and control area reports regularly (the frequency will depend on the scale, complexity



and level of IRRBB exposures) to the management body and senior management the following information, as a minimum:

- a. an overview of the current IRRBB exposures, P&L results and risk calculation, and the drivers of level and direction of IRRBB;
- b. significant breaches of IRRBB limits;
- c. changes in the major assumptions or parameters on which the procedures for assessing IRRBB are based; and
- d. changes in interest rate derivatives position and whether this is related to changes in the underlying hedging strategy.

Internal control framework

338. Competent authorities should assess whether the institution has a strong and comprehensive control framework and sound safeguards to mitigate its exposures to IRRBB in line with its risk management strategy and risk appetite. They should take into account:
 - a. whether the scope covered by the institution's control function includes all consolidated entities, all geographical locations and all financial activities;
 - b. whether there are internal controls, operating limits and other practices aimed at keeping IRRBB exposures at or below levels acceptable to the institution, in accordance with the parameters set by the management body and senior management and the institution's risk appetite; and
 - c. whether the institution has appropriate internal controls and practices to ensure that breaches of and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.
339. Competent authorities should assess the limit system, including whether:
 - a. it is consistent with the risk management strategy and risk appetite of the institution;
 - b. it is adequate for the complexity of the institution's organisation and IRRBB exposures, and for its ability to measure and manage this risk;
 - c. it addresses the potential impact of changes in interest rates on earnings and the institution's economic value; from an earning perspective, limits should specify acceptable levels of volatility for earnings under specified interest rate scenarios; the form of limits for addressing the effect of rates on an institution's



economic value should be appropriate for the size and complexity of the institution's activities and underlying positions;

d. the limits established are absolute or whether breaches of limits are possible; in the latter case, the institution's policies should clearly set out the period of time during which and the specific circumstances under which such breaches of limits are possible; competent authorities should request information about measures that ensure limits are adhered to; and

e. the institution has adequate procedures for reviewing its limits regularly.

340. Competent authorities should assess the functionality of the internal audit function. To this end, they should assess whether:

a. the institution conducts internal audits of the IRRBB management framework on a regular basis;

b. the internal audit covers the main elements of IRRBB management, measurement and control across the institution; and

c. the internal audit function is effective in determining adherence to internal policies and the relevant external regulations and addressing any deviations.

6.5.4 Summary of findings and scoring

341. Following the above assessment, competent authorities should form a view on the institution's IRRBB. This view should be reflected in a summary of findings, accompanied by a score based on the considerations specified in Table 7. If, based on the materiality of certain risk sub-categories, the competent authority decides to assess and score them individually, the guidance provided in this table should be applied, as far as possible, by analogy.

Table 7. Supervisory considerations for assigning a score to IRRBB

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is low level of risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The sensitivity of the economic value to changes in interest rates is not material/very low. The sensitivity of earnings to changes in interest rates is not material/very low. The sensitivity of the economic value and earnings to changes in the underlying assumptions (e.g. products with embedded 	<ul style="list-style-type: none"> There is consistency between the institution's interest rate risk policy and strategy and its overall strategy and risk appetite. The organisational framework for interest rate risk is robust with clear responsibilities and



		customer optionality) is not material/very low.	
2	There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The sensitivity of the economic value to changes in interest rates is low to medium. • The sensitivity of earnings to changes in interest rates is low to medium. • The sensitivity of the economic value and earnings to changes in the underlying assumptions (e.g. products with embedded customer optionality) is low to medium. 	<p>a clear separation of tasks between risk takers and management and control functions.</p> <ul style="list-style-type: none"> • Interest rate risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the control framework for interest rate risk are sound and are in line with the institution’s risk strategy and risk appetite.
3	There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The sensitivity of the economic value to changes in interest rates is medium to high. • The sensitivity of earnings to changes in interest rates is medium to high. • The sensitivity of the economic value and earnings to changes in the underlying assumptions (e.g. products with embedded customer optionality) is medium to high. 	
4	There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The sensitivity of the economic value to changes in interest rates is high. • The sensitivity of earnings to changes in interest rates is high. • The sensitivity of the economic value and earnings to changes in the underlying assumptions (e.g. products with embedded customer optionality) is high. 	



- (31). After paragraph 320 a new paragraph is added as follows:
“To address potential capital inadequacies in stressed conditions, competent authorities should take appropriate supervisory measures, including, where relevant, establishing and communicating Pillar 2 capital guidance (P2G) which is the quantity (amount) and quality (composition) of own funds that the institution is expected to hold over and above the OCR.”
- (32). Paragraph 323 is amended as follows:
“After considering the outcomes of the assessment of risks to capital as specified in Title 6, competent authorities should undertake the following steps as part of the SREP capital assessment process:
- i. determination of the additional own funds requirements;
 - ii. reconciliation of P2R and P2G with any macroprudential requirements;
 - iii. determination and articulation of the TSCR and OCR;
 - iv. assessment of the risk of excessive leverage;
 - v. assessment of whether the OCR and TSCR can be met in stressed conditions; and
 - vi. determination of P2G; and
 - vii. determination of the capital score.”
- (33). Section 7.3 is repealed and replaced by the following:

7.3 Reconciliation with macroprudential requirements

346. In determining additional own funds requirements (or other capital measures), competent authorities should reconcile the additional own funds requirements against any existing capital buffer requirements and/or macroprudential requirements addressing the same risks or elements of those risks. Competent authorities should not set additional own funds requirements or other capital measures (including P2G) where the same risk is already covered by specific capital buffer requirements and/or additional macroprudential requirements.
- (34). After paragraph 354, the example is deleted.
- (35). Paragraph 355 is amended as follows:
- a. the following phrase is added at the end of the paragraph “Also see the example provided in Section 7.9”;
 - b. the example is deleted



(36). Section 7.7 is repealed and replaced by the following:

7.7 Meeting requirements in stressed conditions

382. Competent authorities should determine by means of stress testing the adequacy of the institution's own funds (quantity and composition) in stressed conditions and whether supervisory measures, including P2G, capital plan and other measures as provided in Section 10 are necessary to address potential inadequacies.
383. To assess capital adequacy in stressed conditions, competent authorities should consider:
- a. the use of qualitative outcomes (e.g. identified deficiencies in risk management and controls) of institutions' stress tests and supervisory stress testing; and
 - b. the use of quantitative outcomes of ICAAP stress tests, if the ICAAP is deemed reliable in accordance with paragraph 358, and supervisory stress tests (i.e. outcomes in terms of changes in own funds ratios), pursuant to Article 100 of Directive 2013/36/EU as specified in Title 12 of these Guidelines, and ranging from, for example:
 - i. prescribing specific 'anchor' scenarios/assumptions to be implemented by institutions; to
 - ii. conducting system-wide stress tests using consistent methodologies and scenarios run either by institutions or by supervisors.
384. Competent authorities should assess as appropriate the impact of the quantitative outcomes of stress tests on the adequacy and quality of the institution's own funds and determine whether the quantity and quality of own funds are sufficient to cover applicable capital requirements, and in particular:
- a. OCR including its combined buffer requirements under the baseline scenario over a forward looking time horizon of at least two years;
 - b. TSCR under the adverse scenarios over a forward looking time horizon of at least two years; or
385. In cases where a pre-defined target ratio is set for a system-wide stress test (including country level stress tests) as referred to in paragraph 580, the competent authorities should assess the adequacy and quality of the institution's own funds also considering such target ratio.

