



Strengthening the EU Pillar 2 Framework: Revision of SREP, IRRBB and Stress Testing Guidelines

16 January 2018 | Public Hearing

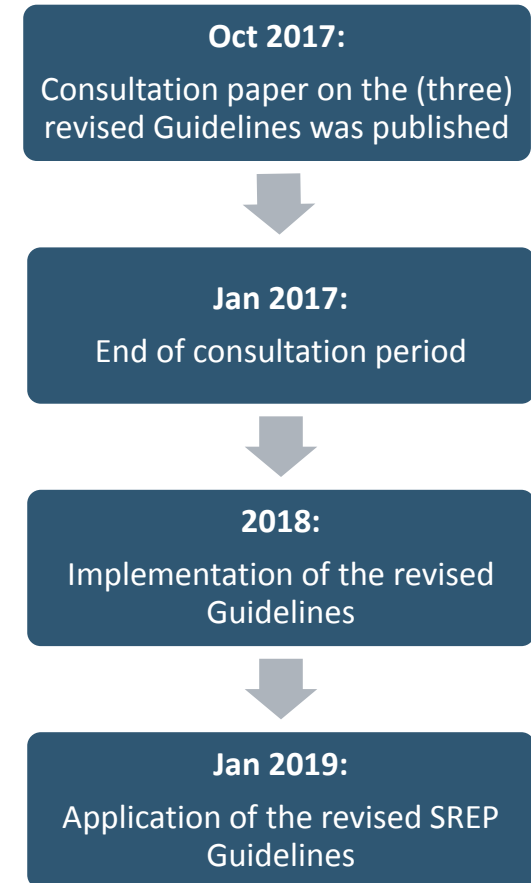
Outline

1. Pillar 2 Roadmap
2. Revision of the SREP Guidelines
3. Revision of the IRRBB Guidelines
4. Revision of Institutions' stress testing Guidelines
5. Next steps
6. Points for discussion
7. Annex

1. Pillar 2 Roadmap

- In March 2017 the EBA's Board of Supervisors approved the [EBA Pillar 2 Roadmap](#).
- A multi-staged approach was agreed for the update of the Pillar 2 framework which is to include:
 - a revision of the SREP Guidelines
 - an update to the IRRBB Guidelines
 - an update to the Guidelines on institutions' stress testing
- SREP Guidelines have been published in 2014 and are in force since 2016, providing a vital framework for SREP and remain valid
- In EBA's view the framework remains robust and serves the purpose of ensuring convergence of supervisory practices well
- In light of the recent developments in the EU and international fora, as well as following EBA findings from ongoing monitoring and assessment of convergence of supervisory practices, certain changes were needed however to strengthen the framework further

Timeline :



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2. Revision of the SREP Guidelines. Overview

Topics	Reference used for drafting
P2G: <ul style="list-style-type: none"> • General considerations • Determination and specification of forms of supervisory stress testing • Communication of TSCR, OCR and P2G • Supervisory reaction function 	<ul style="list-style-type: none"> • Section 7 of CP on Stress testing and supervisory stress testing GL • Other
Supervisory stress testing: <ul style="list-style-type: none"> • Forms of supervisory stress testing • Key elements • Organisation and governance • Process and methodological consideration 	<ul style="list-style-type: none"> • Section 6 of CP on Stress testing and supervisory stress testing GL
Use of supervisory stress tests for capital adequacy assessment: <ul style="list-style-type: none"> • General considerations • Reaction function: P2G, capital plans, additional measures 	<ul style="list-style-type: none"> • Section 7 of CP on Stress testing and supervisory stress testing GL • Section 7.7 of SREP GL
Supervisory assessment of bank stress testing	<ul style="list-style-type: none"> • Section 5 of CP on Stress testing and supervisory stress testing GL
Clarifications of the scoring framework	<ul style="list-style-type: none"> • Section 2.2 of SREP GL
Internal governance consistency checks	<ul style="list-style-type: none"> • EBA publications on internal governance

