



Building common European SREP framework – Guidelines for common SREP

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Outline

1. Key objectives of the common SREP framework
2. Background and related developments
3. Overview of the common SREP framework and Guidelines
4. Use of SREP outcomes in other areas
5. Next steps
6. Questions for the public consultation / discussion

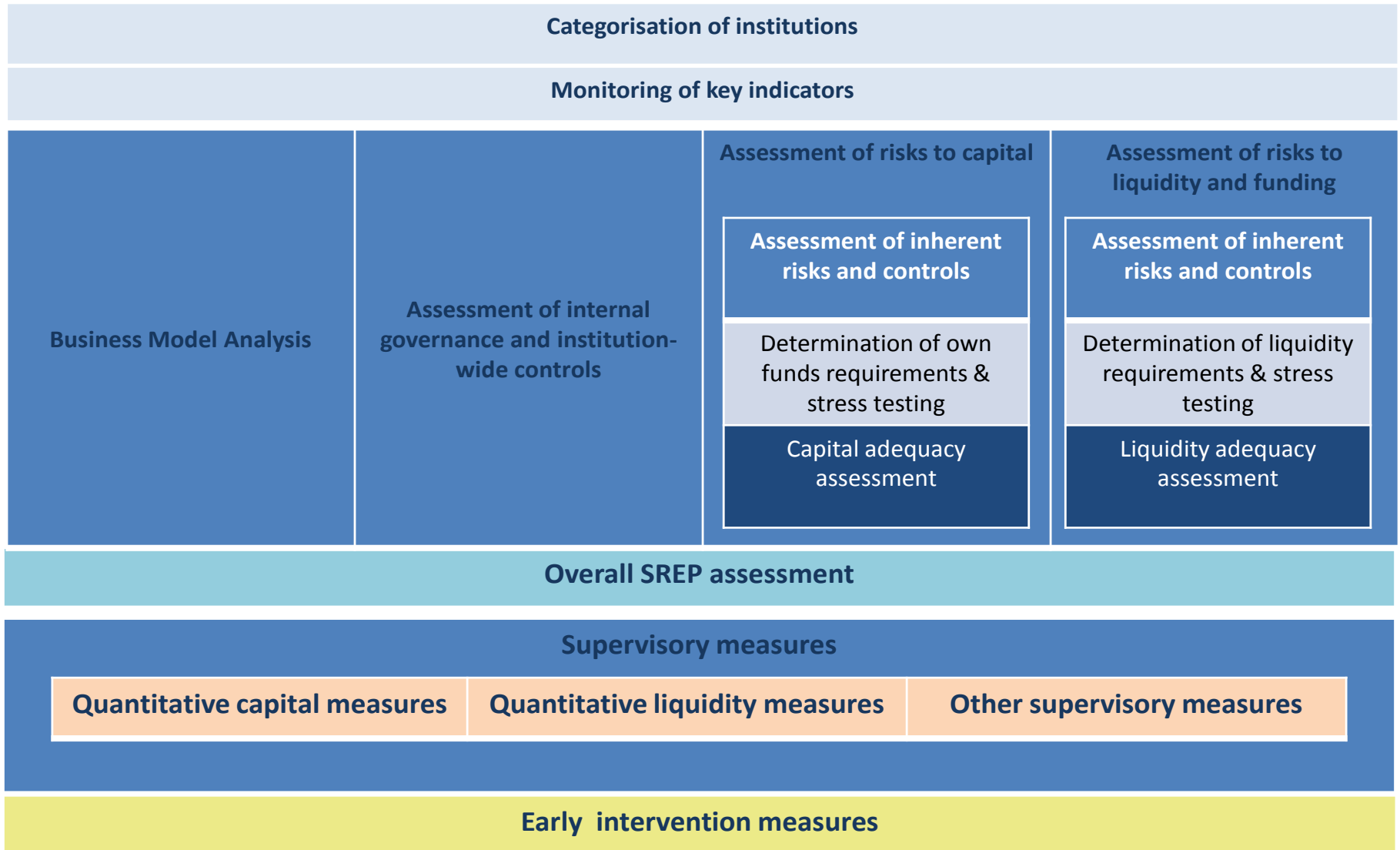
Key objectives of the common SREP framework

- Key component of the Single Rulebook focused on increasing consistency of supervision within the Union (both SSM and non-SSM countries)
- Methodological support to joint decision on capital and liquidity adequacy to be reached by colleges of supervisors
- Increase the consistency of supervisory response – Pillar 2 capital and liquidity requirements and other supervisory measures
- Support changes in the regulatory framework covering SREP (CRD):
 - Introduction of business model analysis
 - Introduction of the assessment of liquidity and funding risks and liquidity adequacy
- Building links between on-going supervision and recovery and resolution regimes (triggers for early intervention and assessment of whether institution is ‘failing or likely to fail’)



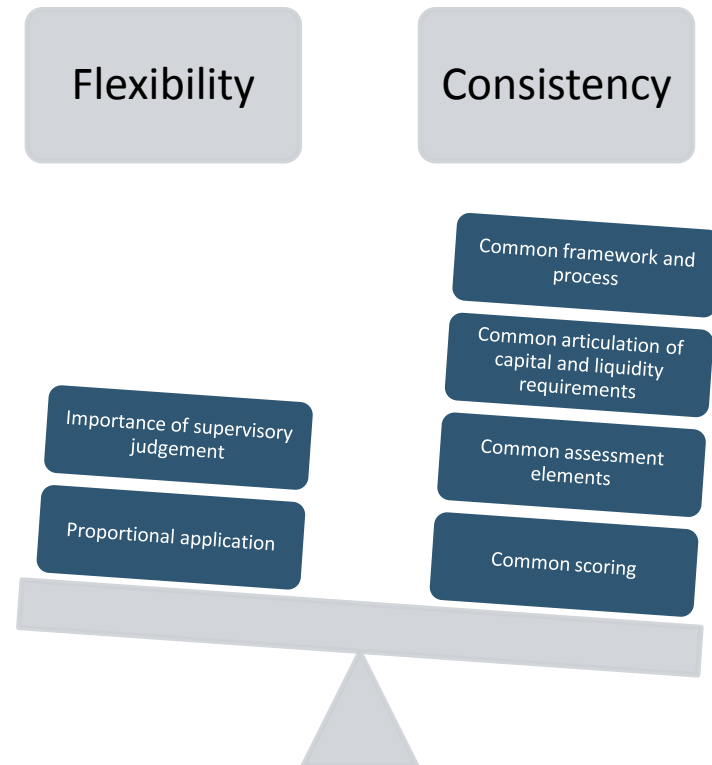
EBA primary objective in SREP:
increase the consistency and quality of supervisory SREP practices, and hence of their outcomes

