POSITION PAPER

ESBG response to the EBA consultation on guidelines on ICAAP and ILAAP information collected for SREP purposes

ESBG (European Savings and Retail Banking Group)

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Dear Sir/Madam,

Thank you for the opportunity to comment on the EBA consultation on *guidelines on ICAAP and ILAAP information collected for SREP purposes*.

General comments:

In principle, we believe that the EBA's initiative to define a structured set of requirements for the information supporting the SREP is very valuable and useful. ESBG also appreciates the EBA's intention not to generate any additional requirements for institutions' ICAAP and ILAAP when specifying the necessary information.

Furthermore, we certainly welcome the proportionality clauses contained in the draft guidelines. In our view, their effectiveness will, however, depend on whether competent authorities are actually given the proposed discretion in the supervision of less significant institutions referred to in, inter alia, para. 14. In this context, it is very positive that the EBA has not drafted any proposals for reporting formats so as to allow national supervisors to use a broad scope to implement the principle of proportionality.

Seen individually, the requirements for the information to be provided by institutions are largely reasonable, particularly for the ICAAP. As a whole, however, they generate an enormous volume of paper. It is questionable whether supervisors would actually be able to inspect and evaluate all documents properly. For this reason, ESBG believes that it would be essential to examine in detail whether, with materiality and cost-benefit considerations in mind, concentration on fewer information items and documents could be achieved. In this context, we would also like to draw your attention to the EBA Banking Stakeholder Group's December 2015 report on 'Proportionality in Bank Regulation'.

Given the sheer volume of documentation, we suggest including a note in the EBA's draft guidelines expressly stating that the information does not have to be transmitted in paper form.

In addition, we would like to point out that 30 June 2016 as the application date seems very challenging to us, especially in view of the fact that competent authorities may use the draft guidelines to formulate information requests for the 2016 SREP cycle.

Section 4:

Section 4, para. 10:

In section 4, para. 10 of the draft guidelines it is mentioned that the institutions shall include an 'overarching document ('reader's manual') that facilitates the assessment of ICAAP and ILAAP documents by providing an overview of the documents and their status, an overview of where the information can be found in the documentation provided by the institution and any other information that may be relevant for the competent authority at the start of the assessment'.

As the guidelines are meant to facilitate a consistent approach to the assessment of the institutions' ICAAP and ILAAP, we believe that it would be useful for the institutions to use a common template for the 'reader's manual' specified by the EBA. In ESBG's view, this would contribute to the goal that all institutions structure and organise their documentation in a similar manner.

In the absence of a template, we would at least like to express our interest in having an overview of the methodology and description of processes. We believe it would be helpful if the EBA considered publishing such a document.

Section 4, para. 13:

Is it correct to assume that the 'one' single set date mainly refers to quantitative data only, so that the last day of a quarter would be a reasonable choice? Moreover, the EBA could add that all additional documents should be the ones that are valid on this particular set date. Updating and approving all accompanying documents would impose an unduly heavy burden on institutions and jeopardise the quality of the approval process.

Section 4, para. 19:

ESBG is not sure whether the proposal delivers a real benefit. On the contrary, in cases where a document is already available to a competent authority, it would be easier for an institution to submit the most up-to-date document instead of regularly confirming which version the competent authority last received.

Section 4, para. 20:

We are of the impression that it would only be the competent authority that benefits in this case, as it does not have to look at the documents. Institutions, on the other hand, are obliged to indicate which information they have not included. If in doubt, it is easier for institutions to simply forward the complete information. ESBG therefore suggests that institutions should be free to decide which approach to adopt. Clarification on this point would be appreciated at any rate.

Section 5:

Section 5.2, para. 23.d:

This paragraph is not entirely clear to us and any clarifications in order to better understand what is expected from the banking industry would be appreciated.

Section 5.3, para. 24:

We assume that the risk appetite framework may consist of different documents and would welcome clarification on this point.

Section 5.4, para. 25:

Para. 25 sets out requirements for information on risk data, aggregation and IT systems. These requirements are very extensive. Their description suggests that financial institutions are required to deliver full and complete documentation on their data and IT architecture, starting with base data. In fact, ESBG has doubts on how competent authorities intend to inspect and evaluate such documentation. A more appropriate approach could be to request summarised information from institutions and examine compliance with the principles by way of checks based on examples and random samples.