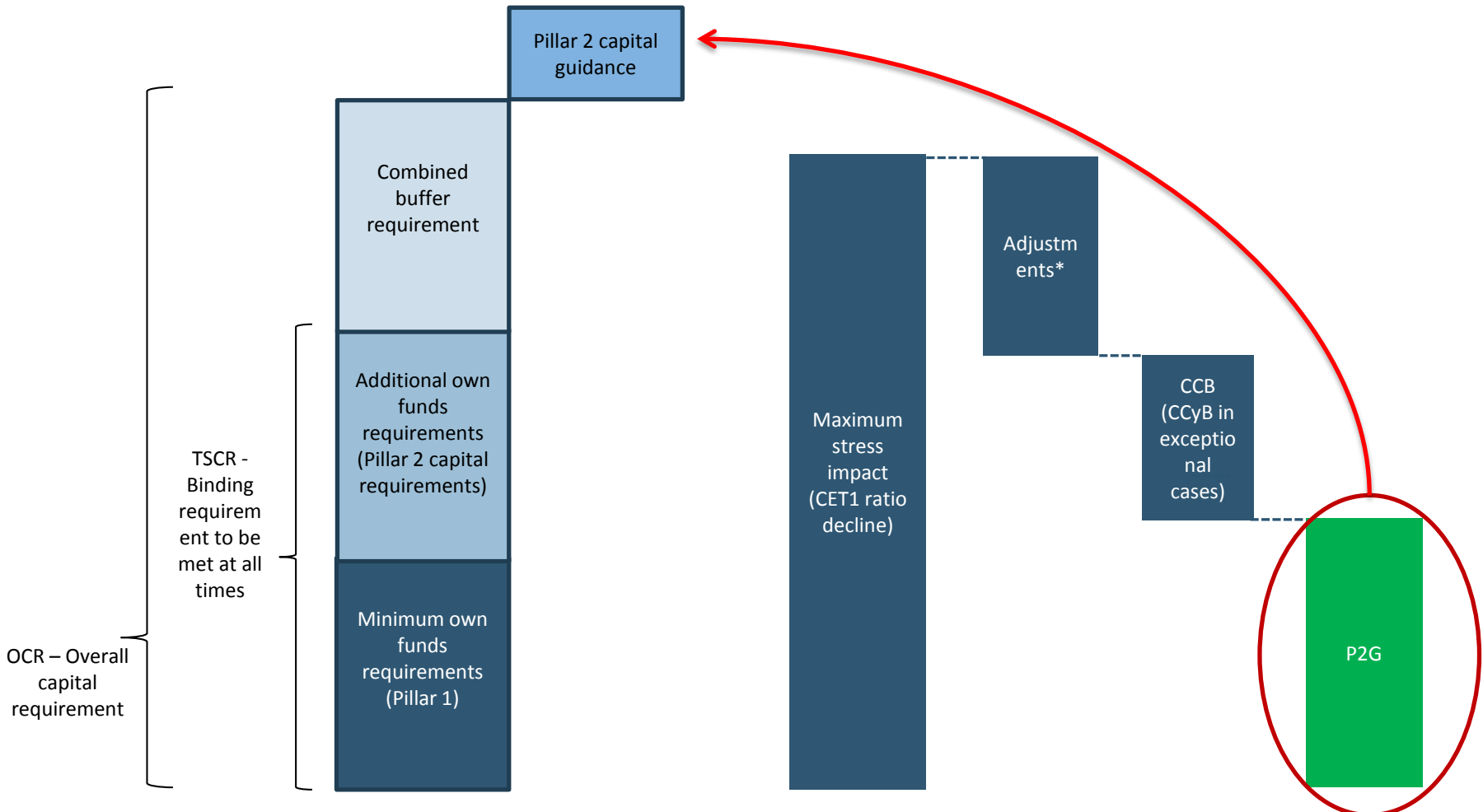
2. Revision of the SREP Guidelines. P2G - General aspects

- The concept of P2G is a new concept which has been developed over the last two years and has been applied for the first time by competent authorities in 2016
- P2G has been introduced publicly by the EBA Pillar 2 Roadmap and is now incorporated into the SREP Guidelines for the first time
- P2G is an additional layer of capital to be held in response to the **quantitative outcomes of supervisory stress tests**
- The frequency of setting P2G should be aligned with the minimum engagement model for an institution, or whenever supervisors run or update their supervisory stress test for a bank
- P2G is to be held above Pillar 1, Pillar 2 requirements and any combined buffer requirements (P2G is not MDA relevant)
- Falling below the level of P2G does not trigger any automatic supervisory reaction. The supervisory response will depend on the circumstances under which the bank fails to meet its P2G
- No double counting is allowed: a bank cannot allocate the same CET1 to meet both its buffer requirements and P2G
- Institutions are generally expected not to disclose P2G, unless they are legally required to do so (institutions are expected to assess whether the information constitutes to insider information)