Overview of the common SREP framework



Key features/innovations

- Common approach/process to all institutions → recognition of the principle of proportionality through categorisation of institutions
- Common scoring definitions and considerations (risks scores and ‘viability’ scores for SREP elements and Overall SREP score)
- Guidance on the assessment of material risks (reflecting current best practices) expanded to risks to liquidity and funding
- Common approach to assessment of capital and liquidity adequacy, and articulation of additional own funds and liquidity requirements (what should be covered, what instruments allowed, how these relate to CRD capital buffers)
- Importance of supervisory judgement → no formulas, no scoring matrices, but constrains by means of ‘considerations’
- Guidance on application of quantitative and qualitative supervisory measures
- Focus on the overall risk to the viability of an institution → use of SREP outcomes in crisis management, recovery and resolution



Categorisation of institutions

- Tool to put principle of proportionality into practice → supervisory engagement model
- Four categories of institutions reflecting their complexity and systemic importance → way of addressing assessment of systemic risk
- Broad definition of categories → system is suitable for different markets and countries allowing room for supervisory judgment

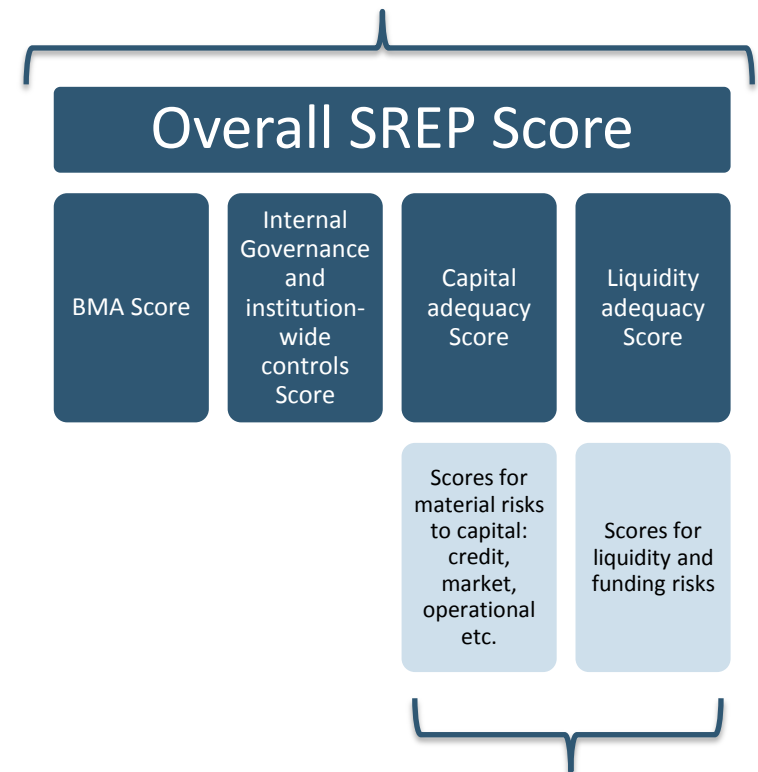
Intensity of engagement

Category	Monitoring of key indicators	Assessment of all SREP elements (at least)	Summary of the Overall SREP assessment	Minimum level of engagement
1 (G-SII, O-SII other large institutions)	Quarterly	Annual	Annual	<u>Ongoing engagement</u> with institution's management body and senior management; engagement with institution for assessment of each element.
2	Quarterly	Every 2 years	Annual	<u>Ongoing engagement</u> with institution's management body and senior management; engagement with institution for assessment of each element.
3	Quarterly	Every 3 years	Annual	<u>Risk-based engagement</u> with institution's management body and senior management; engagement with institution for assessment of material risk element(s).
4 (small non-complex domestic institutions)	Quarterly	Every 3 years	Annual	Engagement with institution's management body and senior management <u>at least every three years.</u>