7.7.2 Using P2G to address quantitative outcomes of stress testing

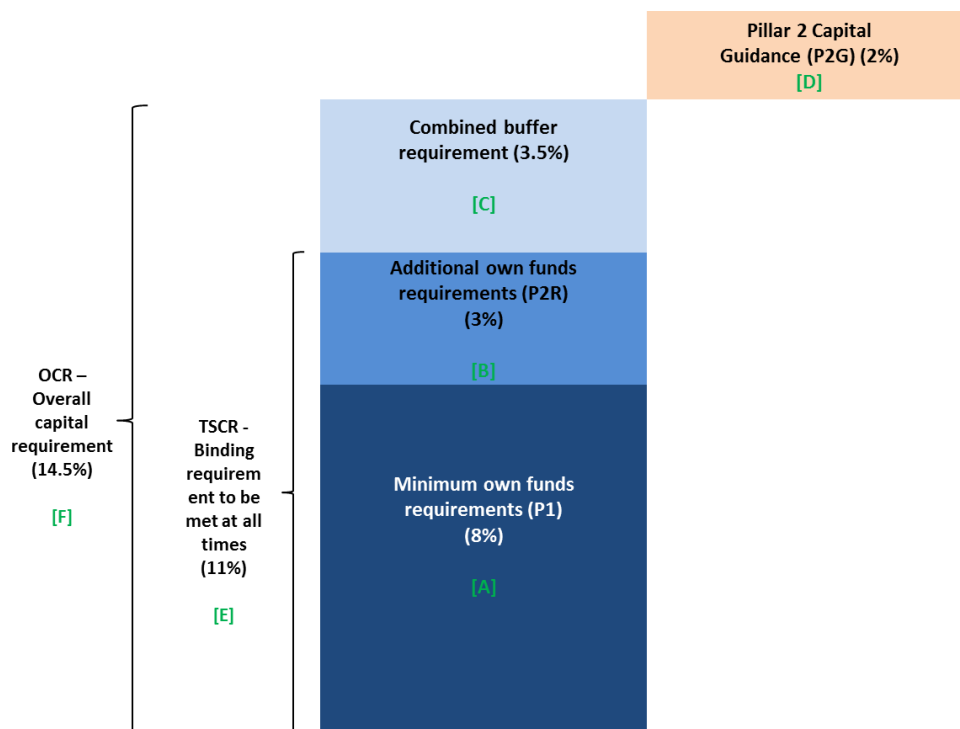
Determining and setting P2G



386. Competent authorities should determine P2G as specified in this section and where the determination leads to a positive value, competent authority should, set P2G to address supervisory concerns over the sensitivity of the institution towards adverse scenarios assumed in the supervisory stress tests.
387. Where the quantitative outcomes of the supervisory stress tests suggest that the institution is not expected to breach its TSCR under the adverse stress test scenario, competent authorities may decide not to set P2G.
388. Competent authorities should determine and set P2G based on the outcomes of the adverse scenario of the relevant supervisory stress tests including the EU-wide stress tests performed by the EBA or any other relevant supervisory stress tests performed on a system-wide basis using a multi-factor scenario analysis over a forward-looking horizon of at least two years (either top-down or bottom-up).
389. On the basis of establishing a proportionate approach for non-Category 1 institutions and subsidiaries of cross-border groups, for setting and updating P2G competent authorities may consider the outcomes of simplified forms of supervisory stress tests (e.g. through the use of supervisory prescribed 'anchor' scenarios, sensitivity analysis, 'top-down' stress tests conducted by designated authorities, portfolio level impacts from consolidated level stress tests) or past supervisory stress tests.
390. Competent authorities should determine and set P2G in accordance with the minimum engagement model specified in Section 2.2.4. In particular, the frequency for determining and setting P2G should follow the frequency of the capital adequacy assessment under the SREP minimum engagement model.
391. Notwithstanding the previous paragraph, competent authorities should assess whether the existing P2G level is still appropriate whenever the results of new supervisory stress tests are available, and revise the level of P2G, if necessary.
392. For institutions, where capital adequacy according to the SREP minimum engagement model should be assessed annually (e.g. SREP Category 1 institutions), P2G can be determined and set only every second year instead of annually. In the other year, competent authorities should assess on the basis of all relevant information, including outcomes of past supervisory stress tests together with additional sensitivity analysis, i.e. simplified forms of supervisory stress testing, whether P2G is still relevant or needs to be updated.
393. Competent authorities should generally not use P2G to cover risks which should be covered by the additional own funds requirements in accordance with Section 7.2 of these guidelines. P2G may cover certain aspects of the same risks addressed by P2R, to the extent that it covers aspects of those risks that are not already covered

under P2R. Likewise, competent authorities should not set P2R where the identified deficiencies should be addressed by means of P2G.

Figure 6. Stacking order of own funds requirements and P2G (please refer to the example presented in Title 7.9)



394. When determining the size of P2G, competent authorities should ensure that it is set at a level appropriate to cover at least the anticipated maximum stress impact, which should be calculated based on the changes in the CET1 ratio (i.e. considering both movements in CET1 capital and TREA) in the worst year of stress and taking into account the level of applicable capital requirements and considerations set out in paragraphs 395 – 397.

395. When determining the size of P2G, competent authorities should also consider, where relevant, the following factors:

- a. the year when maximum stress impact occurs in relation to the starting point and time horizon of the scenario of stress tests;
- b. the outcome of reliable ICAAP stress test to assess severity of the results;
- c. relevant management mitigating actions of the institution that are deemed credible following their supervisory assessment;



- d. information about and supervisory views on the relevance of the supervisory stress testing to the institution's strategy, financial plans and business model;
 - e. the quality (composition) of the institution's available own funds, including at the worst year of stress; and
 - f. whether the institution is under restructuring or resolution.
396. For the purpose of paragraph 395(b), competent authorities should also consider the extent to which stress scenarios cover all the material risks contributing to the additional own funds requirements in the TSCR. Competent authorities should in particular have regard to the fact that macro-economic downturn scenarios may not entirely capture some risks, for example conduct risk, pension risk or some elements of credit concentration risk (e.g. single name concentration) which may amplify potential losses under the tested adverse scenarios.
397. In addition, competent authorities should consider the extent to which the existing combined buffer requirements and other applicable macro-prudential measures already cover risks revealed by stress testing. Competent authorities should offset P2G against the capital conservation buffer (CCB), as P2G and CCB overlap in nature. Furthermore, while no overlap is in principle expected between P2G and the countercyclical capital buffer (CCyB), competent authorities should, in exceptional cases, offset P2G on a case-by-case basis against the CCyB based on the consideration of underlying risks covered by the buffer and factored into the design of the scenarios used for the stress tests, after liaising with the macro-prudential authority. Competent authorities should not offset P2G against the systemic risk buffers (G-SII/O-SII buffers and systemic risk buffer) as those are intended to cover the risks an institution poses to the financial system.

Communication and composition of P2G

398. Where P2G is set or updated, competent authorities should communicate to institutions the level of P2G and the relevant time limits for its establishment in accordance with paragraph 402. Competent authorities should also explain the potential supervisory reaction to situations where P2G is not met.
399. Competent authorities should communicate to institutions that P2G is expected to be met with CET1 eligible own funds and incorporated into their capital planning and risk management frameworks, including the risk appetite framework and recovery planning.
400. Competent authorities should also communicate to the institutions that own funds held for the purposes of P2G cannot be used to meet any other regulatory requirements (Pillar 1, P2R or the combined buffer requirements), and therefore



cannot be used twice: to cover P2G and to cover for any shortfall of AT1 or T2 instruments to cover TSCR revealed by the outcome of the stress test.

401. Competent authorities should additionally communicate to institutions and where relevant, other competent authorities, all applicable own funds ratios affected by P2G (CET1, T1 and total own funds).
402. When setting and communicating to the institutions time limits to establish P2G competent authorities should consider at least the following:
 - a. whether an institution is under the restructuring or resolution; and
 - b. the potential implication CET1 denominated P2G may have on other parts of the capital requirements and ability of institutions to issue AT1 or Tier 2 instruments.
403. Institutions are generally expected not to disclose P2G, unless they are legally required to do so. In particular, institutions are expected to evaluate whether that information meets the criteria of insider information, and if so, ensure compliance with EU legislation, including Regulation No 596/2014/EU.

7.7.3 Capital planning and other supervisory measures to address capital adequacy in stressed conditions

Capital planning

404. When the quantitative outcomes of the stress tests referred to in section 7.7.1 indicate that, under the given stress scenarios, an institution will not be able to meet the applicable capital requirements, competent authorities should require the institution to submit a credible capital plan that addresses the risk of not meeting its applicable capital requirements.
405. To determine the credibility of the capital plan, the competent authority should consider, as appropriate:
 - a. whether the capital plan covers entirely the assumed time horizon;
 - b. whether the capital plan puts forward a set of credible mitigating and management actions, restricting dividend payments etc.;
 - c. whether the institution is willing and able to take such actions in order to address the breaches of the applicable capital requirements in the system-wide stress tests;
 - d. whether those mitigating and management actions are subject to any legal or reputational constraints, for instance due to contrary or conflicting former public announcements e.g. on dividend policies, business plans and risk appetite;



- e. the probability that mitigating and management action would enable the institution to fully meet its applicable capital requirements within an appropriate timeframe; and
 - f. whether the proposed actions are broadly in line with macro-economic considerations and with future regulatory changes affecting an institution within the scope and timeline of the assumed adverse scenarios.
406. When assessing capital plans, the competent authority should, where appropriate, following an effective dialogue with the institution, require the institution to make changes to those plans as appropriate, including to the proposed management actions, or require institutions to take additional mitigating actions that would become relevant given the scenarios and current macroeconomic conditions.
407. Competent authorities should expect institutions to implement the revised capital plan, including further changes made based on the results of the supervisory assessment and dialogue with an institution.

Additional supervisory measures

408. Competent authorities should, where relevant, consider the application of additional supervisory measures specified in Title 10, to ensure that the institution is adequately capitalised in stressed conditions.
409. In particular, where the quantitative outcomes of the stress tests indicate that the institution is likely to breach its applicable capital requirements under the adverse scenario within the following 12 months, the competent authorities should, where appropriate, treat such information as one of the possible circumstances within the meaning of Directive 2013/36/EU Article 102 (1)(b). In such cases the competent authorities should apply appropriate measures in accordance with Article 104(1) of Directive 2013/36/EU aimed at ensuring sufficient levels of own funds. In particular, when such measures relate to capital, competent authorities should notably consider one, or both of the following, as defined in Directive 2013/36/EU Article 104(1)(a) and (f):
- a. requiring institutions to hold appropriate amount of additional own funds in the form of a nominal amount, considering the outcome of the SREP assessment;
 - b. requiring the reduction of the inherent risk of its activities, products and systems.
- (37). In paragraph 369 before the words “score based” the word “viability” is added.
- (38). Table 8 is replaced by the following:

Score	Supervisory view	Considerations
1	The quantity and composition of own funds held pose low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution is able to comfortably meet its P2G. • The institution holds a level of own funds comfortably above the OCR and is expected to do so in the future. • Stress testing does not reveal any discernible risk regarding the impact of a severe but plausible economic downturn on own funds. • The free flow of capital between entities in the group, where relevant, is not impeded, or all entities are well capitalised above supervisory requirements. • The institution has a plausible and credible capital plan that has the potential to be effective if required. • The institution's leverage ratio is comfortably above any regulatory minimum and there is not material/very low risk of excessive leverage.
2	The quantity and composition of own funds held pose a medium-low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution has difficulty to meet its P2G. Management mitigating actions to address this are assessed as credible. • The institution is near to breaching some of its capital buffers but is still clearly above its TSCR. • Stress testing reveals a low level of risk regarding the impact of a severe but plausible economic downturn on own funds, but management actions to address this seem credible. • The free flow of capital between entities in the group, where relevant, is or could

		<p>be marginally impeded.</p> <ul style="list-style-type: none"> • The institution has a plausible and credible capital plan that, although not without risk, has the potential to be effective if required. • The institution's leverage ratio is above any regulatory minimum. There is a low level of risk of excessive leverage.
3	The quantity and composition of own funds held pose a medium-high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution does not meet its P2G. There are concerns over the credibility of management mitigating actions to address this. • The institution is using some of its capital buffers. There is potential for the institution to breach its TSCR if the situation deteriorates. • Stress testing reveals a medium level of risk regarding the impact of a severe but plausible economic downturn on own funds. Management actions may not credibly address this. • The free flow of capital between entities in the group, where relevant, is impeded. • The institution has a capital plan that is unlikely to be effective. • The institution's leverage ratio is above any regulatory minimum, but stress testing reveals concerns about the impact of a severe but plausible economic downturn on the ratio. There is a medium level of risk of excessive leverage.
4	The quantity and composition of own funds held pose a high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution does not meet its P2G (or deliberately does not establish P2G) and is not able to do so in the foreseeable future. Management mitigating actions to address this are assessed as not credible.