In addition, we consider it important to point out that small financial institutions often outsource risk management structures to specialised external service providers. We believe it is, for practical reasons and due to the burden it would impose, not a good idea to request from every single institution using such external service providers' individual information on the external provider's database, data aggregation and IT systems. A sensible solution for such cases could therefore be the delivery of a standardised description by the external service provider that is supplemented, where necessary, by institution-specific descriptions.

Section 5.5, para. 26:

ESBG has difficulties to understand the requirements relating to the disclosure of information and would hence like to draw the EBA's attention to the following concerns.

With regard to para. 26.a, the relevant disclosure requirements are set out in the CRR (mainly Art. 435(1) and Art. 438(a)). Thus, we don't see the absolute need to explain them again separately in the EBA guidelines.

In our view, para. 26.b would, if at all, only be of relevance to financial institutions with a capital market focus. Yet, in their case too, any impact on capital adequacy and funding emanates mainly from annual reports and possible ad hoc reporting, as well as from direct communication with investors. Disclosure under Pillar 3 only plays a subordinate role here in our experience. Furthermore, we wonder how the influence of Pillar 3 information is to be assessed separately from the other public relations activities. In order to conduct such an assessment, individual investors would have to be specifically interviewed to determine how helpful they found the disclosure report for their decisions. ESBG believes that this imposes an unnecessary burden and therefore suggests removing this requirement.

In relation to para. 26.c, we would like to underline that, because of the principle of confidentiality and materiality inherent in Pillar 3, there are always deviations between internal information and disclosed information, particularly in the level of detail. Explaining these would impose an unnecessary additional burden on institutions.

Based on the several concerns presented above, the EBA could even consider dropping para. 26 in its entirety. ESBG believes that it should generally be sufficient to inspect institution's current disclosure report as part of the audit. These reports are publicly available, so that they do not need to be requested separately from institutions.

Section 6:

Section 6.2, para. 30.b:

In section 6, para. 2.2, which refers to the operational documentation, it is mentioned that the results of the calculation of all material risk categories and subcategories covered by ICAAP have to be provided.

The risk materiality assessment of a bank is based on the taxonomy framework and outlines all material risk types the bank is exposed to. However, some subcategories comprised in main risk types (e.g. country and political risk within credit risk) are not quantified with economic capital and mitigated in a qualitative manner. Similarly, some categories might not be provided on a more granular level. Only a unified taxonomy across Europe would allow comparability among banks and an alignment across the sector. However, if changes to the bank's specific taxonomy were not intended, it would be unclear how banks should proceed in case risk types are not quantified with economic capital.

Section 6.5, para. 36:

Reports on ICAAP/ILAAP stress tests (para. 36.a, para. 51.a) should be requested annually or less frequently. It remains unclear whether institutions are required to make available to the competent authorities on the date for delivery of information all reports for a year or only an end-of-year report in summarised form.

Given that competent authorities closely monitor Category 1 financial institutions also over the course of a year and promptly inspect numerous documents, ESBG believes that it is of little help to subsequently request an additional consolidated end-of-year report. This seems superfluous.

Section 6.6, para. 37:

On a regular basis, a requirement is set for financial institutions to not only deliver decisions and results but to also document discussions (see para. 37 and, similarly, para. 54 on ILAAP). This raises the question of how detailed such documentation should be. ESBG has the feeling that the verbatim or action minutes of meetings would generally be too lengthy. We therefore suggest making it clear that a brief account of the different positions taken in a discussion, indicating the outcome of the discussion, would be sufficient. This should apply particularly to management board meetings.

Section 7:

In ESBG's point of view, the proposed order of contents of the ILAAP could be simplified and alternately structured in a way that allows firms to more clearly demonstrate their liquidity adequacy. As currently drafted, the order of sections begins with the liquidity risk management framework, moves on to funding strategy, then to liquidity buffers, funds transfer pricing, intraday risk, stress testing and contingency funding planning. This order could be perceived as confusing and could hence be simplified in order to allow firms to better present their main liquidity and funding risks and the way they manage these. ESBG would consequently welcome further clarity regarding the structure of the ILAAP contents.

As a practical alternative measure, the EBA could consider the proposed structure and content of ILAAP documents published by the PRA in their June 2015 paper ('PRA's approach to supervising liquidity and funding risks'). The structure suggested therein allows firms to clearly describe the conclusions of their overall liquidity adequacy review, clearly state their LCR positions, level of high-quality liquid assets, inflows and outflows, then describe their liquidity and funding risk assessments, before describing their risk management frameworks.