Common scoring

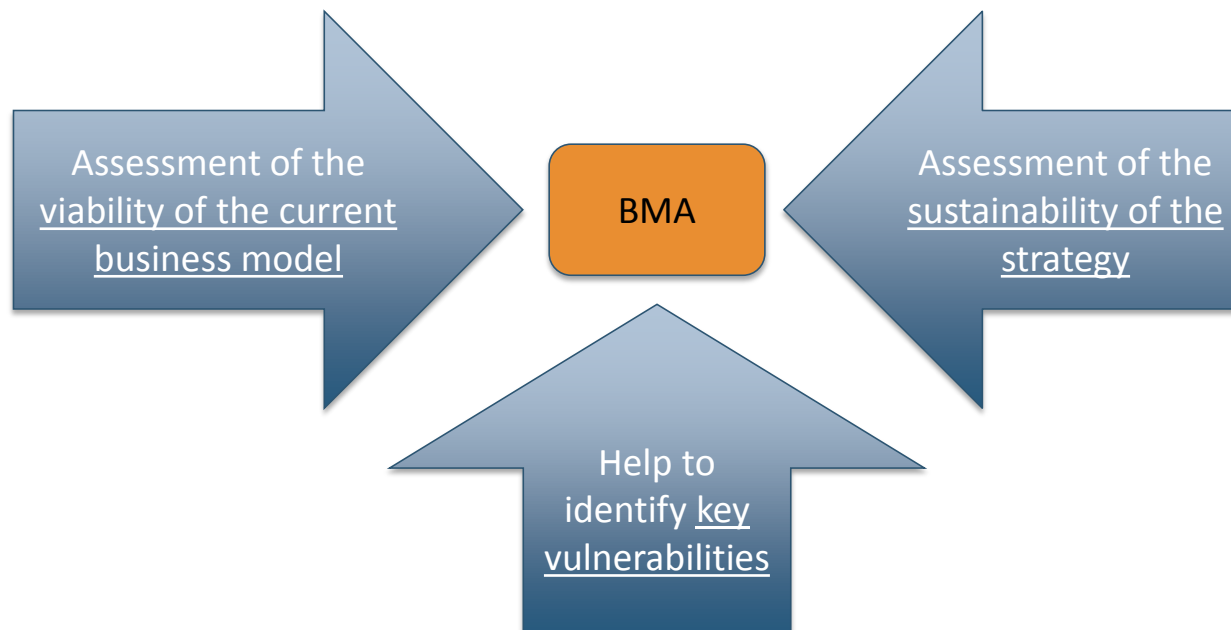
- Viability scores and risk scores
- ‘1’ (no discernible risk) to ‘4’ (high risk) scale
- Overall SREP score
 - an indication of the institution’s overall viability
 - an indication of the likelihood that early intervention measures should be taken, and to act as a trigger for them
 - an indication through the assessment of the overall viability of the institution, whether that institution is failing or is likely to fail
- Overall SREP score has additional ‘F’ grade – institution is considered ‘failing or likely to fail’
- All scores are defined and supported by ‘supervisory consideration’, although there are no matrixes → aggregation is judgement based

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



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

Business model analysis



Essential questions of the BMA:

1. *How is the institution making profits today?*
2. *What are the key drivers of its profitability?*
3. *How does it plan to make profits tomorrow?*
4. *How will the key drivers of profitability change? And what is driving this change?*

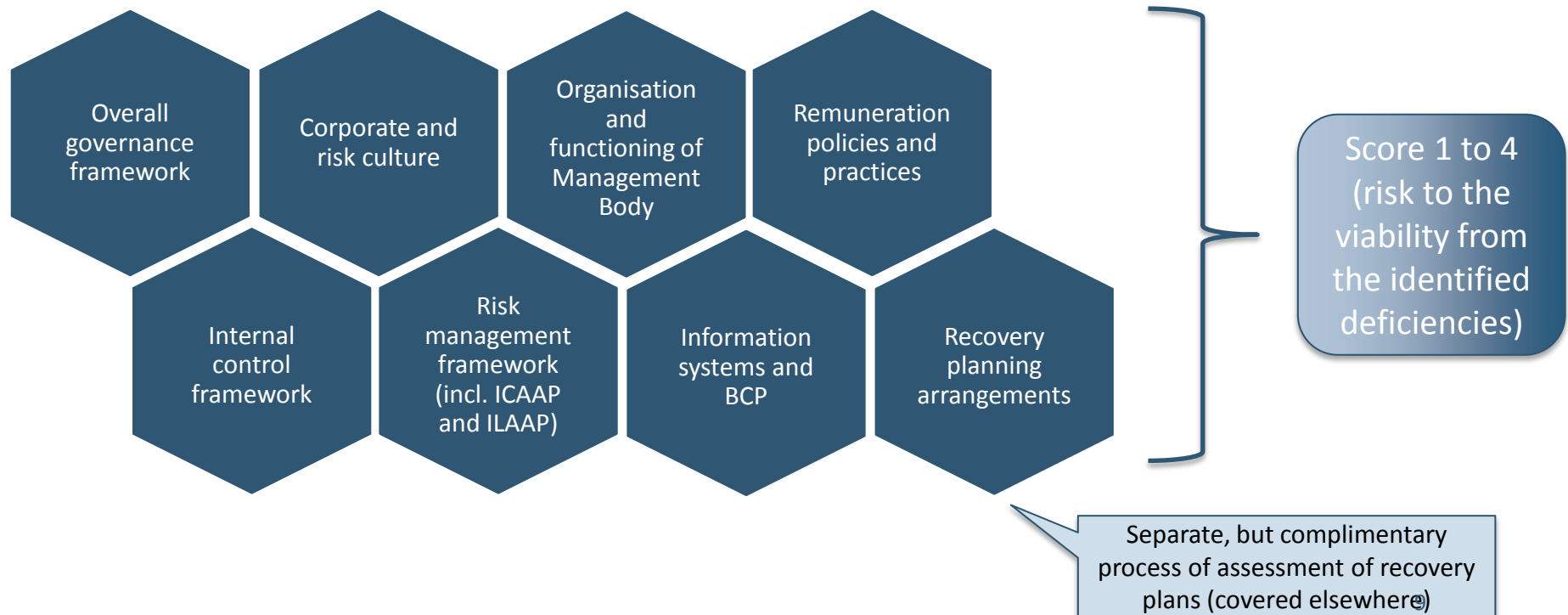
Key elements:

- Identification of the focus (e.g. business lines)
- Assessment of business environment
- Quantitative and qualitative analyses of current model
- Analysis of forward-looking strategy and financial plans
- Forming supervisory view and scoring

Assessment of internal governance and controls

Focus on:

- Ensuring that internal governance and institution-wide controls are adequate to its risk profile, business model, size and complexity of the institution
- assessing the degree to which the institution adheres to the requirements and standards of good internal governance and risk controls arrangements



Assessment of individual risks to capital 1/2

Common risk taxonomy

- Based on risk nature
- Sub-categories, if differ from the Guidelines should be agreed within colleges

Material risks

Credit	Mkt	Op	IRRBB	Other
<ul style="list-style-type: none"> • Concentration • Dilution • Securitisation • Residual • 	<ul style="list-style-type: none"> • Equity, IR, FX • CVA • Structural FX • Credit spread • 	<ul style="list-style-type: none"> • Conduct • IT • Model* • Reputational** • 	<ul style="list-style-type: none"> • Pre-payment • Behavioral • Optionalities • Other 	<ul style="list-style-type: none"> • Pension •