2. Revision of the SREP Guidelines. P2G - Stacking order and calculations

Stacking order

'The mechanics'



2. Revision of the SREP Guidelines. Supervisory stress testing

Background

- Draft *Guidelines on stress testing and supervisory stress testing* were publicly consulted in H1 2016 but not finalised due to the links with the ongoing work on Pillar 2 Guidance concepts
- The part of the Guidelines addressed to competent authorities (i.e. supervisory stress testing) will be now finalised as part of the revised SREP framework and will be **incorporated as a new section** in the updated *Guidelines on common procedures and methodologies for SREP and supervisory stress testing*. The *Guidelines on stress testing* addressed to institutions will be also finalised as a stand-alone document following the same timeline as the updated SREP Guidelines
- This addition is intended to link the forms of supervisory stress testing that could be used for the determination of P2G with the need to narrow down the wide range of forms of supervisory stress tests described in the draft GL on stress testing as not all the forms of supervisory stress testing may lead to determining P2G



Guidelines on supervisory stress testing – Aim and Purpose

- Aim: Achieve convergence of practices followed by competent authorities for stress testing across the EU
- Purpose: To provide guidance with a view to ensure convergence for supervisory stress testing in the context of the SREP performed by competent authorities in accordance with Article 100 of Directive 2013/36/EU (where supervisory stress testing should be carried out at least annually on supervised institutions to facilitate SREP)

2. Revision of the SREP Guidelines. Key characteristics of supervisory stress testing

- GL reflect lessons learned during the 2014 EU-wide Stress Test and build on the conclusions of the peer review of the implementation of the CEBS Guidelines on Stress Testing (GL32)
- GL do not prescribe or set detailed methodologies for supervisory stress tests however, they set the context to facilitate discussions on the future of supervisory stress tests
- GL provide a very important description and guidance on the use of supervisory stress testing by competent authorities, on the forms of supervisory stress testing, on the organisational and governance arrangements within competent authorities, and on the general process and methodological considerations. For instance, the forms of supervisory stress testing covers important key elements such as: coverage, design, scope, sample of institutions covered by the stress tests, and approach, in terms of top-down stress test, bottom-up stress test, or combination of both
- This updated text on supervisory stress testing has been also amended to reflect recent approaches, developments and applications followed by competent authorities on the supervisory stress testing

Note: GL text has been reviewed in light of the comments received to the public consultation relevant to supervisory stress testing. Only a few comments were received on the supervisory stress testing elements, as more attention was given to the sections addressed to institutions (e.g. practical implementation date of GL, link to recovery planning, concerns on using pass/fail ratios alongside with the publication of respective outcomes)

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3. Revision of the IRRBB Guidelines. Implementation BCBS Standards - Transitional approach

1st Phase

Update of EBA IRRBB Guidelines



Guidance addressed to institutions

Update of EBA SREP Guidelines



Guidance addressed to competent authorities

Revised IRRBB and SREP Guidelines published for public consultation 31 Oct 2017 (closing 31 Jan 2018)



2nd Phase

Implementation of CRDV – CRRII

- Draft proposal published 23 Nov 2016

Implementation of related IRRBB policy products as per EBA mandates (as in draft proposal):

- Guidelines on IRRBB/CSRBB
- RTS on standardised methodology
- RTS on supervisory outlier test
- RTS on common assumptions for NII calculations

3. Revision of the IRRBB Guidelines. Key aspects

Background for the revision

- New BCBS IRRBB Standards (published April 2016)
- Refinement of the current EBA IRRBB Guidelines
- Current market environment



Key changes

- **Credit spread risk in the banking book (CSRBB)** has been included into the scope of the Guidelines under the form of high level guidance for institutions to identify their CSRBB exposures and ensure that CSRBB is adequately measured, monitored and controlled (with transitional provisions for smaller institutions)
- **Guidance has been added in the governance section** with regards to the assessment of new products and activities in terms of IRRBB, and model validation
- **Guidance has been added for the internal IRRBB measurement** such as for institutions to consider negative interest rates in low interest rate environments
- **A number of changes have been made to the existing supervisory outlier test.** A set of new principles has been added to the calculation such as the removal of the zero bound floor, and the inclusion of NPEs
- The **revised outlier test** introduced by the BCBS Standards (threshold 15% of Tier 1 capital) has been **included as an “early warning signal”** on top of the current outlier test (threshold 20% of own funds) (with transitional provisions for smaller institutions)

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4. Revision of Institutions' Stress Testing Guidelines.

