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EBA

EUROPEAN
BANKING
AUTHORITY

Draft SREP Guidelines and draft RTS on Pillar 2 add- ons for investment firms

Public hearing

18 January 2022

Overview



Agenda

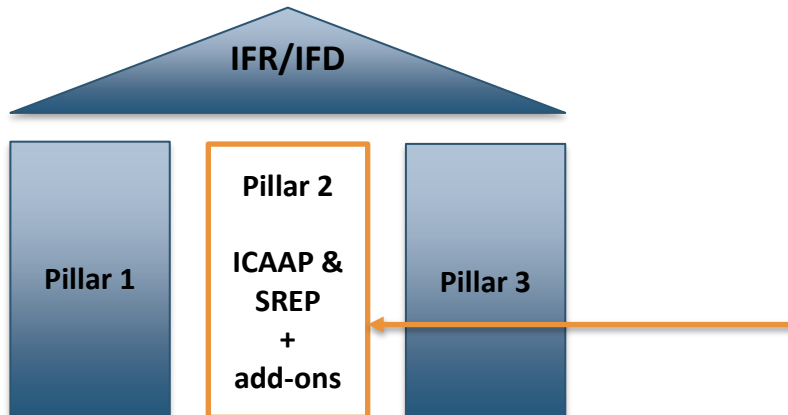
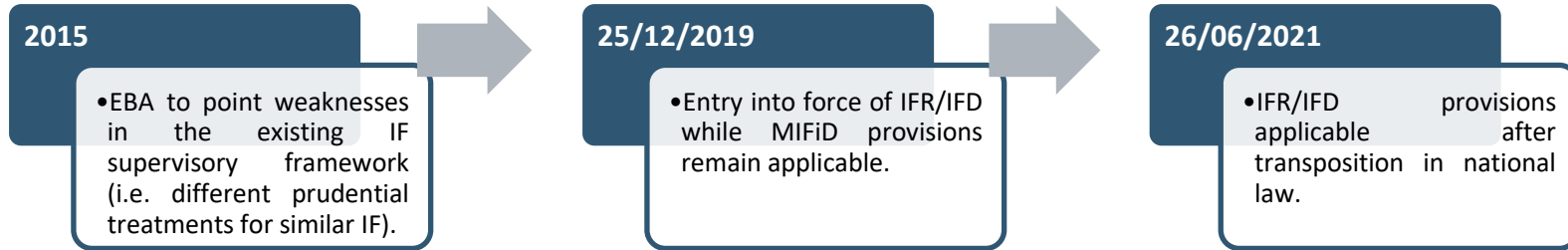
- EBA presentation
 - Introduction and timelines
 - SREP Guidelines under IFD
 - Questions for consultation
 - RTS on Pillar 2 add-ons
 - Questions for consultation
- Comments and questions from participants

House keeping rules

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

New framework for investment firms



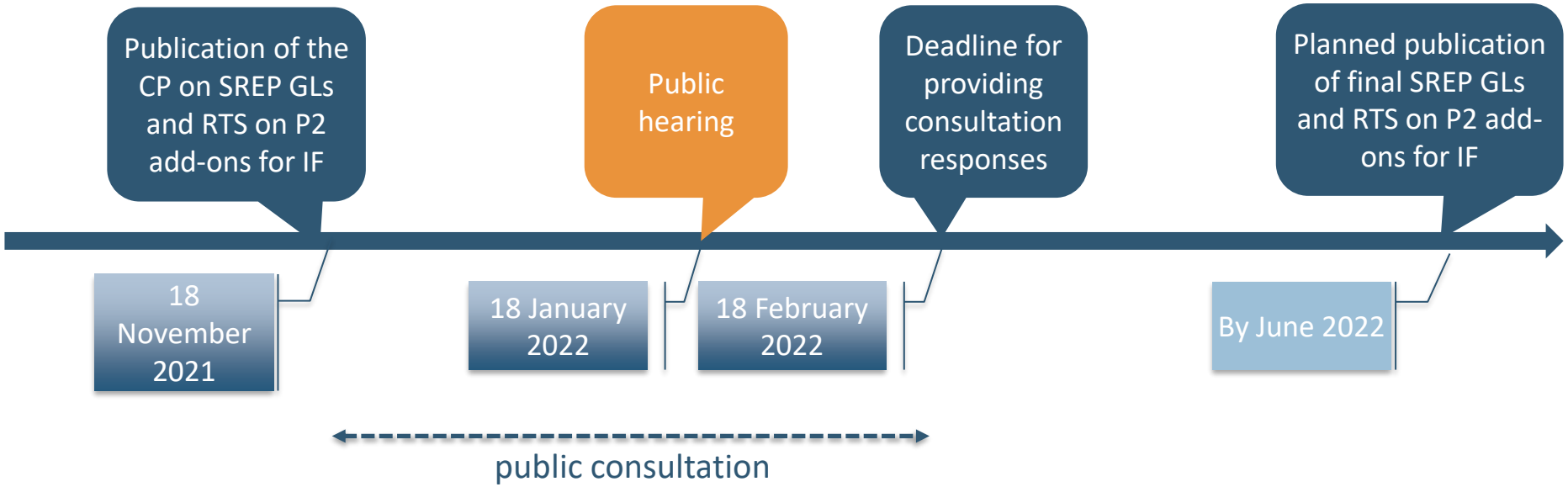
- IFR/IFD preserve the structure of the framework based on 3 pillars
- **ICAAP and SREP (Art. 24 and Art. 36/37 IFD)** to ensure IFs comply with IFD/IFR and that all risks the IF is exposed to or poses to others are adequately addressed.
- *Specific carve-out for class 3 firms unless CAs decide to carry out SREP and impose add-ons.*