Sub categories can be assessed individually when material

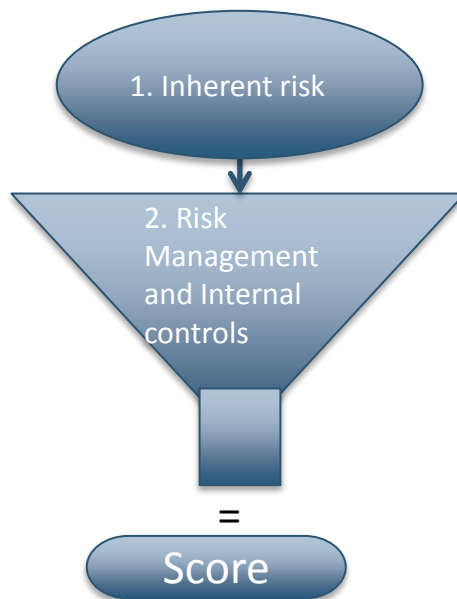
*Model risk for internal approaches should be assessed within each risk category. Risk arising from wider use of models should be considered under operational risk assessment

** Reputational risk is assessed under operational risk because of shared risk management practices and risk drivers

Assessment of individual risks to capital 2/2

Common assessment approach

- Combination of inherent risk (risk exposure) and internal controls assessments
- Based on current and forward looking views (consideration of strategies and environment)



- Risk identification and assessment of the nature and significance of risk
- Risk evolution from internal and regulatory perspectives
- Peer review, on-site inspections and ICAAP
- Outcomes of BMA and monitoring of Risk Indicators

- a. Risk management framework and organisation, policies and procedures
- b. Risk strategies and consistency with risk appetite
- c. Risk monitoring and reporting, including management response
- d. Risk measurement and stress testing

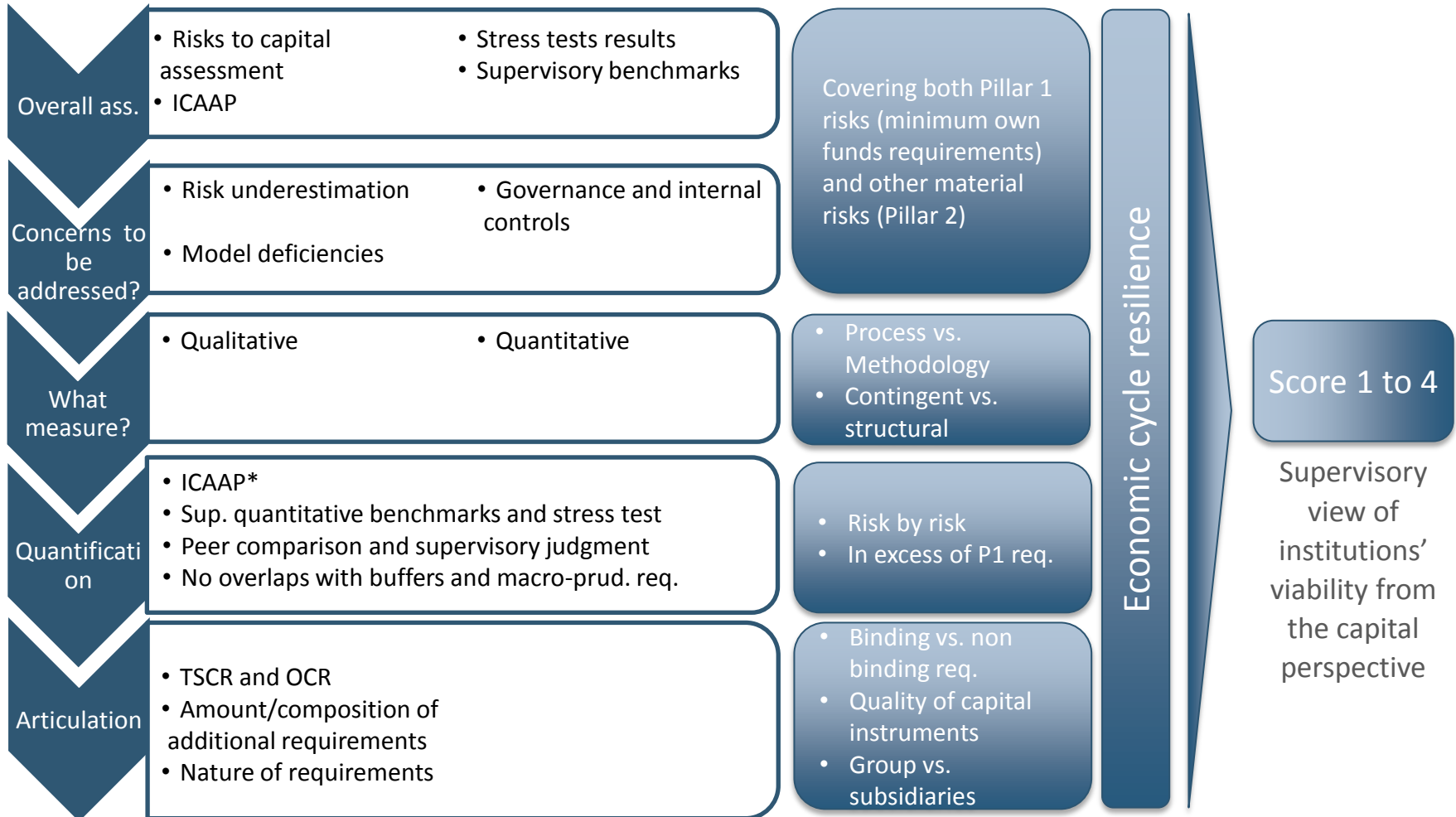
- a. Supervisory qualitative view on the prudential impact, reflecting findings
- b. Expressed on a 4-grade scale, with a qualitative description
- c. Specific to each material risk