		<ul style="list-style-type: none"> • The institution is near to breaching its TSCR. • Stress testing reveals that the TSCR would be breached near the beginning of a severe but plausible economic downturn. Management actions will not credibly address this. • The free flow of capital between entities in the group, where relevant, is impeded. • The institution has no capital plan, or one that is manifestly inadequate. • The institution's leverage ratio is near to breaching any regulatory minimum. There is a high level of risk of excessive leverage.
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(39). After section 7.8 the following section is added:

7.9 Communication of prudential requirements

Example of communicating prudential requirements (see also Figure 6):

As of DATE and until otherwise communicated, INSTITUTION is expected to operate above a ratio of [16.5%] of the TREA, that is the sum of TSCR (E), the combined buffer (C) and P2G (D), the latter to be covered with 100% CET1.

Of this [16.5%]:

- ***[11%] represents the total SREP capital requirement (TSCR) (E), which must be met at all times, of which:***

- ***8% (comprising at least 56% CET1 and 75% T1) represents own funds requirements specified in Article 92 of Regulation (EU) No 575/2013;***

- ***[3%] represents additional own funds in excess of the requirements (B) specified in Article 92 of Regulation (EU) No 575/2013, of which [2%] (comprising at least XX% CET1 and YY% T1) is to cover unexpected losses identified through the SREP and [1%] (comprising at least XX% CET1 and YY% T1) is to cover OTHER [e.g. governance concerns] identified through the SREP.***

- ***[3.5%] represents the combined buffer requirements (C) (100% CET1) applicable to INSTITUTION, of which:***

- ***[2.5%] represents the capital conservation buffer requirement;***

- ***[1%] represents the OTHER [e.g. counter-cyclical capital buffer (CCyB) and O-SII] requirement.***

- ***[2%] represents the Pillar 2 Guidance (P2G) (D) which is a non-legally binding***

expectation on top of the 14.5 % OCR (F) identified in an idiosyncratic and risk sensitive way, to address INSTITUTION's ability to maintain applicable own funds requirements (and effectively systemic risk buffers) in stressed conditions as revealed by the quantitative results of the supervisory stress tests performed in accordance with Article 100 of Directive 2013/36/EU.

For the above communication, it should be kept in mind that buffer rates may change prior to the next SREP decision (implying potentially a different OCR in the meantime).

For the above example, capital requirements can be summarised as follows:

Total SREP Capital Requirement (TSCR), Overall Capital Requirement (OCR) and Pillar 2 Guidance (P2G)		
Prudential requirements	Amount	Background calculations
Total SREP capital requirement ratio (TSCR)	11.0%	
of which: respective CET1 capital ratio	6.2%	<i>Pillar 1 CET1 ratio (4.5%) plus P2R CET1 ratio (56% of 3%)</i>
of which: respective Tier 1 ratio	8.3%	<i>Pillar 1 T1 ratio (6%) plus P2R T1 ratio (75% of 3%)</i>
Overall capital requirement ratio (OCR)	14.5%	
of which: respective CET1 capital ratio	9.7%	<i>TSCR CET1 ratio (6.2%) plus the combined buffer (3.5%)</i>
of which: respective Tier 1 ratio	11.8%	<i>TSCR T1 ratio (8.3%) plus the combined buffer (3.5%)</i>
OCR and Pillar 2 Guidance (P2G)	16.5%	
of which: respective CET1 capital ratio	11.7%	<i>OCR CET1 ratio (9.7%) plus P2G (2%)</i>
of which: respective Tier 1 ratio	13.8%	<i>OCR T1 ratio (11.8%) plus P2G (2%)</i>

(40). At the end of paragraph 378 after the word 'score' the following phrase is added: "as explained in the following sections."

(41). The content of paragraphs 379 and 380 is deleted.

(42). In paragraph 408 the phrase 'CEBS Guidelines on stress testing' is replaced by "EBA Guidelines on institution's stress testing"

(43). In paragraph 425 the word 'risk' is added before the word 'score'.



(44). Table 9 is replaced by the following:

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is low level of risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • There is non-material/very low risk arising from mismatches (e.g. between maturities, currencies, etc.). • The size and composition of the liquidity buffer is adequate and appropriate. • Other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) are not material/very low. 	<ul style="list-style-type: none"> • There is consistency between the institution’s liquidity risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for liquidity risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. • Liquidity risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the control framework for liquidity risk are sound and are in line with the institution’s risk management strategy and risk appetite/tolerance.
2	There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • Mismatches (e.g. between maturities, currencies, etc.) imply low to medium risk. • The risk from the size and composition of the liquidity buffer is low to medium. • Other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) are low to medium. 	
3	There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • Mismatches (e.g. between maturities, currencies, etc.) imply medium to high risk. • The risk from the size and composition of the liquidity buffer is medium to high. • Other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) are medium to high. 	
4	There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • Mismatches (e.g. between maturities, currencies, etc.) imply high risk. • The risk from the size and composition of the liquidity buffer is high. • Other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) are high. 	

(45). Table 10 replaced by the following:

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is low level of risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • There is non-material/very low risk arising from mismatches (e.g. between maturities, currencies, etc.). • The size and composition of the liquidity buffer is adequate and appropriate. • Other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) are not material/very low. 	<ul style="list-style-type: none"> • There is consistency between the institution's liquidity risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for liquidity risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. • Liquidity risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the control framework for liquidity risk are sound and are in line with the institution's risk management strategy and risk appetite/tolerance.
2	There is a medium-low risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • Mismatches (e.g. between maturities, currencies, etc.) imply low to medium risk. • The risk from the size and composition of the liquidity buffer is low to medium. • Other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) are low to medium. 	
3	There is a medium-high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • Mismatches (e.g. between maturities, currencies, etc.) imply medium to high risk. • The risk from the size and composition of the liquidity buffer is medium to high. • Other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) are medium to high. 	
4	There is a high risk of significant prudential impact on the institution considering the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • Mismatches (e.g. between maturities, currencies, etc.) imply high risk. • The risk from the size and composition of the liquidity buffer is high. • Other drivers of liquidity risk (e.g. reputational risk, inability to transfer intra-group liquidity, etc.) are high. 	

(46). In paragraph 454 the word 'viability' is added before the word 'score'.

(47). Table 12 is replaced by the following:

Score	Supervisory view	Considerations
1	The institution's liquidity position and funding profile pose low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are comfortably above specific supervisory quantitative requirements and are expected to remain so in the future. • The composition and stability of longer-term funding (>1 year) pose non-material/very low risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is not impeded, or all entities have a counterbalancing capacity and liquidity buffers above supervisory requirements. • The institution has a plausible and credible liquidity contingency plan that has the potential to be effective if required.
2	The institution's liquidity position and/or funding profile pose a medium-low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are above the specific supervisory quantitative requirements, but there is a risk that they will not remain so. • The composition and stability of longer-term funding (>1 year) pose a low level of risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is or could be marginally impeded. • The institution has a plausible and credible liquidity contingency plan that, although not without risk, has the potential to be effective if required.

3	The institution's liquidity position and/or funding profile pose a medium-high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are deteriorating and/or are below specific supervisory quantitative requirements, and there are concerns about the institution's ability to restore compliance with these requirements in a timely manner. • The composition and stability of longer-term funding (>1 year) pose a medium level of risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is impeded. • The institution has a liquidity contingency plan that is unlikely to be effective.
4	The institution's liquidity position and/or funding profile pose a high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are rapidly deteriorating and/or are below the specific supervisory quantitative requirements, and there are serious concerns about the institution's ability to restore compliance with these requirements in a timely manner. • The composition and stability of longer-term funding (>1 year) pose a high level of risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is severely impeded. • The institution has no liquidity contingency plan, or one that is manifestly inadequate.

(48). In paragraph 463 the word 'viability' is added before the words 'score based'.

(49). Table 13 is replaced by the following:

Score	Supervisory view	Considerations
1	The risks identified pose low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution's business model and strategy do not raise concerns. • The internal governance and institution-wide control arrangements do not raise concerns. • The institution's risks to capital and liquidity pose non-material/very low risk of a significant prudential impact. • The composition and quantity of own funds held do not raise concerns. • The institution's liquidity position and funding profile do not raise concerns. • The institution's overall recovery capacity does not raise concerns.
2	The risks identified pose a medium-low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • There is a low to medium level of concern about the institution's business model and strategy. • There is a low to medium level of concern about the institution's governance or institution-wide control arrangements. • There is a low to medium level of risk of significant prudential impact from risks to capital and liquidity. • There is a low to medium level of concern about the composition and quantity of own funds held. • There is a low to medium level of concern about the institution's liquidity position and/or funding profile. • There is a low to medium level of concern about the institution's overall recovery capacity.
3	The risks identified pose a medium-high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • There is a medium to high level of concern about the institution's business model and strategy. • There is a medium to high level of concern about the institution's governance or institution-wide control arrangements. • There is a medium to high level of risk of significant prudential impact from risks to capital and liquidity.