General aspects

- Second consultation on the revision of 2010 Guidelines on stress testing (GL32)
- Sections on supervisory stress testing (section 5, 6 and 7) have been moved to the SREP Guidelines
- Only the part regarding the banks' stress tests (section 4) has been kept- as in the previous version of the Guidelines on stress testing
- The current draft Guidelines on stress testing incorporate the comments received during the first consultation period which ended in March 2016
- A second consultation period has started, aligned with the consultation period for the SREP Guidelines

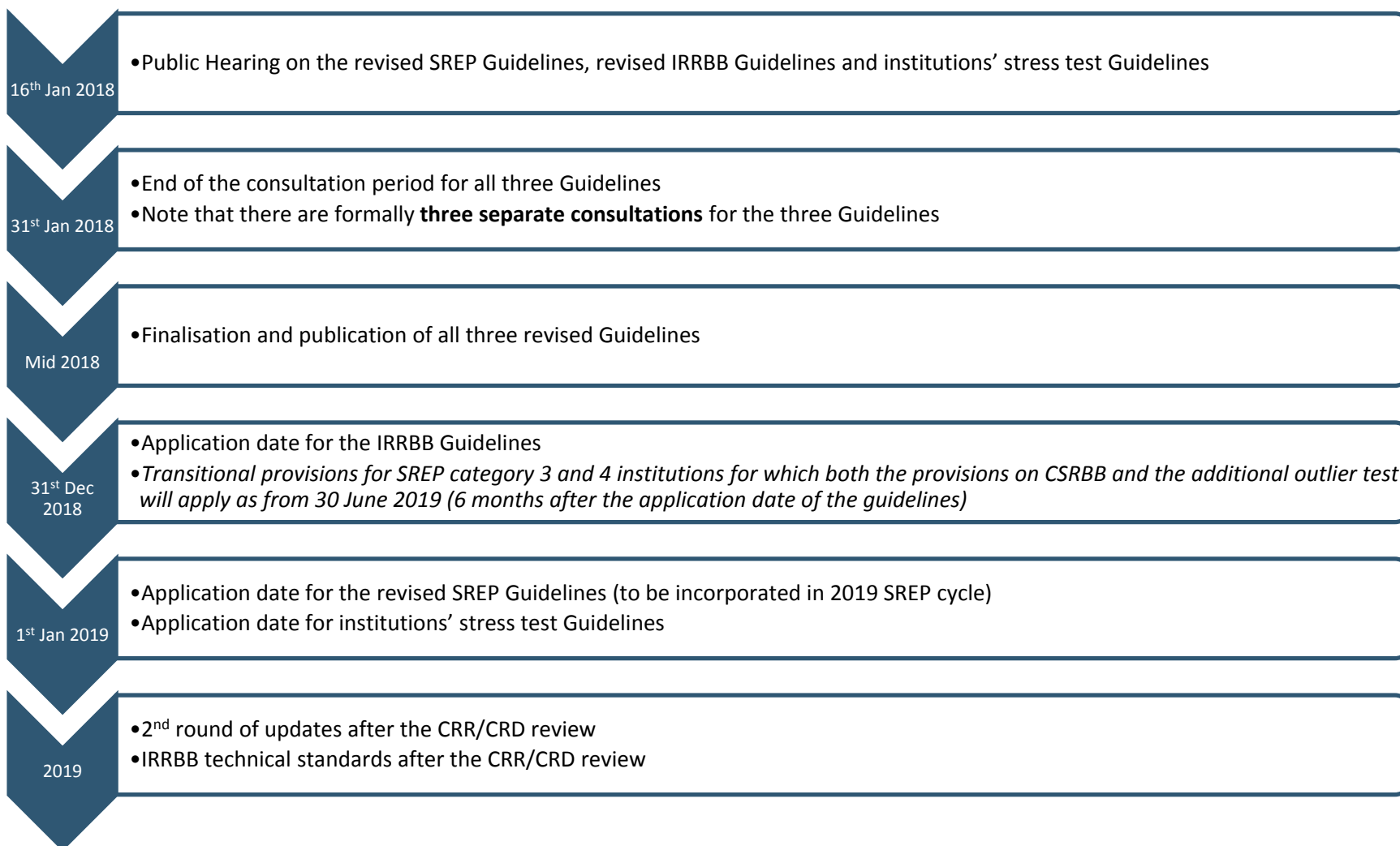
4. Revision of Institutions' Stress Testing Guidelines. First consultation round