A score of 4 does not necessarily imply a capital measure

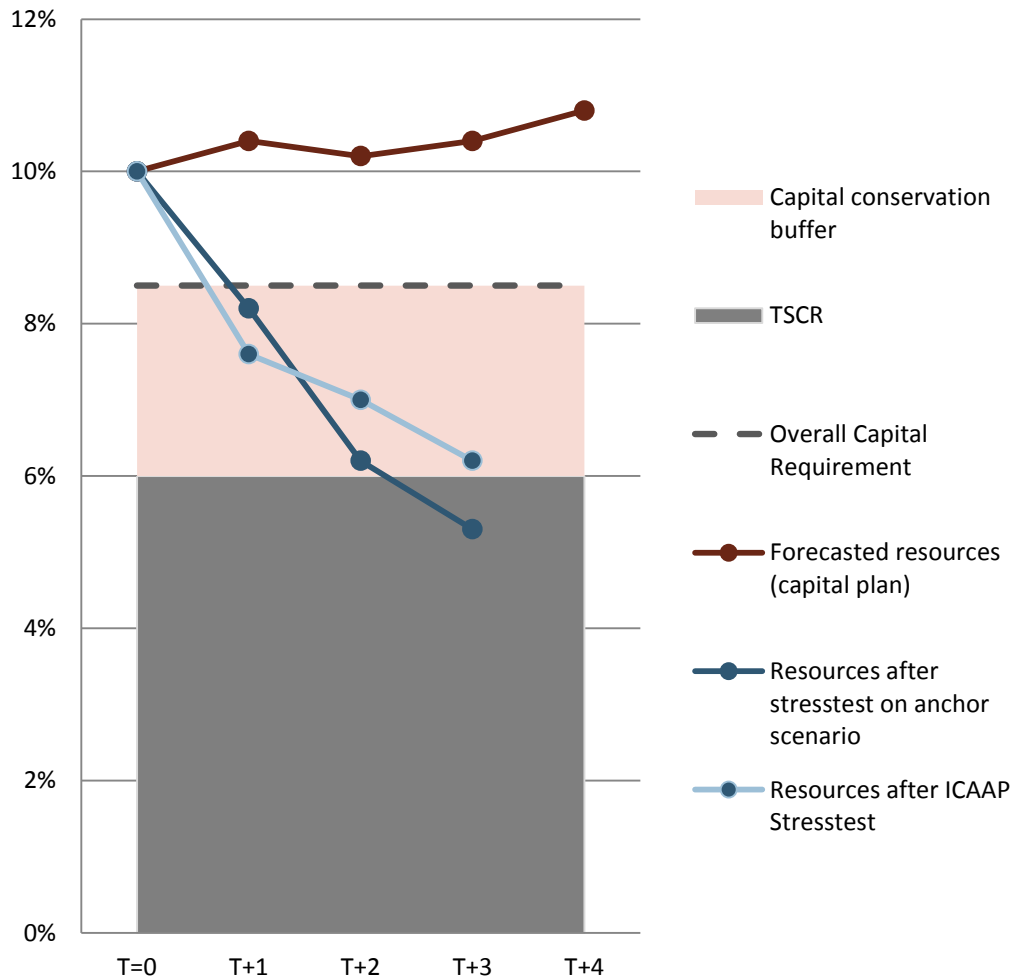
Assessment of capital adequacy

- Capital adequacy is a key determinant of institutions' viability and subject to joint decisions for cross-border groups



* ICAAP considered subject to satisfaction of soundness requirements

Meeting the own funds requirement over cycle

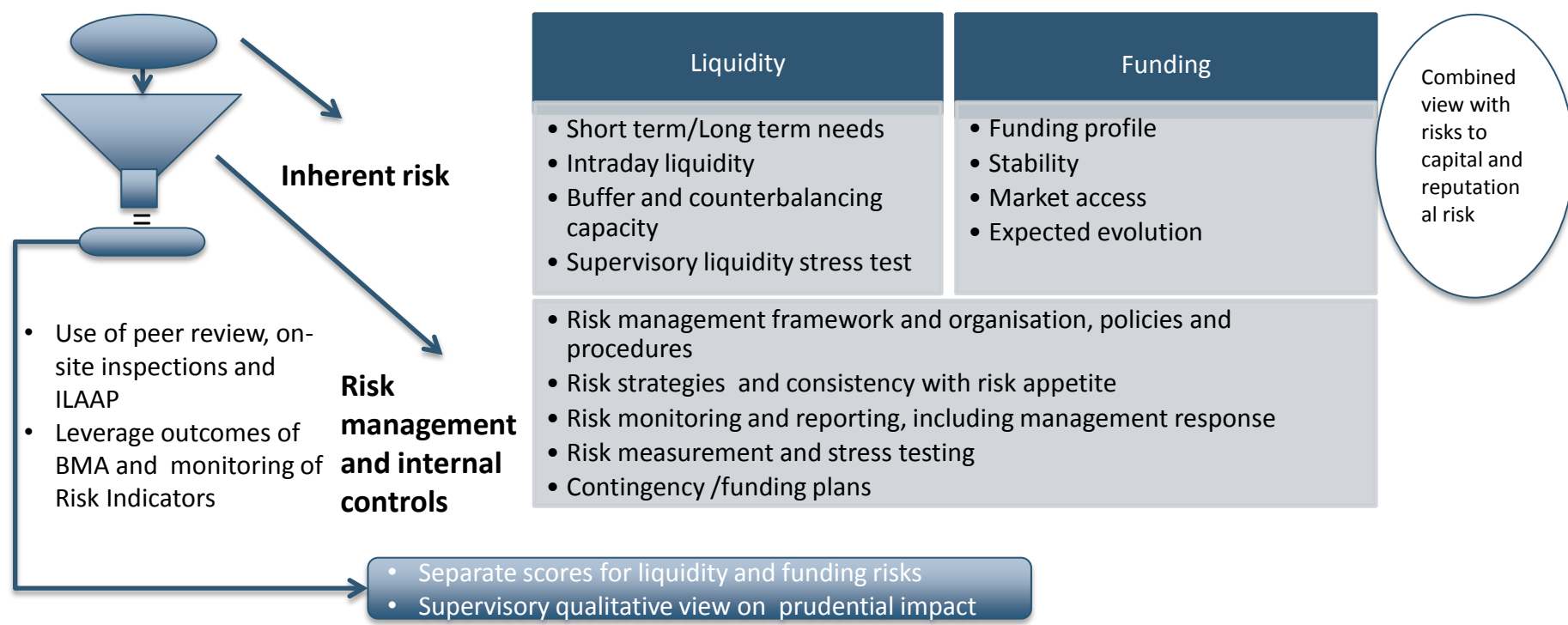


Competent authorities should consider which measures are necessary to address any findings that:

- own funds are unlikely to be sufficient to cover the OCR (during the base case), and
- TSCR (during the stress),
- and/or to address findings that the institution's leverage ratio would be negatively affected during the stress

Assessment of risks to liquidity and funding

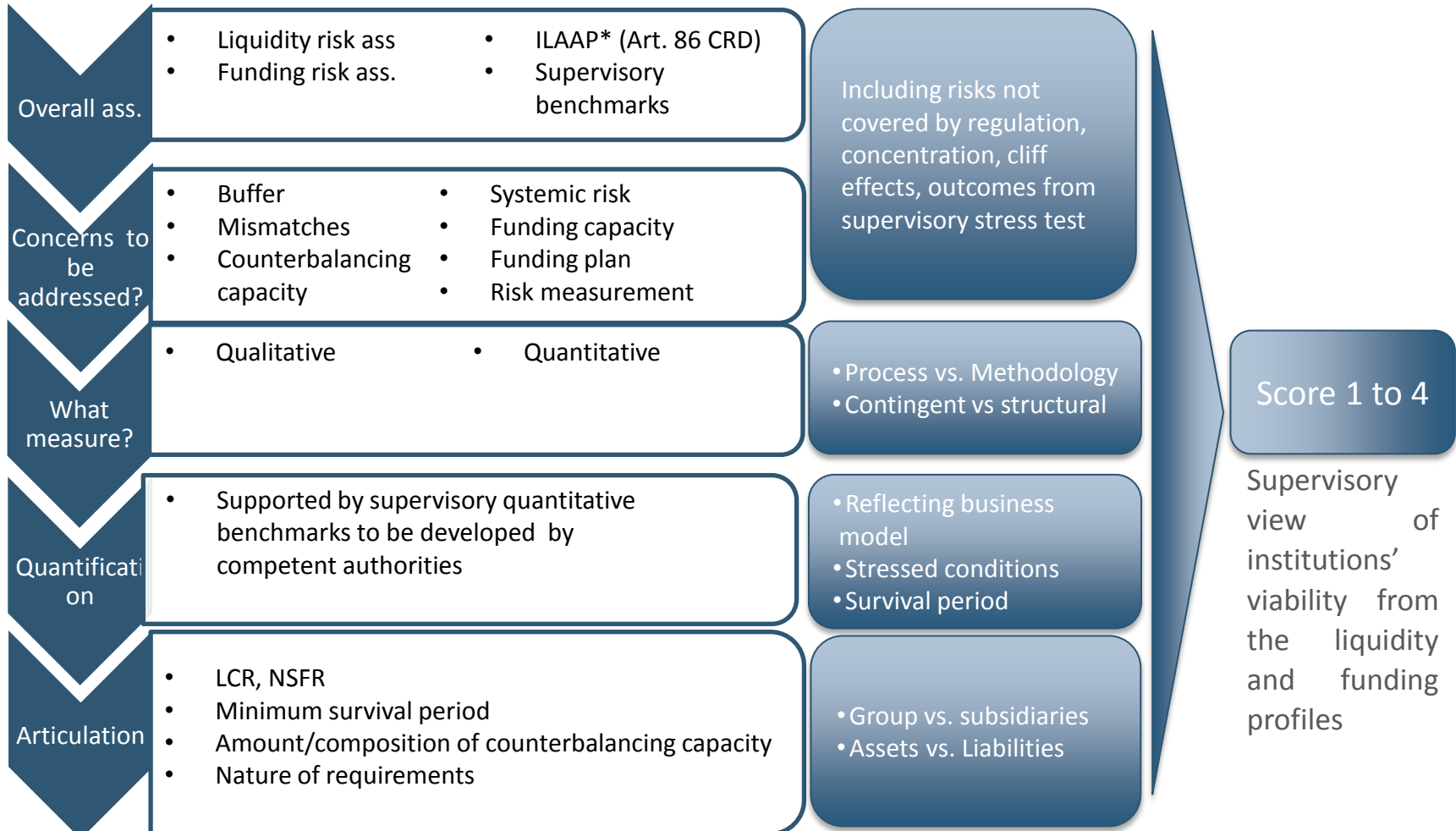
- Common elements for assessing liquidity and funding* risk
- Based on the same approach for risks to capital



**the risk that the institution does not have stable sources of funding in the medium and long term, resulting in the current or prospective risk that an institution cannot meet its financial obligations, such as payments and collateral needs, as they fall due in the medium to long term, either at all or without increasing funding costs unacceptably*