		<ul style="list-style-type: none"> • There is a medium to high level of concern about the composition and quantity of own funds held by the institution. • There is a medium to high level of concern about the institution's liquidity position and/or funding profile. • There is a medium to high level of concern about the institution's overall recovery capacity.
4	The risks identified pose a high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • There is a high level of concern about the institution's business model and strategy. • There is a high level of concern about the institution's governance or institution-wide control arrangements. • There is a high level of risk of significant prudential impact from risks to capital and liquidity. • There is a high level of concern about the composition and quantity of own funds held by the institution. • There is a high level of concern about the institution's liquidity position and/or funding profile. • There is a high level of concern about the institution's overall recovery capacity.
F	The institution is considered to be 'failing or likely to fail'.	<ul style="list-style-type: none"> • 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/EU²³.

(50). Paragraph 465 is replaced by the following:

“Competent authorities should impose additional own funds requirements and establish own funds expectations by setting the TSCR and determining P2G where relevant in accordance with the process and criteria specified in Title 7”.

²³ In particular, the competent authority is of the view that (1) the institution infringes, or there are objective elements to support a determination that the institution will, in the near future, infringe, the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority, for reasons including but not limited to the fact that the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds; (2) the institution's assets are, or there are objective elements to support a determination that the institution's assets will, in the near future, be, less than its liabilities; or (3) the institution is, or there are objective elements to support a determination that the institution will, in the near future, be, unable to pay its debts or other liabilities as they fall due.

Article 32(4)(d) of Directive [2014/59/EU](#) also identifies extraordinary public support criteria for the determination of whether an institution is 'failing or likely to fail', but these criteria are not considered for the SREP and the determination made by the competent authorities.



(51). The following subsection is added after paragraph 476:

Supervisory measures based on the outcome of the qualitative review of stress testing

516. Based on the outcomes of the qualitative review of stress testing programmes and in case deficiencies are identified, competent authorities should require the institution:
- a. to develop a plan of remedial actions aimed at improving the stress testing programmes and practices. In cases where material shortcomings are identified in how an institution addresses the outputs of stress tests, or if management actions are not deemed credible, competent authorities should require the institution to take further remedial actions, including requirements to make changes to the institution's capital plan;
 - b. where appropriate, require institutions to run specific prescribed scenarios (or elements of those) or specific assumptions.
517. Furthermore, competent authorities may apply other supervisory measures that are provided in Articles 104 and 105 of Directive 2013/36/EU and which are more appropriate to address the identified deficiencies as described in this section.
518. It is noted that supervisory assessment of the outcomes of reverse stress tests should assist with the assessment of business model viability and sustainability, and assessment of scenarios used for ICAAP and ILAAP purposes, as well as in recovery planning.
519. Competent authorities should also use the outcomes of reverse stress tests performed by institutions to take into account possible systemic implications. Where several institutions identify similar reverse stress test scenarios that would expose these institutions to severe vulnerabilities, such scenarios should be analysed as an alert about possible systemic implications. Competent authorities should in such case inform the relevant designated authorities about the nature of the stress scenarios identified.'

(52). After paragraph 499 the following sections are added:

10.6 Supervisory reaction to the situation where TSCR is not met

543. TSCR is a legally binding requirement that institutions have to meet at all times, including in stressed conditions. Notably, if the TSCR set in accordance with these guidelines is no longer met, the competent authorities should consider additional intervention powers in accordance with Directive 2013/36/EU and 2014/59/EU, including withdrawal of authorisation in accordance with Article 18(d) of Directive



2013/36/EU, application of early intervention measures in accordance with Article 27 of Directive 2014/59/EU and resolution actions in accordance with that Directive. When exercising those powers competent authorities should consider whether measures are proportionate to the circumstances and their judgement on how the situation is likely to develop.

544. The breach of the TSCR should also be considered in determining whether an institution is 'failing or likely to fail' in accordance with Article 32(4)(a) of Directive 2014/59/EU and the *EBA Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail*, as it is one of the conditions where the competent authorities may withdraw the authorisation in accordance with Article 18(d) of Directive 2013/36/EU.

10.7 Supervisory reaction to the situation where P2G is not met

545. Competent authorities should monitor whether the amount of own funds expected according to P2G is established and maintained by the institution over time.
546. When the institutions' own funds drop, or are likely to drop below the level determined by P2G, the competent authority should expect the institution to notify the competent authority and prepare a revised capital plan. In its notification, the institution should explain what adverse consequences are likely to force it to do so and what actions are envisaged for the eventual restoration of compliance with P2G as part of an enhanced supervisory dialogue.
547. There are generally three situations to be considered by a competent authority in which an institution could fail to meet the P2G:
- a. where the level of own funds fall below the level of the P2G (while remaining above the OCR) in institution-specific or external circumstances in which the risks that P2G was aimed at covering have materialised, the institution may temporarily operate below the level of the P2G provided that the competent authority considers its revised capital plan credible in accordance with the criteria set out in section 7.7.3. The competent authority may also consider adjusting the level of P2G where appropriate;
 - b. where the level of own funds fall below the level of P2G (while remaining above the OCR) in institution-specific or external circumstances was a result of the materialisation of the risks that P2G was not aimed at covering, competent authorities should expect the institution to increase the level of own funds to the level of P2G within an appropriate time line;
 - c. where the institution disregards P2G, does not incorporate it into its risk management framework or does not establish own funds to meet P2G within



the time limits set in accordance with paragraph 398, this may lead to competent authorities applying additional supervisory measures as set out in Sections 10.3 and 10.5. Where appropriate, the competent authority may decide to review the level of additional own funds requirement, in accordance with Title 7.

548. Notwithstanding particular supervisory responses in accordance with the previous paragraph, competent authorities may also consider the application of capital and additional supervisory measures set out in Sections 10.3 and 10.5 where deemed more appropriate to address the reasons for the own funds falling below the level determined by P2G.

(53). Paragraph 503 is replaced by:

‘Where the macro-prudential measure, because of its design specificities, does not cover a particular institution (as discussed above), competent authorities may consider after having consulted the relevant designated authority, extending the effects of the measure directly to that institution (e.g. by applying the equivalent risk weights for certain classes of exposures targeted by the macro-prudential measure).’

(54). After paragraph 518 the following paragraphs are added:

“568. All relevant information regarding the determination of P2G (including its size, composition of own funds to cover it, and supervisory reaction) for parent or subsidiary institutions of a cross-border group should be shared among competent authorities as part of the joint decision process pursuant to Article 113 of Directive 2013/36/EU. In particular, competent authorities should discuss the approach to establishing P2G at solo levels where no data from the supervisory stress tests is available at solo level, or, where relevant, agree on the application of P2G at the consolidated level only.

569. Where P2G is set, relevant information should be duly reflected in the joint decision document prepared in accordance with Article 113 of Directive 2013/36/EU and the Commission Implementing Regulations (EU) No 710/2014, and included as an ‘information item’ similar to the application of other supervisory measures formally outside the scope of joint decision.”

(55). After paragraph 520 a new Title 12 is added as follows:

Title 12. Supervisory stress testing

12.1 Use of supervisory stress testing by competent authorities



572. Competent authorities should, also on the basis of Article 100 of Directive 2013/36/EU, use supervisory stress testing to facilitate the SREP and, in particular, supervisory assessment of its key elements, as these are described in Title 4 – Title 9. In particular, supervisory stress testing should help, where appropriate, competent authorities with the following:
- a. to assist in the assessment of the institutions' individual risks to capital as referred to in Title 6, or risks to liquidity and funding as referred to in Title 8;
 - b. to assess the reliability of institutions' stress testing programme as well as the relevance, severity and plausibility of scenarios for institution's own stress tests used for ICAAP and ILAAP purposes. This may include challenging institutions' main assumptions and risk drivers.;
 - c. to assess the institution's ability to meet the respective TSCR and OCR in the context of the assessment of capital adequacy, as specified in Section 7.7. Depending on the coverage and type of the supervisory stress test, such assessment may be limited only to some elements of the TSCR covered by the design features of the supervisory stress testing (e.g. additional own funds requirements for individual risk categories, in case the stress test covers only such risk categories);
 - d. to assist with the determination of P2G for institutions;
 - e. to assist in the identification of possible vulnerabilities or weaknesses in institutions' risk management and controls of individual risk areas;
 - f. to assist in the identification of possible deficiencies in the overall governance arrangements or institution-wide controls: supervisory stress testing should be considered by competent authorities as an additional source of information for the purposes of the SREP assessment of internal governance and institution-wide controls referred to in Title 5. In particular, if a competent authority identifies by means of supervisory stress testing, deficiencies in the institution's own stress testing programmes or supporting risk data infrastructure, these should be taken into account in the assessment of the overall governance and risk management framework of that institution;
 - g. to contribute to the determination of specific quantitative liquidity requirements in the context of the assessment of liquidity adequacy, especially in the case when a competent authority has not developed specific supervisory benchmarks for liquidity requirements. Certain elements of the liquidity supervisory stress tests should, where appropriate, be used as an input into setting specific liquidity requirements to institutions (e.g. from comparative analysis, under adverse scenarios, of net cash outflows and eligible liquid assets over a set of time horizons, assessment of stressed maturity ladder) as specified in Section 9.4.
573. Furthermore, supervisory stress testing should help competent authorities with assessing supervisory organisational procedures and with planning supervisory resources, considering also other relevant information, in particular for the more frequent and in-depth assessment of certain SREP elements in case of non-Category 1 institutions, and for



the purposes of determining the scope of supervisory examination programme as required by Article 99 of Directive 2013/36/EU.