Scope of investment firms addressed



- Class 1: Investment firms that are systemic or exposed to the same types of risks as credit institutions
 - **Class 2: Other investment firms** to which a tailored prudential regime based on K-factors applies
 - **Class 3: Small and non-interconnected investment firms**
- Class 1 investment firms are outside the scope of these GL and RTS as with regard to prudential supervision they are subject to the requirements of CRD
 - **Class 2 firms is the main group of investment firms targeted by these GL and RTS**
 - **Class 3: Small and non-interconnected investment firms** – the GL and RTS apply to the extent that competent authority considers necessary

Timelines for the SREP Guidelines and RTS on Pillar 2 add-ons for IF



Part 1: SREP Guidelines under IFD

Mandate for the SREP Guidelines under IFD



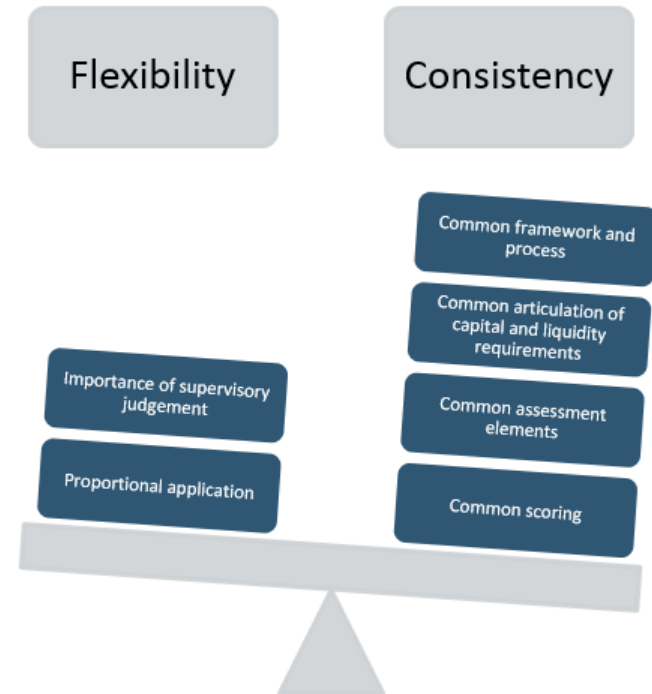
Article 45(2) of Regulation (EU) 2019/2034 (IFD)

*EBA and ESMA shall issue guidelines for the competent authorities in accordance with Article 16 of Regulation (EU) No 1093/2010 and Article 16 of Regulation (EU) No 1095/2010, as applicable, to further specify, in a manner that is **appropriate to the size, the structure and the internal organisation of investment firms and the nature, scope and complexity of their activities**, the common procedures and methodologies for the supervisory review and evaluation process referred to in paragraph 1 and the assessment of the treatment of the risks referred to in Article 29 of this Directive.*