- Comments from the first consultation round have focussed mainly on the following areas:
 - i. General issues - clarifications provided on:
 - Application date of the Guidelines
 - Proportionality
 - Impacts of a changing prudential framework
 - Net Interest Income (NII) stress test modelling
 - ii. Taxonomy
 - Clarifications on specific terms
 - iii. Data infrastructure
 - Clarification that Guidelines apply not only to G-SII/O-SIIs but also to other institutions with the appropriate degree of proportionality
 - iv. The use of reverse stress testing process
 - Clarification provided regarding useful ways to assess severity of scenarios; clarified the alignment of risk appetite and use of reverse stress testing

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6. Points for discussion

Revised SREP Guidelines:

- What are your views in general on the revisions to the SREP Guidelines and, in particular on the introduction and mechanics of P2G?
- In particular, what are your views regarding disclosure of P2G, having in mind the criteria for insider information?

Revised IRRBB Guidelines:

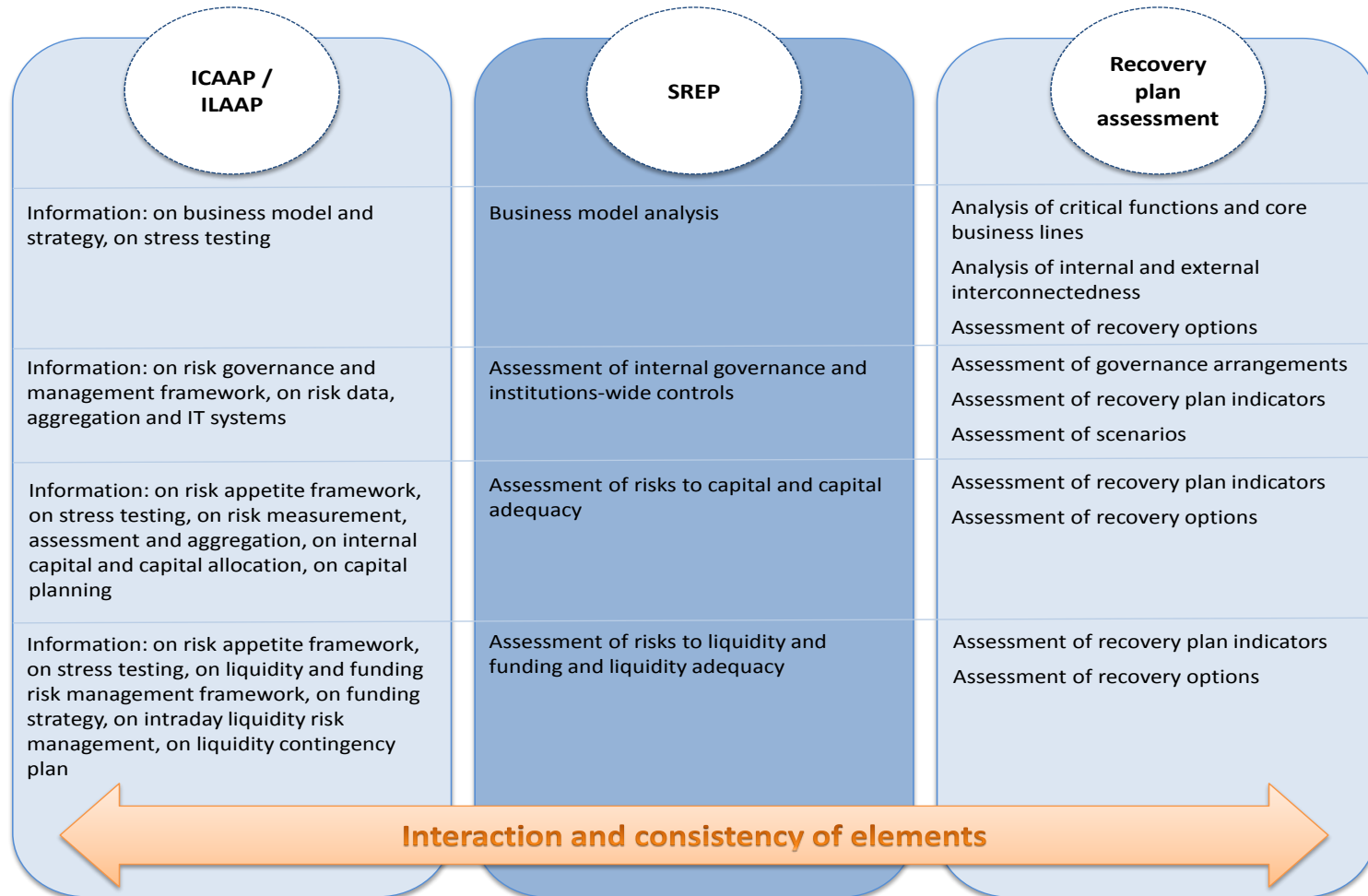
- What are your views in general on the revisions to the IRRBB Guidelines?
- In particular what are your views on the introduction of the new threshold of 15% of Tier 1 as an “early warning signal” for the supervisory outlier test and the related transitional provisions?