Assessment of liquidity adequacy

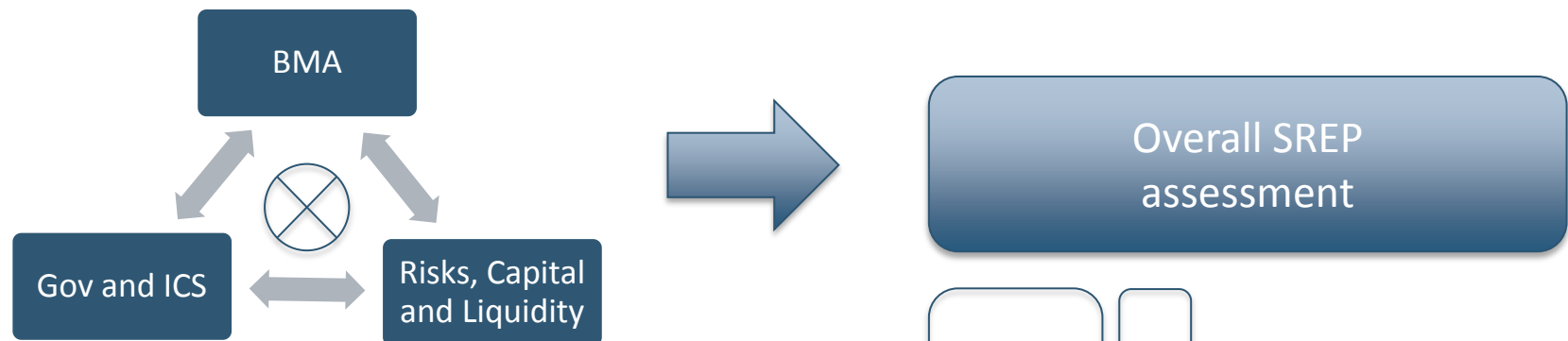
- Liquidity adequacy is a key determinant of institutions' viability and subject to Joint decisions for cross – border groups



* ILAAP considered subject to satisfaction of soundness requirements

Overall SREP summary and score

- Overall SREP assessment is the synthesis of all the other elements (not just simple sum)



SREP elements combine each other and can play as a mitigation or as an amplification of other elements' weaknesses/strengths

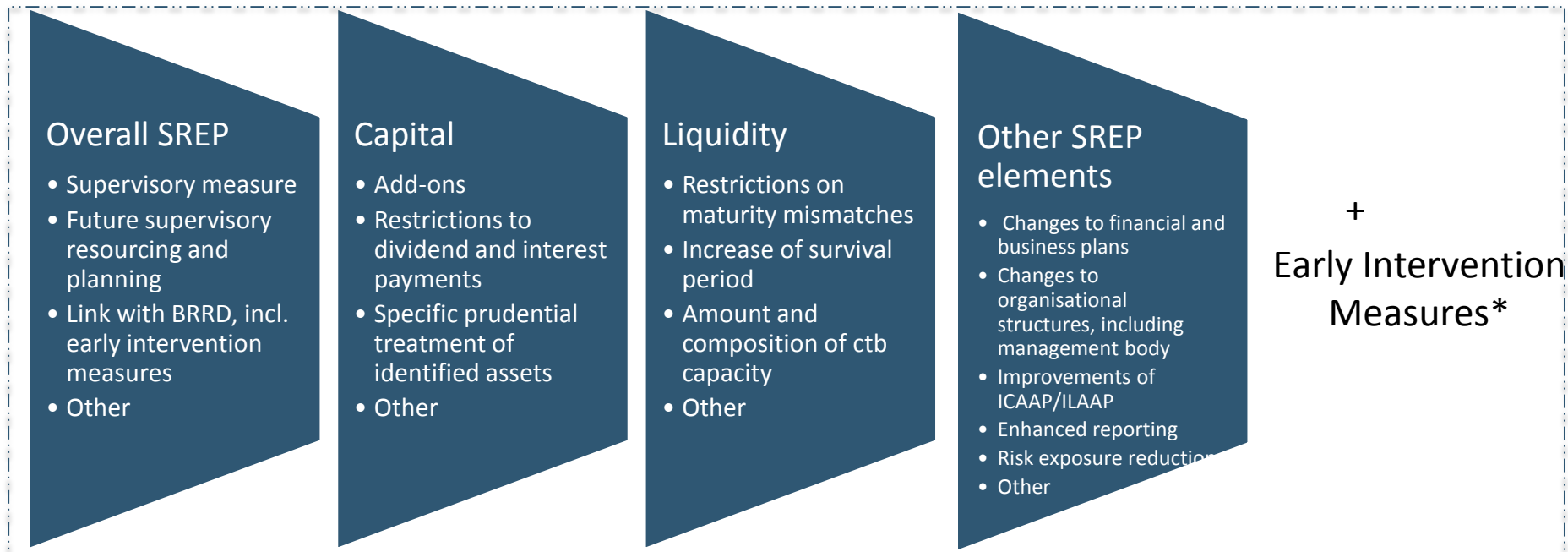
Viability score	1	No discernible risk
	2	Low risk
	3	Medium risk
	4	High risk
	F	Failing or likely to fail

There is an immediate risk to the viability of the institution → BRRD provisions apply

- Annual summary
- Overall SREP assessment
 - Overall SREP score
 - SREP elements scores
 - Any supervisory findings in the last 12 months

SREP outcomes – supervisory measures

- Different Supervisory measures are foreseen, depending on the areas of concern and on the level of criticality



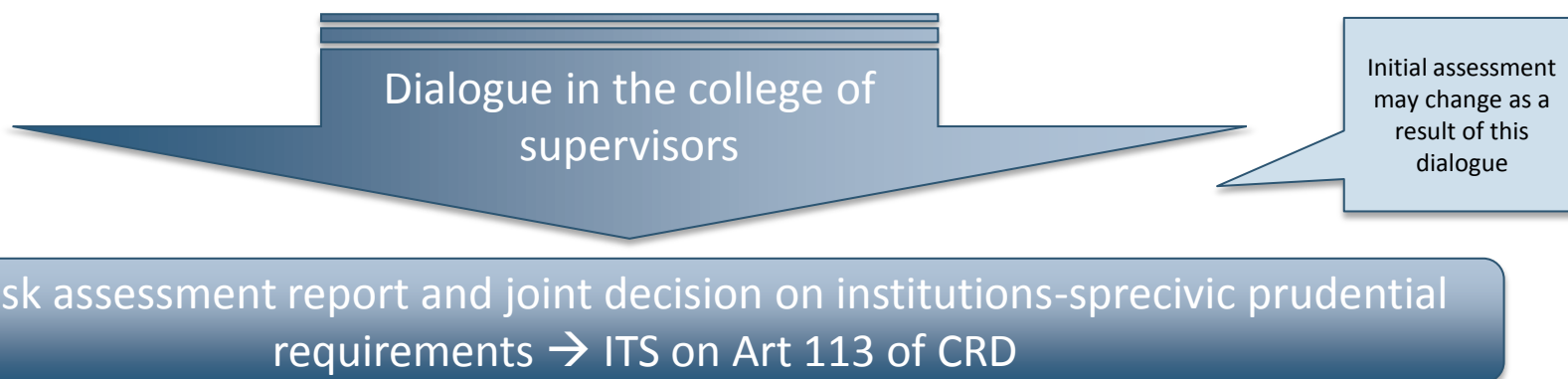
- Duration and severity of the **measures proportionate** to gravity of the deficiencies
- **Aimed at restoring compliance**/enhancing institutions' prudential soundness
- Can be **adopted anytime** during SREP and following on-site inspections
- Can enhance **effectiveness of macro-prudential measures** for specific institutions