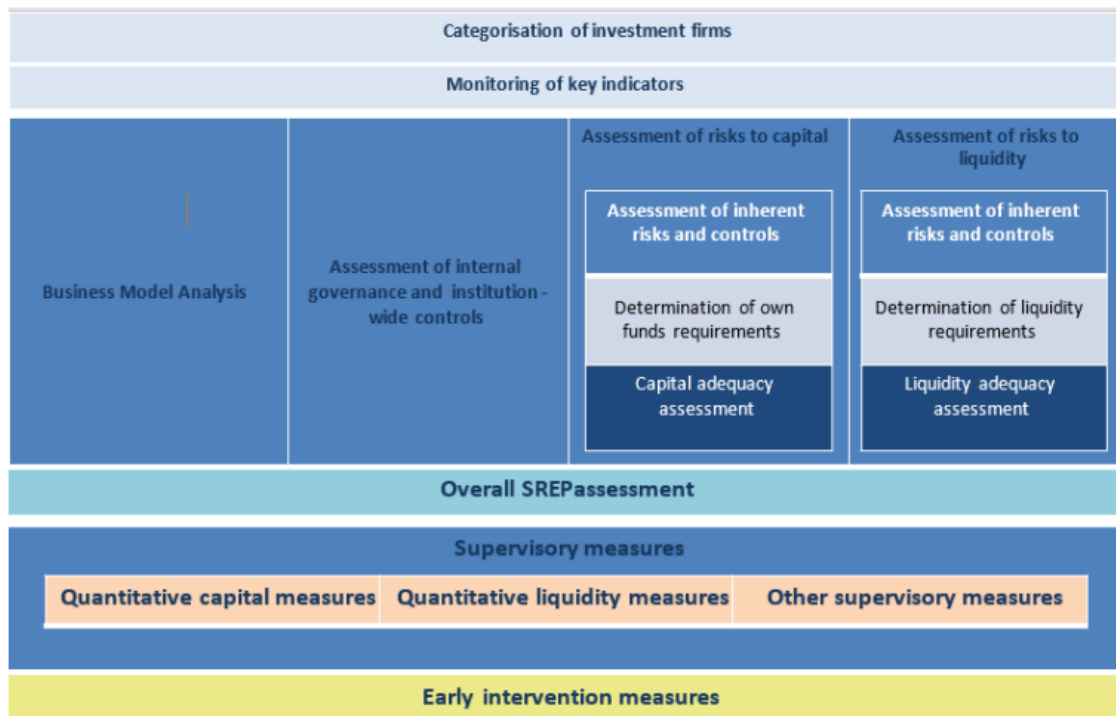
Overview of the common SREP framework (1/2)

Supervisory review and evaluation process (SREP):

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



Overview of the common SREP framework (2/2)



→ **Proportionality** (frequency and intensity of assessment)

Sources of information:

- Supervisory reporting
- Inspections and off-site reviews
- Information from the firms
- Benchmark calculations and comparisons to peers
- Supervisory judgement
- Any other relevant inputs

Categorisation and minimum engagement model



Category	Monitoring of key indicators	Assessment of all SREP elements	Minimum level of engagement / dialogue
1* - size** ≥ EUR 1 billion or - size** ≥ EUR 250 million and activities 3 or 6 or - considered significant by the CA	Quarterly	2 years***	Ongoing dialogue
2* EUR 250 million < size** < EUR 1 billion and not category 1	Quarterly	3 years***	At least every 3 years
3* size** < EUR 250 million and not class 3	Quarterly	Event-based	Event-based engagement
Class 3: small and non-interconnected meeting criteria of Article 12 IFR	Yearly	Event-based	Event-based engagement

* Possibility to reclassify a firm one notch up or down based on **qualitative considerations**

** Size based on **total assets and off-balance sheet exposures** (without clients' assets under management)

*** Minimum frequency subject to **event-based increased frequency criteria**

Business model analysis (BMA)

- Assessment of the business and strategic risks to determine:
 - **the viability of the current business model** – ability to generate acceptable returns over next 12 months
 - **the sustainability of the investment firm's strategy** – ability to generate acceptable returns over a forward-looking period of at least 3 years
- **Principle of proportionality:**
 - **Granularity of BMA** depends on the IF's specific situation, risk profile, scale and complexity of activities.
 - **Specificities for smaller IFs:**
 - **Category 3:** CA may perform a simplified assessment, focusing at least on the viability of the business model and the sustainability of the IF's strategy while identifying key vulnerabilities.
 - **Small and non-complex IF:** case-by-case basis assessment, at least identifying how IF generate returns and its vulnerabilities.