Revised Guidelines on institution’s stress testing:

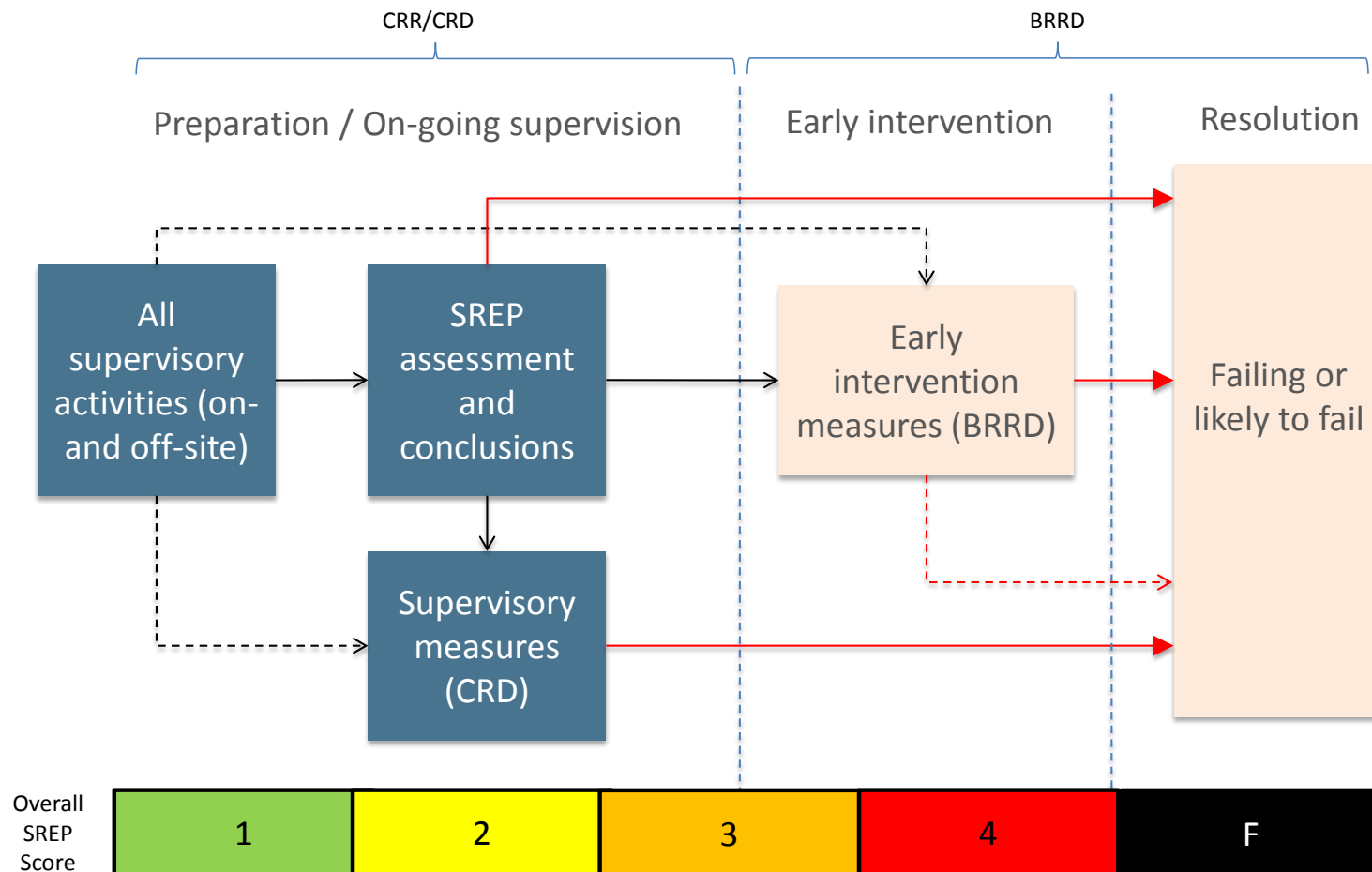
- What are your views in general on the revisions to the Guidelines on institution’s stress testing?