574. Competent authorities should also, where appropriate, use the scenarios and outcomes of supervisory stress tests as additional sources of information in the assessment of institutions' recovery plans, in particular, when assessing the choice and severity of scenarios and assumptions used by the institution. In this assessment, the supervisory stress tests scenarios should, where appropriate, in particular where they satisfy the conditions set out in the EBA Guidelines on the range of scenarios to be used in recovery plans, be used as a reference point for the assessment of the institution's own scenarios and assumptions.
575. Competent authorities should also, where appropriate, use supervisory stress testing outcomes to support the analysis needed for the purposes of granting various permissions and authorisations required by Regulation (EU) 575/2013 or Directive 2013/36/EU, for example in relation to qualifying holdings, mergers and acquisitions, shares buy-backs.
576. Competent authorities should also use the outcomes of supervisory stress testing, where appropriate, to support thematic analysis of potential vulnerabilities of a group of institutions with similar risk profiles.
577. Competent authorities should also, where appropriate, use supervisory stress testing as a way to motivate institutions to enhance their internal stress testing and risk management capabilities: in particular, a supervisory stress test with a bottom-up component could motivate institutions to further develop and improve their data aggregation, risk modelling and IT tools for stress testing and risk management purposes.

12.2 Key elements of supervisory stress testing

578. When deciding on the key elements of supervisory stress testing, competent authorities should consider, inter alia, the following:
 - a. Coverage, in terms of covering certain risk factors or multiple risk factors, certain individual portfolio or activities or sectors/geographies, all or several portfolios.
 - b. Design, in terms of the following: (1) sensitivity analysis (single- or simple multi-factor), (2) scenario analysis, or (3) reverse stress testing. Competent authorities should choose the design that is the most appropriate for the objective pursued by the stress test: sensitivity analysis to a single or multiple risk factors should normally be favoured when assessing individual risk to capital or risks to liquidity or funding; the scenario analysis approach should normally be favoured when the assessment of overall capital adequacy is sought; while reverse stress testing may, among others, be deemed appropriate for assessing the severity of the scenarios used by the institutions.
 - c. Scope, in terms of covering the perimeter of cross-border groups: for the purposes of the assessment of the overall group capital adequacy, competent authorities should ensure that all relevant group entities are taken into account for such stress test.



- d. Sample of institutions covered by the stress tests: when considering supervisory stress testing for more than one institution, competent authorities should consider the appropriate sample for the purposes of the exercise, in particular when using supervisory stress testing for thematic assessments of certain business lines/models or impact studies/assessments.
 - e. Approach, in terms of top-down stress test, bottom-up stress test, or combination of both.
579. When designing and conducting supervisory stress tests for SREP purposes, competent authorities should consider the outcomes of asset quality reviews (AQR), where available, appropriate and not already incorporated in institutions' financial statements. Combining supervisory stress testing together with AQR can be considered useful for ensuring that the balance sheet positions of the institutions covered by the supervisory stress tests are reported accurately with improved and comparable starting points across participating institutions.
580. Competent authorities may also consider setting pre-defined target capital ratios, especially in the context of system-wide stress tests (including country level stress tests), or setting general or idiosyncratic thresholds. In such cases, those must be suitable by taking into account the supervisory objectives. Such targets or thresholds should apply consistently to the institutions under the scope of the supervisory stress tests.

12.3 Organisational and governance arrangements within competent authorities

581. Competent authorities should establish an effective programme for supervisory stress testing. This programme should be supported by appropriate organisation, governance and IT arrangements ensuring that supervisory stress tests can be conducted with appropriate frequency. The supervisory stress testing programme should support the effective implementation of the supervisory examination programme for the individual institutions. The programme should also reflect how the competent authority takes decisions regarding the choice of forms of supervisory stress testing in close connection to the objectives of each exercise.
582. The governance, organisation and IT arrangements supporting the supervisory stress testing programme should include at least the following:
- a. sufficient human and material resources, data and IT infrastructure to design and conduct supervisory stress tests. In particular, the supervisory stress testing programme should be supported by adequate data and an appropriate methodological approach covering all aspects, including scenarios and assumptions (e.g. templates, guidance, documentation) and ensuring both flexibility and appropriate levels of quality and controls;



- b. quality assurance process covering stress testing design, development and execution and comparability of results across institutions;
 - c. integration of supervisory stress testing into other relevant supervisory processes. Hence, when required and subject to any legal constraints, the organisation should support the internal sharing of information and utilisation of all aspects of the stress testing programme (e.g. both quantitative and qualitative results).
583. Within the governance arrangement, competent authorities should ensure that the supervisory stress testing programme is reviewed regularly, both qualitatively and quantitatively to ensure it is adequate.
584. Competent authorities should ensure that they have processes and arrangements in place for an effective dialogue with institutions regarding supervisory stress tests and their outcomes. This dialogue should reflect the intended objectives, be established in particular but not exclusively when the supervisory stress tests are run for the purposes of the assessment of the overall capital adequacy of institutions and be organised within the more general context of the SREP assessments as set out in these Guidelines. For the purposes of such dialogue both at the technical and managerial level, where relevant, the competent authorities should ensure that:
- a. adequate, sufficiently detailed and accurate explanation and guidance is provided to institutions on the application of the methodologies and assumptions for a bottom-up stress test;
 - b. adequate, sufficiently detailed and accurate instructions are given to institutions with regard to the supporting information required by them to be submitted to competent authorities along with the results of the calculation of the stress tests;
 - c. explanation is provided to institutions following discussions, where relevant, of the outcomes of supervisory stress tests that lead to the application of supervisory measures. This should be particularly considered by competent authorities especially in the context of system-wide stress tests which trigger supervisory measures.
585. When applying supervisory stress testing to cross-border groups and their entities, competent authorities should exchange information and, where practically possible, appropriately discuss the process within the framework of colleges of supervisors. In particular, the competent authorities should ensure that relevant details on the methodologies, scenarios, major assumptions as well as the results of supervisory stress testing, especially those aimed at assessing capital or liquidity adequacy, are provided and discussed.
586. Competent authorities should also identify what information regarding supervisory stress tests and their outcomes may be publicly disclosed, taking into account the intended purposes of the supervisory stress tests. When deciding on the public disclosure of the results or methodologies of supervisory stress tests, competent authorities should



consider their own role in the exercise and the approach chosen (top-down stress test, bottom-up stress test) and also consider the extent of their own analysis to accompany published results.

12.4 Process and methodological considerations

587. The supervisory stress testing programme set out by the competent authorities should ensure at least the following:
- a. When designing methodologies and assumptions for supervisory stress tests, competent authorities should decide on the design and features of the exercise which are most suitable for its intended purpose, i.e. that is linked to the supervisory (or other) objectives set by the competent authority.
 - b. When conducting supervisory stress tests on a wider sample of different institutions, competent authorities may consider adopting the design of supervisory stress tests for different categories of institutions as set out in Section 2.4, especially if the exercise is run top-down.
 - c. Competent authorities should consider the appropriate timelines for conducting supervisory stress tests, including the time horizon of the scenarios and the period over which the management actions proposed by institutions in the stress test exercise are analysed. The timelines of the exercise should also factor in the dialogue with an institution, where relevant for the intended purpose of the exercise and the extent to which the data supplied by the participating institution will remain relevant.
 - d. Competent authorities should consider, where relevant for the intended purpose of the exercise, all known future regulatory changes affecting institutions within the scope and time horizon of the exercise.
588. In case of a scenario analysis stress tests, competent authorities should decide whether to run a single scenario to be applied to all institutions included in the scope of the exercise, or to develop institution-specific scenarios for individual institutions (the latter should not be seen as relieving institutions from the responsibility of designing own scenarios for the purposes of ICAAP and ILAAP stress testing), or a combination of the two. Competent authorities should consider the transferability of capital and liquidity resources in stressed conditions and consider any possible impediments, including legal and operational impediments that may exist.
589. Furthermore, the following aspects should be considered when developing the methodologies for supervisory stress tests:
- a. for the purposes of the assessment of capital adequacy, competent authorities should consider the impact of the stress test on the institutions' profit and loss, balance sheet, risk exposure amount, leverage ratio, and analyse the impact of the stress test capital ratios of institutions covered by the exercise.

- b. for the purposes of bottom-up stress tests, competent authorities should consider the extent to which they prescribe the methodologies for modelling institutions' balance sheets and profit and loss. Indicatively, institutions' balance sheets may be taken as static, allowing competent authorities to assess of current risks over time. Alternatively, they may be allowed to be dynamic, permitting for example, a more forward-looking exploration of how institutions' business plans might evolve under the stress scenario or how credit volumes could evolve over time. For enhanced comparability, competent authorities may consider opting for the static balance sheet approach. Conversely, for enhanced feedback on the institutions' intended or planned reactions vis-a-vis stresses and shocks, the dynamic balance sheet approach may be favoured.
- c. competent authorities should consider how to take account of systemic feedback or second round effects in the stress tests, where relevant, recognising the limitation of providing ex ante assumptions in the case of bottom-up stress tests.
- d. for the purposes of bottom-up supervisory stress tests competent authorities should aim to assess the impact of such exercises consistently and fairly across the institutions covered by supervisory stress tests respecting the level playing field. Competent authorities should also consider the extent to which stress testing results reflect differences in modelling choices and judgements among institutions, rather than true differences in the risks to which they are exposed.
590. Competent authorities should aim to assess model risk across stress testing exercises and have access to different types of comparative information. It is recommended to have, where appropriate, several perspectives/benchmarks. It is important to recognise that all models are imperfect and to clearly identify known and potential weaknesses. Understanding these limitations and weaknesses of individual institutions' stress testing models can inform the supervisory stress testing process and mitigate potential problems from model risk.