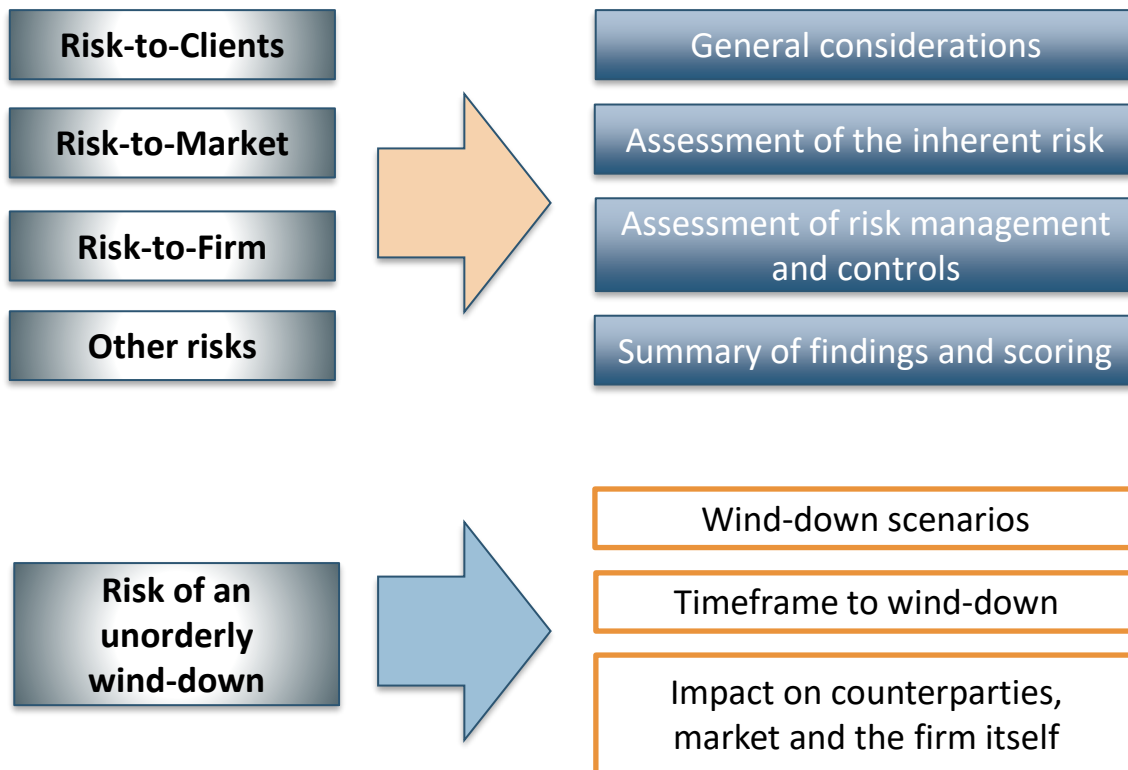
Assessment of internal governance arrangements

- The GL provides guidance for the assessment of the following areas:

1	Overall internal governance framework
2	Organisation and functioning of the MB and committees
3	Remuneration policies and practices
4	Internal control framework and functions
5	Risk management framework
6	New products and significant changes
7	Outsourcing
8	ML/TF risks and prudential concerns
9	Information and communication technologies
10	Business contingency and continuity planning
11	Application at the consolidated level and implications for group entities

- **Principle of proportionality:**
 - Detailed list of proportionality criteria
 - IFs with a more complex organisation or with a larger scale of activities expected to have more sophisticated governance arrangements
 - **Category 3 IFs:** subject to simplified assessment criteria
 - **Small and non-interconnected IFs:** flexibility to apply assessment criteria as necessary

Assessment of risks to capital



SREP Capital assessment (P2R)



- 5 areas where CAs could determine additional own funds requirements (Art 40(1) IFD)

<ul style="list-style-type: none">- Risks not covered or not sufficiently covered by P1		Addressed in the RTS on Pillar 2 add-ons
<ul style="list-style-type: none">- Deficiencies in governance/strategies- Deficiencies in prudent valuation of the trading book- Deficiencies in internal models for regulatory purposes		Additional own funds determined only if considered as the most appropriate supervisory measure and on an interim basis
<ul style="list-style-type: none">- Repeated inability to meet P2G		Where no supervisory permission to operate below P2G has been granted, and where P2G is repeatedly breached, additional own funds should be determined