Annex

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



Annex 1. SREP: Link between on-going supervision, early intervention and resolution



Annex 2. IRRBB: BCBS 2016 Standards on IRRBB – Main elements

Definitions

- Prior four subtypes of IRRBB (repricing risk, yield curve risk, basis risk and optionality risk)
- Reduced to three subtypes of IRRBB (gap risk, basis risk and option risk).

Enhanced Pillar 2

- Pillar 2 deemed more appropriate for heterogeneous nature of IRRBB.
- “Enhanced” Pillar 2 (combining ICAAP and SREP, outlier approach and mandatory disclosures).

Measurement and management

- Expanded guidance on expectations for IRRBB management.
- Consideration of impact on both Economic Value (EV) and Earnings (NII).
- More extensive guidance on key behavioural and modelling assumptions.
- Internal validation process for models.

Standardised Methodology

- Supervisors can mandate banks to apply the standardised framework for IRRBB.
- Banks can choose to adopt the standardised framework for IRRBB.

Outlier test

- Stricter outlier threshold for supervisors to identify “outlier” banks.
- Threshold reduced from 20% of a bank’s total capital to 15% of its Tier 1 capital.
- Outlier test to be calculated using 6 prescribed scenarios (with currency-specific shocks).

Disclosures

- More extensive disclosure requirements under Pillar 3.
- Prescribed format for qualitative and quantitative disclosures.
- Promote consistency, comparability and transparency.

Annex 3. Revision of the IRRBB Guidelines - Implementation BCBS Standards – Phase 1

Proposed revised EBA IRRBB Guidelines	Proposed revised SREP Guidelines
<p>Definitions</p> <ul style="list-style-type: none"> - Adjustment of definitions (three subtypes of IRRBB); - New definitions (e.g. (un)conditional cash flow modelling). 	<p>Definitions</p> <ul style="list-style-type: none"> - Adjustment of definitions (three subtypes of IRRBB).
<p>General provisions</p> <ul style="list-style-type: none"> - Addition that the following instruments should be considered as interest rate sensitive instruments: (i) non—performing exposures (net of provisions), and (ii) interest rate derivatives and off-balance sheet items such as interest rate sensitive loan commitments. 	<p>General provisions</p> <ul style="list-style-type: none"> - Addition that the following instruments should be considered as interest rate sensitive instruments: (i) non—performing exposures (net of provisions), and (ii) interest rate derivatives and off-balance sheet items such as interest rate sensitive loan commitments.
<p>Governance, measurement and management</p> <ul style="list-style-type: none"> - Guidance added on assessment of new products/activities in terms of IRRBB and delegation of monitoring and management of IRRBB. - High level expectation for identification, monitoring and measurement of CSRBB (with transitional provisions). - Measurement and reporting of IRRBB both in terms of Economic Value (EV) and Earnings (NII). - Internal validation process for models. - Guidance on currency specific shocks for material currencies. 	<p>Assessment of Governance, measurement and management</p> <ul style="list-style-type: none"> - Assessment of development and internal validation process for models added.
<p>Supervisory outlier test</p> <ul style="list-style-type: none"> - Current outlier test (20% Own funds threshold- 2 scenarios) kept. - Additional outlier test (15% Tier 1 threshold - 6 scenarios (with currency-specific shocks)) included as “early warning signal” (transitional provisions). - Replacement of 0% floor by linear lower bound. 	<p>Assessment of outcomes supervisory outlier test</p> <ul style="list-style-type: none"> - Assessment of outcome supervisory outlier tests and supervisory stress tests, as well as institution’s interest rate shock scenarios and interest rate stress scenarios.



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