(56). The following annexes are added:

Annex 5. Key features and differences between P2R and P2G

	<u>P2R</u>	<u>P2G</u>
Nature	Requirement on top of Pillar 1 and below the combined buffer requirement set in accordance with Article 104 of CRD.	Expectation on top of the combined buffer requirement.
Scope	(1) Risk of unexpected losses over 12 months period not covered by minimum requirements; (2) risk of	Quantitative outcomes of relevant stress tests (other potential areas to be explored further).

	expected losses over 12 months insufficiently covered by provisions; (3) risk of underestimation of risk due to model deficiencies; (4) risks arising from governance deficiencies ²⁴ .	
Determination	Calculation based on ICAAP as a starting point, where assessed as reliable, supported by e.g. supervisory benchmarks applied in relation to ICAAP calculations, supervisory judgment, etc. ²⁵	Calculation based on the maximum impact of the adverse scenario on the CET1 ratio, adjusted, e.g. for credible mitigating actions and other factors, and offset against the own funds held to meet CCB and in exceptional cases CCyB if it cover the same risks assumed in the stress test.
Quality of capital	Regulatory eligible own funds, at least in the same composition as Pillar 1	CET1 only.
Relevance for the restrictions on distributions under article 141 of Directive 2013/36/EU	Yes	No
Communication to institution	Part of TSCR ratio articulated in relation to all Pillar1 ratios (total own funds, T1, CET1)	As a separate ratio, not part of TSCR or OCR explaining how it affects all capital ratios (T1 and total own funds).
Public disclosure	Competent authorities may require institutions to disclose under Regulation (EU) 575/2013	Institutions are expected to treat all information confidential unless they are required to disclose it under relevant national or EU legislation.
Compliance	Requirements to be met at all times, including in stressed conditions	Institutions are expected to incorporate P2G into their capital planning, risk management and

²⁴ See paragraph 348

²⁵ See paragraph 349



		recovery planning and operate above P2G.
Supervisory response to breaches	All supervisory measures can be applied, a breach is a potential condition for the withdrawal of authorisation breach is considered as FOLTF for resolution purposes	No automatic link between the level of own funds falling below P2G and specific supervisory measures but enhanced supervisory dialogue and engagement with an institution as there is a need to provide a credible capital plan.

Annex 6. Overview of 2017 Updates to the SREP Guidelines

2017 Updates/changes to the SREP Guidelines	Title/section affected in the SREP Guidelines*
Pillar 2 capital guidance	Title 1.2 'Definitions' Title 7.1 'General considerations' Title 7.7.2 'Determining P2G to address capital inadequacy in stressed conditions' Title 7.8 'Summary of findings and scoring' (including Table 8) Title 7.9 'Communication of prudential requirements' Title 10.3 'Application of capital measures' Title 10.7 'Supervisory reaction to the situation where P2G is not met' Title 11.2 'SREP capital assessment and institution-specific prudential requirements' Annex 5 'Key features and differences between P2R and P2G'
Supervisory stress testing	Title 1.1 'Subject Matter' Title 1.2 'Definitions' Title 12 'Supervisory stress testing' Title 13 'Final provisions and implementation'
Supervisory assessment of institutions' stress testing	Title 5.6.3 'Assessment of institutions' stress testing' Title 10.5 'Application of supervisory measures'
Alignment of supervisory assessment of IRRBB with the revision of the IRRBB guidelines	Title 6.5 'Assessment of interest rate risk from non-trading activities'
Scoring framework	Title 1.2 'Definitions' Title 2.2 'Scoring in the SREP' Title 4.1, Title 5.1.1, Title 6.2.4, Title 6.3.4, Title 6.4.5, Title 6.5.4, Title 7.8, Title 8.5, Title 9.6 - 'Summary of findings and scoring' Title 6.1, Title 8.1 - 'General considerations' Title 10.2 'Overall SREP assessment' (including Table 13)
Articulation of total SREP capital requirements (TSCR) and overall capital requirements (OCR) and communication of supervisory capital expectations to the institutions	Title 7.5 'Articulation of own funds requirements' Title 7.9 'Communication of prudential requirements'
Other	General clarifications added to the 'Background and rationale' section Title 10.6 'Supervisory reaction to the situation where TSCR is not met' (<i>new section</i>)

* Note that the numbering of some sections have changed in the updated version. Titles provided in this table refer to the new numbering in the updated version of the guidelines. Some sections have been newly created. There may be additional changes as part of the forthcoming work.



(57). Competent authorities should implement the above amendments to the guidelines by incorporating them in their supervisory processes and procedures by 1 January 2019.

Accompanying documents

Draft cost-benefit analysis / impact assessment

As per Article 16(2) of Regulation (EU) No 1093/2010 (EBA Regulation), any guidelines developed by the EBA shall be accompanied by an Impact Assessment (IA) which analyses ‘the potential related costs and benefits’. Such an analysis shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problems and their potential impacts.

This analysis presents the IA with cost-benefit analysis of the policy options included in the revisions on the SREP Guidelines, described in this Consultation Paper. Given the nature and the scope of the revisions, the IA is high-level and mainly qualitative in nature. The section covers also quantitative analyses when appropriate and possible, using available supervisory data.

The analysis presented in this section is focusing on the newly introduced section on P2G without covering the other topics due to the following reasons:

- The revisions to the SREP Guidelines do not introduce significant changes to the requirements for supervisory stress testing compared to the EBA Consultation Paper on Guidelines on stress testing and supervisory stress testing, which has been already consulted alongside its relevant impact assessment through the first draft, and therefore an impact analysis related to supervisory stress testing is not considered in this section.
- Additional clarifications on the supervisory assessment of institutions’ stress testing are based entirely on the EBA Consultation Paper on Guidelines on stress testing and supervisory stress testing and had also been consulted together with the associated impact assessment.
- Additional clarifications related to scoring were considered necessary to fine-tune the text of the Guidelines with the current supervisory practices without changing the policy direction. These further clarifications do not have material impact on the initial SREP Guidelines and therefore an additional impact assessment was not considered necessary.
- Changes introduced to the section on the assessment of internal governance and institution-wide controls represent the alignment of the text with the revised structure and content of the EBA Guidelines on internal governance²⁶, where the requirements have been subject to a separate public consultation and impact assessment.

²⁶ <https://www.eba.europa.eu/regulation-and-policy/internal-governance/guidelines-on-internal-governance-revised->



A. Problem identification

One of the main problems the revisions of the SREP Guidelines aim to address is the approach to addressing quantitative outcomes of supervisory stress tests in the SREP assessment of capital adequacy, and differences observed in the definition and implementation of P2G, and the potential risk this may pose to the level playing field across the EU banking sector.

P2G is currently applied in various jurisdictions (e.g. UK, SE, DK, NO, SSM) but the practices differ across jurisdictions. Current practices suggest that the basis for setting P2G differs across jurisdictions as not all the competent authorities apply it on the basis of quantitative results of stress testing. For example, in 2016 only 30% of the competent authorities applied P2G on the basis of supervisory stress test results with banks' P2G levels ranging from 0% to 14.2%. By contrast, 70% of the competent authorities did not apply P2G at all or applied it on the basis of other parameters rather than solely on supervisory stress testing results²⁷.

Existing differences in definition and implementation would lead to different approaches and different levels of P2G across Europe, which are not necessarily justified by different risk profiles of banks but rather by the differences in application.

Moreover, it was observed that for some competent authorities the scope of binding Pillar 2 requirements (P2R) is not clearly separated from P2G. In theory, while the former aims to address risks partially covered or not covered at all under Pillar 1 requirements, the latter is designed to address supervisory concerns related to quantitative outcomes of supervisory stress testing. This lack of clear distinction may create distortions in regulatory practice and markets: P2G should be of a non-legally binding nature and sit on top of banks' total capital requirements (Pillar 1, P2R and combined buffers), and should not affect the automatic restrictions of distributions (MDA trigger and calculation). Uncertainty around the basis and the drivers behind P2G versus P2R and how stress test results are treated in this context across different jurisdictions, could therefore have a substantial impact on markets and investors. These distortions across jurisdictions and markets may result in hampering the level playing field in the EU banking sector and thereby impact fair competition.

B. Policy objectives and baseline scenario

The main objective of the SREP Guidelines' revisions is to address problems identified in the implementation of the current SREP framework and also reflect recent developments. This aims inter alia at clearly distinguish P2R and P2G and establish a clear link between supervisory stress testing and the supervisory review and evaluation process.

While the general objectives of the Guidelines are to:

²⁷ Note that these numbers apply to a surveyed sample of 17 NCAs only.



- strengthen and achieve supervisory convergence and eliminating room for misinterpretation in the implementation of SREP framework;
- ensure a level playing field for banks and jurisdictions across the EU banking sector;

The specific objectives of this update are to:

- link the output of supervisory stress testing to supervisory responses (in the form of P2G) and ensure competent authorities are consistent in its application;
- remove overlaps between P2R and P2G as well as with capital buffers and establish a common guidance on general aspects related to the calculation and application of P2G.