Guidance for the determination of P2R to address risks not covered or not sufficiently covered by P1:

- Key role of the **ICAAP** in risks' identification and assessment
- ICAAP to be taken into account in P2R quantification if deemed sufficiently reliable
- Use of the **Recovery Plan** to determine the capital considered adequate to cover an **orderly wind-down**, where appropriate

P2R expression and communication:

- At any time, P2R should be the highest of:
 - a. Absolute amount as a result of Article 40(3)IFD
 - b. Relative amount as a percentage of Pillar 1 requirement ('D' in Article 11 IFR)
- CAs to substantiate their decision

SREP Capital assessment (P2G)

- **Small and non-interconnected IFs excluded from P2G**
- For non-class 3 firms: competent authorities to assess the **impact of economic cyclical fluctuations**
 - assessment based on:
 - supervisory stress tests,
 - investment firm's stress tests, or
 - other forms of analysis
 - assessment aims at capturing situations where IF may not be able to comply with own funds requirements, incl. P2R, or to orderly wind-down.



P2G

- to be expressed as an absolute amount, ensuring the coverage of the maximum anticipated variations of IF's CET1 under adverse conditions
- to be set over a predefined period of time and covered in CET1
- to be timely reviewed in case it is considered inadequate based on new relevant information

Liquidity assessment

- Competent authorities to **identify and assess material risks** to liquidity the investment firm may be exposed to, as well as related **liquidity risks management and controls**.
- The **scope of assessment is based on the investment firm's activities** while the **granularity of assessment** takes into account the its size, the structure and the internal organization of the investment firm and the nature, scope and complexity of its activities.



- Following this assessment competent authorities may determine specific liquidity measures, in line the draft RTS on specific liquidity measurement for investment firms (EBA/CP/2021/41).
- **Public hearing on that RTS today at 12h30.**

Other aspects addressed in the Guidelines

- Overall SREP assessment – viability score
- Potential actions following the assessment:
 - supervisory measures to address concerns;
 - determination whether any specific supervisory activities should follow;
 - where applicable, early intervention measures as specified in Article 27 of Directive 2014/59/EU;
 - consideration whether the investment firm is ‘failing or likely to fail’.
- Application of the SREP to investment firm groups – discussion and coordination within the framework of colleges of supervisors (where established)
 - planning and timelines for the assessment;
 - details of the assessment (approaches benchmarks, scoring);
 - outcomes of the assessment, including SREP scores;
 - cross-border prudential implications of ML/TF risks and concerns;
 - planned supervisory and early intervention measures, if relevant.

Questions for consultation purposes (1/2)

Categorisation

Question 1: Do you agree with the proposed categorization and the proportionate approach to the application of the SREP to different categories of investment firms?

BMA

Question 2: Do you agree with our proposal regarding business model analysis? Are there any other drivers of business model/strategy that you believe competent authorities should consider when conducting the investment firms' business model analysis?

Governance and risk management framework

Question 3: Do you agree with the proposed criteria for the assessment of internal governance and firm-wide controls?

Question 4: What are the appropriate methods for investment firms to analyse the potential impact of cyclical economic fluctuations on their activities and risks? Are they currently used by investment firms in their risk management processes?

Risks-to-capital

Question 5: Do you agree with the proposed criteria for the assessment of risks-to-capital? Does the breakdown of risk categories and subcategories provide appropriate coverage and scope for the supervisory review, having in mind various business models of investment firms?

Questions for consultation purposes (2/2)



Capital adequacy

Question 6: Do you agree with the proposed guidance for the setting and communication of additional own funds requirements?

Question 7: What are your view regarding the interactions between SREP and internal processes of investment firms (such as recovery planning or ICARAP)?

Question 8: Do you agree with the proposed guidance for the setting and communication of P2G? Would you consider it appropriate to express P2G not only as an absolute amount of own funds but also as a percentage of Pillar 1 own funds requirements? Please provide rationale for your view.

Risks-to-liquidity

Question 9: Do you agree with the proposed criteria for the assessment of liquidity risk? Should investment firms that deal on own account, in particular market makers, be subject to more comprehensive liquidity risk assessment?