Implementation plans to be approved and monitored by CAs

* Authorities could require the institution to implement any measures set out in the recovery plan, draw up an action programme and a timetable for its implementation, require the convening of a meeting of shareholders to adopt urgent decisions, and require the institution to draw up a plan for restructuring of debt with its creditors. In addition, supervisors will have the power to appoint a special manager for a limited period to restore the financial situation of the bank and the sound and prudent management of its business¹⁷

Cross-border implications

- Consolidating supervisors should perform the initial assessment of the parent undertaking and the group of institutions on the consolidated level
- Competent authorities should perform the initial assessment on the level of the entities under their supervision (solo, or sub-consolidated, where relevant).



Capital:

- All additional own funds requirements as provided in Art 104(1)(a) → TSCR

Liquidity:

- quantitative specific liquidity requirements are proposed by competent authorities
- measures other than quantitative specific liquidity requirements are proposed by competent authorities and the score assigned to liquidity risk and/or funding risk is a '3' or '4'

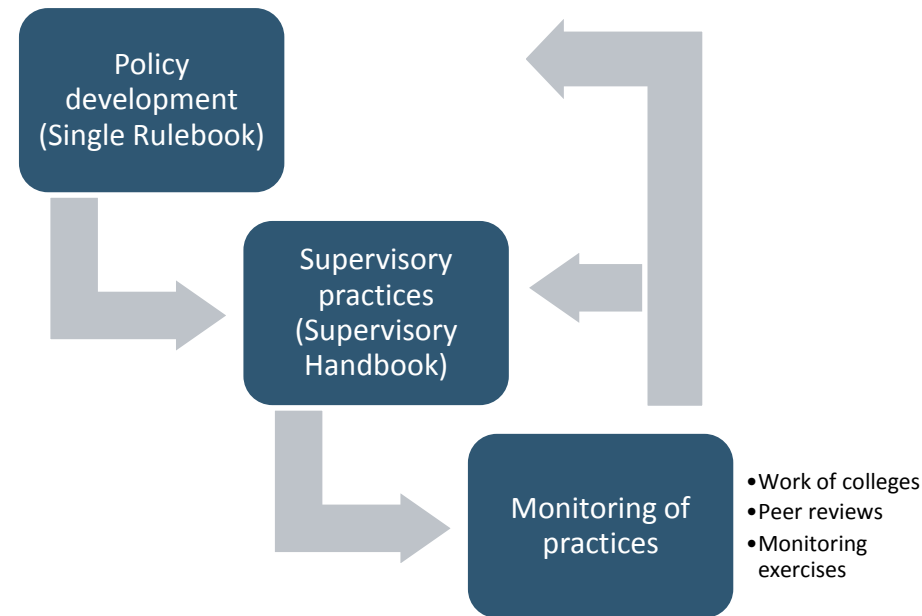
Next steps – finalisation and implementation



- Public consultation runs until 7 October
- Finalisation of the Guidelines in December 2014
- Planned implementation by 1 January 2016 (Guidelines should be applied for the 2016 SREP cycle and joint decisions)
- ‘Comply or explain’ based implementation in national guidelines/manuals etc.
- Transitional arrangements:
 - Implementation of supervisory benchmarks and articulation of quantitative requirements linked to LCR and NSFR is not required until LCR and NSFR requirements are in place
 - Approach to inter-risk diversification and requirements regarding composition of own funds in the Pillar 2 subject to later implementation due to expected significant impacts in some countries in combination with CRR requirements and to the development of supervisory benchmarks

Next steps – monitoring and follow-up work

- EBA will address additional technical details (e.g. supervisory benchmarks for assessment of capital adequacy) in the EBA Single Supervisory Handbook
- EBA will be monitoring the implementation and use of common SREP framework through the work of colleges of supervisors
- EBA will use the guidelines as benchmark in:
 - monitoring of consistency of supervisory reviews and methodologies used to apply supervisory measures → statutory obligation
 - formal peer reviews
 - settlement of disagreements between authorities / mediation
- The guidelines (and Handbook modules) will be amended and updated, where necessary, based on the outcomes of the monitoring



Questions for the consultation

1. Do the guidelines specify the SREP process sufficiently? Are there areas where the EBA should aim for greater harmonisation, or where more flexibility would be appropriate?
2. Do you agree with the proportionate approach to the application of the SREP to different categories of institutions? (Title 2)
3. Are there other drivers of business model / strategy success and failure that you believe competent authorities should consider when conducting the BMA? (Title 4)
4. Does the breakdown of risk categories and sub-categories proposed provide appropriate coverage and scope for conducting supervisory risk assessments? (Title 6)
5. Do you agree with the use of a standard approach for the articulation of additional own funds requirements to be used by competent authorities across the Union? (Title 7)
6. Do you agree that competent authorities should be granted additional transition periods for meeting certain capital and liquidity provisions in the guidelines (Title 12)?



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