More specifically, the revised sections on the capital adequacy assessment aim to address the potential gaps and inconsistencies in the application of a particular SREP element and harmonise the approach to using the outcomes of various forms of stress testing in the SREP, and, in particular quantitative outcomes of supervisory stress tests in the capital adequacy assessment. The revisions aim at bringing additional consistency to practices where the EBA has previously observed divergent approaches employed by competent authorities. In particular, in some cases the current practices do not always establish a consistent interplay between the applied SREP framework, P2R, supervisory stress testing and P2G.

The revised SREP Guidelines clarify the way quantitative outcomes of supervisory stress tests should be used in the capital adequacy assessment element of SREP, making sure competent authorities do not incorporate such outcomes into the legally binding TSCR, but rather reflect them in P2G.

C. Options considered

This section presents the main technical policy options discussed and the decisions made during the development of this update with regards to the new sections introduced on P2G. The next section in turn discusses the reasoning, the advantages and disadvantages, as well as potential costs and benefits of the policy options. The reasoning presented is mostly qualitative and includes, where possible, quantitative analysis.

Status quo / intervention

Option 1a: No action: do not revise/update SREP guidelines (EBA/GL/2014/13)

Option 1b: Regulatory intervention: revise/update SREP guidelines (EBA/GL/2014/13)

Stress test scenario type for P2G purposes

Option 2a: Baseline scenario



Option 2b: Adverse scenario

Calculation of the maximum stress impact

Option 3a: Considering movements in CET1 capital only and keeping TREA constant at reference point

Option 3b: Considering movements in CET1 capital and TREA in the worst year of scenario

Treatment of CRD capital buffers

Option 4a: No offsetting effect between (elements of) the combined capital buffer and P2G

Option 4b: Offsetting P2G against (elements of) combined capital buffer

Quality of capital

Option 3a: Quality of capital for P2G to mirror quality requirements for P2R

Option 3b: P2G to be met only with CET1 capital

D. Assessment of the options and the preferred option(s)

Status quo / intervention

The current implementation of SREP Guidelines revealed areas where further guidance would be useful to promote harmonisation and consistency across the EU. Moreover, the recent developments in the EU and international fora, as well as EBA findings from the ongoing monitoring and assessment of convergence of supervisory practices, have highlighted the need for some changes in order to reinforce the SREP framework.

In addition to the above, harmonisation of how supervisors reflect their views/concerns regarding institutions' capital positions as a result of the supervisory stress test would also ensure banks are treated in a consistent manner across the EU. P2G would allow competent authorities to oversee banks' capital levels based on the assessment and analysis of supervisory stress testing scenarios and would be looking for different capital levels (P2G) for banks depending on the quantitative outcomes of the stress tests.

As indicated in the problem definition, with no further intervention the identified issues would remain (i.e. inadequate background on P2G and link to supervisory stress testing) and this could lead to inconsistencies and inaccuracies in the implementation. Such inconsistencies, without any EBA intervention, may lead to a situation where some competent authorities could be incorporating outcomes of stress tests into the legally binding P2R, thus putting those banks at a disadvantage compared to banks for which stress tests results are addressed differently, including by means of non-legally binding P2G. Furthermore, the general objective of a level playing field and supervisory convergence would be compromised.



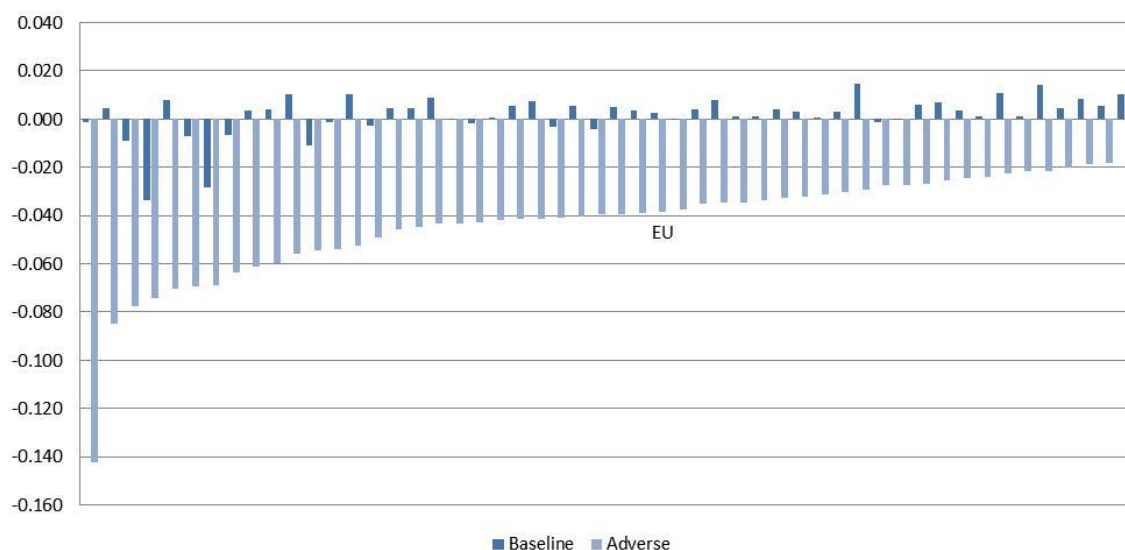
The policy option to intervene is expected to address some of the shortcomings identified in the current regulatory framework by clarifying that stress tests outcomes should not be directly incorporated into P2R, but rather P2G. This is done without adding new rules in addition to what has been included in the first version of the SREP guidelines with regards to P2R. Therefore, no further costs are generally expected; neither for competent authorities nor for institutions. The impact of such an intervention is expected to be positive as competent authorities and institutions would benefit from further clarity and markets from more certainty in the form of a level playing field across the EU. The revision of the SREP Guidelines is generally not expected to add further administrative or operational cost on competent authorities and institutions. The preferred option is Option 1b.

Stress test scenario type for P2G purposes

In line with the provisions of the Guidelines, competent authorities are expected to determine P2G based on quantitative outcomes of supervisory stress test. It is therefore key to streamline the methodologies to determine P2G levels. For general stress testing purposes, competent authorities are required to calculate the depletion of the CET1 ratio of institutions under both the baseline scenario and adverse scenario. The option to be investigated is whether P2G should be established as a capital expectation based on the baseline scenario (Option 2a) or the adverse scenario (Option 2b).

Based on the 2016 EBA stress test results (December 2015 reference data), the following analysis compares the starting CET1 ratio (as of December 2015) with the lowest CET1 ratio of the three-year period (December 2016, December 2017 or December 2018) for each bank. The sample includes 51 EU banks and covers EUR 25.8 tn assets (or roughly 70% of the total EU banking sector). As expected, Figure 1 indicates that the maximum depletion of the CET1 ratio between end-2015 and 2018 is more severe under the adverse scenario for all banks. The data shows that CET1 ratios increase under the baseline scenario for most banks (approximately 70% of the banks in the sample) and for the EU on average.

Figure 1 - Maximum change in CET1 ratio under Baseline scenario and Adverse scenario (by bank and in percentage points)



Source and notes:

2016 EBA Stress Test data (Data as of December 2015).

“EU” indicates the EU (weighted) average.

Adverse and baseline scenario is based on considering impacts of the scenario both on CET1 and TREA.

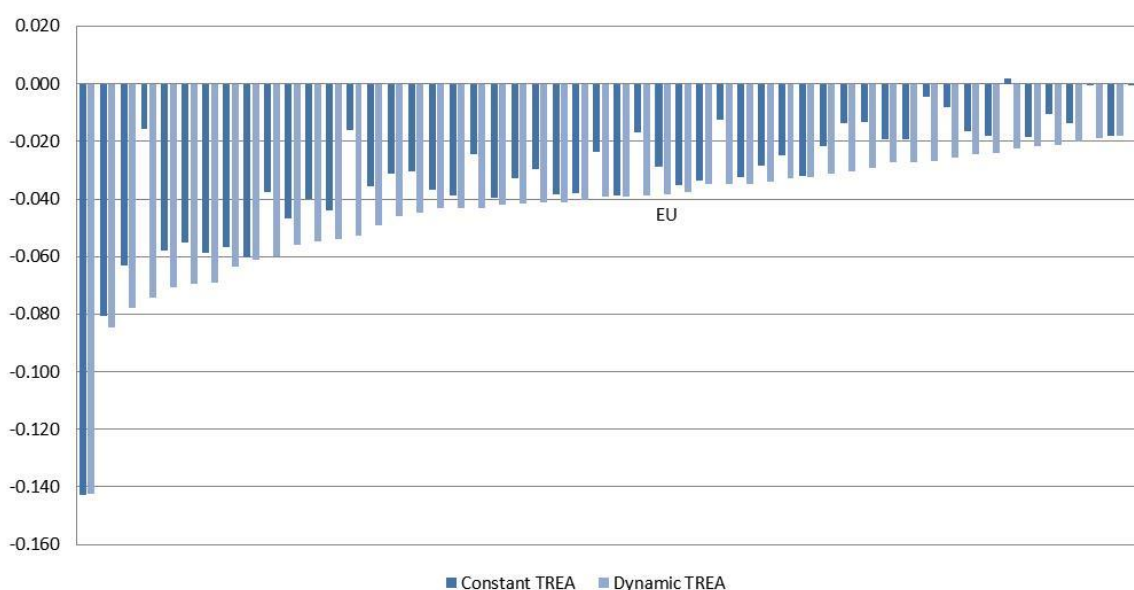
As a baseline scenario is based on macroeconomic forecasts without any adverse component, it is reasonable to argue that taking into consideration an adverse scenario for the determination of P2G provides a more prudent and accurate supervisory approach. Moreover, the purpose of P2G is to ensure banks will preserve their applicable capital requirements ratio under stressed conditions and not under normal economic forecasts. The hypothetical latter case could put the offsetting with the capital conservation buffer into question. As a result, the preferred option is Option 2b, under which for most of the banks P2G should be set based on the outcomes of the stress tests under the adverse scenario. It should be noted, however, as supervisory stress testing and the P2G concept apply to all banks, including those undergoing restructuring (and resolution); that the application of P2G based on the outcomes of the adverse scenario without recognising the ongoing restructuring and resolution may not be appropriate and may jeopardise the ongoing recovery or resolution process. In these specific cases competent authorities should take into account (in the form of adjustments) any on-going restructuring/resolution when determining the P2G applicable to an institution.