Question 10: Do you agree with the proposed guidance for the setting and communication of specific liquidity requirements?

ESG

Question 11: Do you have any views or suggestions with regard to the appropriate incorporation of ESG risks within the SREP, including any proposed methods or criteria for the assessment of ESG risks within the SREP?

Part 2: RTS on Pillar 2 add-ons under IFD

Mandate for the RTS on Pillar 2 add-ons

Article 40(6) of Regulation (EU) 2019/2034 (IFD)

6. EBA, in consultation with ESMA, shall develop draft regulatory technical standards to specify how the risks and elements of risks referred to in paragraph 2 are to be measured, including risks or elements of risks that are explicitly excluded from the own funds requirements set out in Part Three or Four of Regulation (EU) 2019/2033.

EBA shall ensure that the draft regulatory technical standards include indicative qualitative metrics for the amounts of additional own funds referred to in point (a) of Article 39(2), taking into account the range of different business models and legal forms that investment firms may take, and are proportionate in light of:

- (a) the implementation burden on investment firms and competent authorities;
- (b) the possibility that the higher level of own funds requirements that apply where investment firms do not use internal models justifies the imposition of lower own funds requirements when assessing risks and elements of risks in accordance with paragraph 2.

EBA shall submit those draft regulatory technical standards to the Commission by 26 June 2021.

Power is delegated to the Commission to supplement this Directive by adopting the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010.

Scope of the RTS on Pillar 2 add-ons

Additional own funds requirements may be imposed in the following situations, on the basis of the SREP analysis:

Article 40(6) IFD:

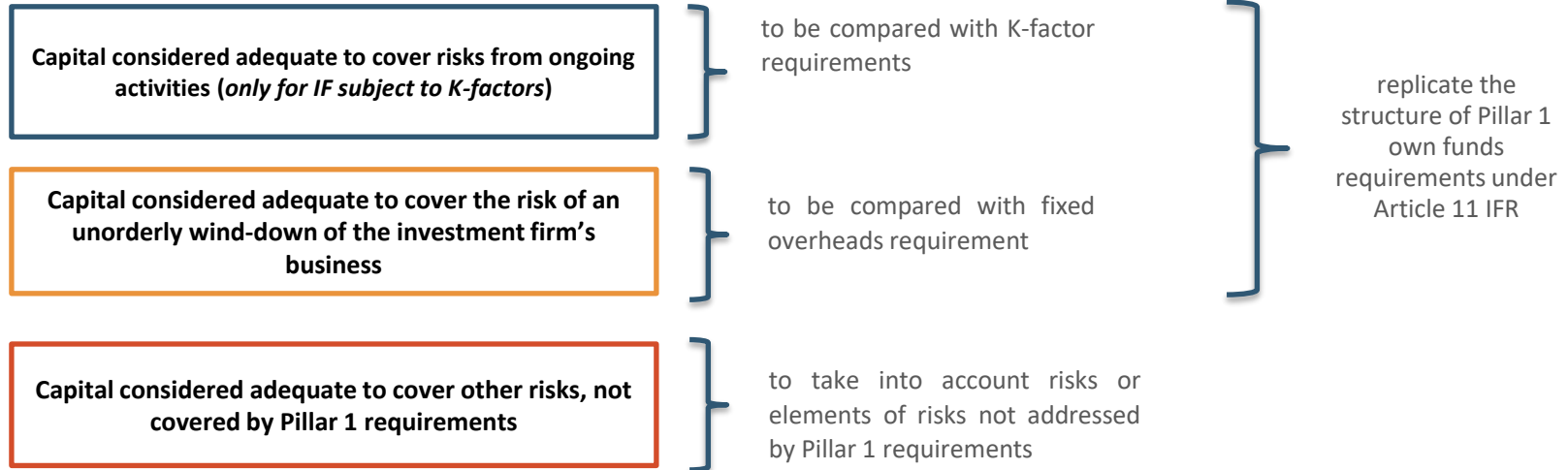
40(1)(a)	Risks or elements of risk not covered or not sufficiently covered by Pillar 1;
40(1)(b)	Inadequate governance arrangements and risk management framework;
40(1)(c)	Inadequate prudent valuation of the trading book;
40(1)(d)	Non-compliance with requirements for the application of the permitted internal models;
40(1)(e)	Repeated failure to meet P2G requirements.



RTS focused on point (a), the other situations covered by the SREP GL.

Capital considered adequate

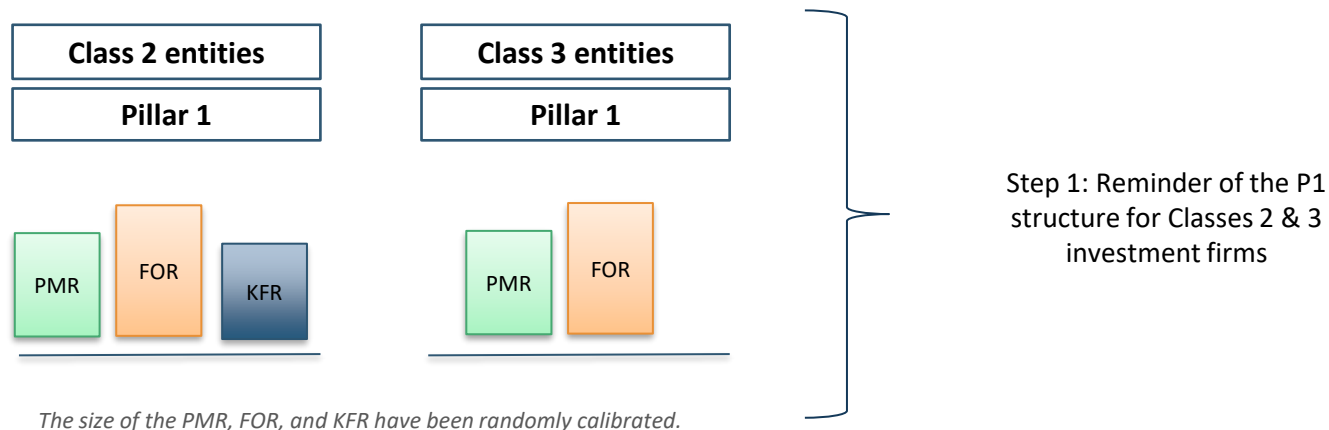
- CAs should identify and quantify material risks
- **3 categories of capital considered adequate to be computed by CAs (Article 1, 2 & 3 of the CP):**



Focus on the methodology for computation of P2 add-on

Retained methodology:

- Step 1: Determine the highest of the P1 requirement (FOR; PMCR; KFR)
- Step 2: Determine the highest of P2 capital considered adequate (FOR-like; KFR-like)
- Step 3: Calculate the difference between the highest P2 and highest P1 (no negative amount).
- Step 4 : Determine the capital considered adequate to cover other risks (if any) and add it to the difference computed under step 3.



The size of the PMR, FOR, and KFR have been randomly calibrated.

Focus on the list of indicative qualitative metrics

Proposal for the RTS:

- List of indicators provided for each category of risks to identify material risks not covered or not sufficiently covered by Pillar 1 requirements and to measure them;
- Some indicators apply to firms providing specific MiFiD services;
- Thresholds for indicators not provided – materiality subject to supervisory judgement;
- CAs may adjust the indicators having regard to:
 - The appropriateness of the metrics vs business model of the IF
 - Burdensomeness of computation regarding the size and complexity of the IF
 - Lack of reliable (historical) data

Examples of indicative metrics:

- For the risk of an unorderly wind-down of the IF's business: the share of non-cancellable contracts and residual duration of these contracts;
- For risk-to-clients: the number of clients complaints and amount of clients' compensations over the past five years;
- For risk-to-firm: significant operational events related to DTF and associated financial losses over the past five years, including processing errors;
- For risk-to-market: specifically for IF using internal models for regulatory purposes, the availability of regular backtesting;
- For other risks: any losses due to disruption due to incidents touching critical ICT services over the last five years.

Questions for consultation purposes

Overall framework

Question 1: Do you have any comments on the structure and elements included in this Consultation Paper for the computation of Pillar 2 additions?

Qualitative indicators

Question 2: Do you agree with the proposed indicative qualitative metrics? Are there any other aspects or situations not sufficiently taken into account in this proposed approach?

Questions and comments from participants

The logo for the European Banking Authority (EBA) is located in the top left corner. It features the letters 'EBA' in a large, white, sans-serif font. To the right of the letters, the words 'EUROPEAN BANKING AUTHORITY' are written in a smaller, white, sans-serif font, stacked vertically. The logo is set against a dark blue background with a subtle grid pattern.

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