Calculation of the maximum stress impact

The calculation of the maximum stress impact under the adverse scenario can be performed according to two different approaches: (i) calculation of the CET1 ratio in the worst year by looking only at the impacts of the scenario on CET1 capital whilst keeping TREA unchanged from the reference date (CET1 in the worst year / TREA in T_0), or (ii) calculation of the CET1 ratio in the worst year by taking into account the impact of the scenario both on CET1 capital and TREA in the

worst year. The two approaches may result in quite a different picture for some banks. While the focus of the former is on identifying the maximum loss to be covered by CET1 capital, the latter also takes into account changes in the quality of the portfolio/ risk profile of an institution and allows for a potential offsetting or reinforcing effect between the numerator and the denominator of the CET1 ratio.

Figure 2 - Change in the CET1 ratio considering impacts of the scenarios on CET1 capital only versus impacts both on CET1 capital and TREA (by bank and in percentage points)



Source and notes:

2016 EBA Stress Test data (Data as of December 2015).

“EU” indicates the EU (weighted) average.

Figure 2 shows that considering movements in both CET1 capital and TREA in the worst year of the scenario results overall in higher depletion of CET1 ratios and can be considered as more prudent. For all banks except one, the decrease in the CET1 ratio is higher when movements in TREA are also taken into account rather than keeping them constant throughout the stress period. In light of the above and to ensure realistic results reflecting current practices in the context of stress testing, the preferred option is Option 3b.

Further analysis suggests that from a sample of 51 banks, in 43 instances (or almost 85% of the cases) the largest drop in the CET1 nominal amount across the three-year period occurs in the same year as the largest drop in the CET1 ratio.

Treatment of CRD capital buffers

The revised guidelines aim to clarify the scope of P2G and eliminate any potential overlap between the additional capital requirements set as P2G and the combined buffer requirement.



Banks' capital levels to be determined through supervisory stress testing are also related to macroprudential capital requirements in the form of the combined capital buffer including the capital conservation buffer, the countercyclical capital buffer, systemic risk buffers (systemic risk, G-SIIs and O-SIIs buffers). While capital buffers contribute to institutions' resilience in addition to the TSCR, they may overlap with the additional capital that institutions are expected to hold as part of P2G to cope with stress situations, as the main idea of the buffers is for banks to have more capital needed for dealing with stress situations. Accordingly, specific elements of the combined buffer may be considered to be offset against the established P2G amount in order to prevent any double counting when setting capital expectations for dealing with stress situations.

More precisely, the objective of the capital conservation buffer (CCB) is to allow an institution to build up capital which can be used in periods of stress. This therefore presents a direct overlap with the additional capital to be held in response to the results of supervisory stress testing, as they are designed for the same purpose, and as a result they could be netted off i.e. the initial calculated level of P2G should be reduced by the amount of the capital conservation buffer.

Secondly, the countercyclical capital buffer (CCyB) aims to protect institutions from periods of excess aggregate credit growth that have often been associated with increased financial system risk. The idea is to build up buffers during times of economic boom, e.g. when credit supply is growing rapidly, so it can be reduced in times of economic downturns. The CCyB is set by the designated (macroprudential) authorities based on the consideration of certain macroeconomic risks that may be also factored into the design of the scenarios used in supervisory stress testing. In such cases there may therefore also be an overlap between the CCyB and the capital set based on stress testing results and therefore a partial off-setting may be possible.

However, no overlap/double counting is expected when it comes to systemic risk buffers and G-SII/O-SII buffers, as these buffers address risks different to those assumed to be covered by stress testing. These particular buffers are institution-specific and are set to compensate for the higher risk that such (systemic) institutions represent for the wider financial system and the potential impact of their failure to the financial system as a whole. Therefore, these elements of the combined buffer should not be used to offset P2G which is set based on supervisory stress tests.

Without providing any specification on the treatment of the CRD capital buffers, some of the issues mentioned above are expected to remain. The operational costs for implementing this option are expected to be negligible for the competent authorities. At the same time, institutions would potentially benefit from recognising the above described duplications on capital expectations as the objective of this option is to eliminate any potential overlap between P2G and capital buffers. The net benefits from offsetting P2G and relevant capital buffers are expected to be positive and higher than no harmonisation. As a result, the preferred option is Option 4b.

Quality of capital

The SREP Guidelines specify the quality of capital competent authorities should require institutions to hold to meet P2R; namely at least the same proportion/composition of the quality of capital required to meet the minimum own funds requirements (competent authorities have



the option though, to require P2R to be fully met with CET1). This is due to the fact that P2R covers the same concept of ‘unexpected losses’ as the minimum own funds requirements. Along the same logic, the quality of capital to be held for the purposes of P2G can mirror the quality requirements for P2R i.e. at least three quarters of P2R should be met with Tier 1 capital with at least three quarters of the Tier 1 capital to be composed of CET 1 capital.

Having P2G covered in a similar way as P2R in terms of the proportion of the different capital instruments, may however have a number of disadvantages:

- First, as P2G is set to cover potential losses revealed by the supervisory stress test and its calculation assumes offsetting with certain elements of the combined buffer (see Option 2b), this would be operationally more difficult to execute if the guidelines require institutions to disentangle the CET1 part of P2G, which would be eligible for offsetting, from other parts. In this case, the operational cost of implementation would be high without generating higher benefits from using different quality requirements to justify this granularity.
- Second, as P2G is aimed at covering losses stemming from the outcomes of supervisory stress tests and is ultimately aimed at allowing an institution to meet its total SREP capital requirement (TSCR) under stressed conditions, with CET1 having a higher loss absorption capacity than AT1 and T2, whereas

Against the above considerations, the preferred approach is to require institutions to hold only CET1 own funds to meet P2G and therefore Option 5b is the preferred option.

D. Conclusion

The overall application of the above policy options (i.e. the use of adverse scenario to calculate the maximum stress impact, considering the movement of TREA in the adverse scenario, allowing an off-set of the maximum stress impact with the CCB buffer only, and in some instances the CCyB, and requiring P2G to be fully met by CET1) may imply a generally higher total supervisory capital demand (OCR plus P2G) for institutions when compared to the current approach of the SREP Guidelines, which do not address the matter in detail.

This regulatory intervention, as a pre-defined, uniform P2G framework across countries based on quantitative supervisory stress test results, by definition will have an impact and in this case, it may lead to higher capital demand through the introduction of P2G in addition to the TSCR and the combined buffer requirements.

An indicative implementation of the above policy options on the EBA 2016 stress test results for the calculation of implied P2G levels (for the 51 banking groups included in the stress test sample)



would suggest an average P2G level of 3.5%, if applied in 2016, with levels ranging between 0% and 13.6% for individual institutions²⁸.

Nevertheless, a number of key factors should be taken into account before concluding on the explicit impact of the newly introduced P2G framework:

- (i) The capital conservation buffer will be fully-loaded at 2.5% in all jurisdictions from January 2019 (end of transitional provisions as per Article 160 of Directive 2013/36/EU). Therefore, the amount by which the P2G can be off-set would be steadily increasing by 2019.
- (ii) The abovementioned calculation does not include any supervisory adjustments which would be considered by competent authorities in accordance with the criteria set out in the revised SREP Guidelines when calculation P2G, and, potentially, further reduce the actual P2G levels.
- (iii) A general increasing trend in actual CET1 ratios has been observed across institutions (in the sample) in the last two years, evidencing that institutions are in the process of building up capital to meet capital demand already communicated by the competent authorities (including P2G which is applicable in some jurisdictions) and any future capital needs.
- (iv) P2R is on a decreasing trend in a number of jurisdictions following the introduction of P2G, thereby partially off-setting the increase in overall supervisory capital demand stemming.

Based on the above considerations, and taking into account that some jurisdictions have already been applying P2G in practice, the overall impact from the implementation of these guidelines and the policy options considered should not be material, whilst the benefits from a consistent approach to addressing quantitative outcomes of supervisory stress tests across the EU in accordance with these guidelines outweigh the impact.

²⁸ This estimation uses the maximum stress impact from the 2016 EBA stress test under the adverse scenario, allowing for movements in both CET1 and TREA. The resulting amounts have been off-set with CCB levels as applicable in January 2016. Adjustments have been assumed to be zero.



Overview of questions for consultation

It is important to note that questions for the consultation focus only on the revised areas of the initial SREP Guidelines.

Q1: What are the respondents' views on the overall amendments and clarifications added to the revised guidelines?

Q2: What are the respondents' views regarding 'the interaction between SREP and other supervisory processes, in particular assessment of recovery plans' provided in the 'Background and rationale' section?

Q3: What are the respondents' views on how the assessment of internal governance and institution-wide controls has been aligned with the revised EBA Guidelines on internal governance (Section 5)?

Q4: What are the respondents' views on the provisions of the newly introduced Pillar 2 Capital Guidance?

Q5: What are the respondents' views regarding disclosure of P2G (paragraph 403), having in mind the criteria for insider information?

Q6: What are the respondents' views on the introduction of supervisory stress testing in the revised guidelines (Section 12)?