Section 7.1, para. 39.a:

The term 'intra-group liquidity risk' is not very well defined in any supervisory rules. It can therefore be interpreted differently. In particular, we have asked ourselves whether it means only the liquidity relationship within a group, excluding any external sources of liquidity of the individual group entities, or whether external sources of liquidity have to be included. Clarification on this point would be much appreciated.

Section 7.2, para. 41.d:

The wording 'after execution of the funding plan' could be misleading. Do competent authorities expect a hypothetical analysis (what-if scenario) or an ex-post analysis (back-testing)?

Section 7.3, para. 42.a:

The wording 'required level of liquid assets' suggests that competent authorities' expectations are influenced strongly by the LCR system. We would like to stress, however, that financial institutions may have their own, broader liquidity management methodology, such as the funding gap/liquidity surplus concept. ESBG therefore suggests replacing the term 'liquid assets' with 'level of required stress liquidity reserve portfolio to cover potential outflows'.

Section 7.3, para. 42.b:

The term 'collateral management' can be interpreted very broadly. Hence, ESBG would like to suggest stating that financial institutions should be left to decide which collateral is concerned in this context.

Section 7.3, para. 43.b:

Please see our comments on para. 42.a. In this case, too, another liquidity term could be used instead of 'buffer of liquid assets'.

Section 7.3, para. 43.d:

ESBG sees the request for 'projections of the development of the internal required minimum volume of liquid assets' as a supervisory requirement going beyond the SREP guidelines that is supposedly based on the need for information. The SREP guidelines do not call for any such projections. In addition, we question the need of this instrument, given that liquidity management is a highly dynamic process that needs to be adapted to changing environments. A 'plan' or 'projection' will very soon be outdated. Projections may be applied to secured funding via covered bonds or securitisation. Other encumbrance, such as repos, lending or collateralisation is hardly projectable, but driven by operational liquidity management considerations. This para. In the EBA's draft guidelines could therefore be dropped.

Section 7.5, para. 48.c:

A new supervisory requirement seems to be created through this paragraph as well. To our knowledge, there is no supervisory requirement to provide such a description. We are not convinced, moreover, that such a description would produce any meaningful results, since interlinkage between intraday liquidity risk management and the Contingency Funding Plan would be very remote.

Section 7.6, para. 51.c:

We understand the requirement to be an obligation to produce a funding plan under stress assumptions in addition to the normal funding plan and we would like to underline that there is so far no supervisory requirement to stress-test funding. The stress-testing requirements set by the draft EBA guidelines sensibly cover liquidity aspects. We therefore think that the deletion of this paragraph could be considered.

Section 7.7, para. 53.b:

We regard the expectations that competent authorities attach to the phrase 'concrete management action' in this context as not appropriate. Information can, at best, be provided through a 'set of possible management actions' since concrete management action can only be ordered in individual cases.

Section 7.8, para. 54.d:

This requirement is worded very generally and consequently one could conclude that every single new product/new market decision documentation that says anything about funds transfer pricing would have to be submitted. In ESBG's opinion, this would go too far. The requirement should be limited to important decisions.

Section 7.8, para. 54.f:

This paragraph could also be removed. The management of intraday liquidity consists of a large number of daily decisions and actions. In this context, 'where relevant' is an undifferentiated term, which cannot be defined more precisely. Competent authorities cannot and surely do not wish to stipulate that they receive a report annually covering actions over approximately 240 business days.

Section 8:

The Model Change Policy (MCP) has applied solely to Pillar 1 so far. Under Pillar 2, changes to the ICAAP concept are typically subject to subsequent examination (i.e. no approval by competent authorities in advance but examination-based decision). The requirements now call for information on changes (made or planned) to the ILAAP/ICAAP frameworks (para. 55.c and 56). In our view, it should be clarified that no MCP and no conditional approval are being introduced at this point.

Furthermore, it could be concluded that under para. 55.a and 55.b any and all changes to the business model, strategies, risk appetite, etc. have to be submitted to competent authorities before being implemented. This would, in ESBG's opinion, constitute interference in management's area of responsibility.

For this reason, the descriptions of made or planned changes called for under para. 55 should be restricted to material changes made so as to keep the documentation burden within reasonable limits.

Section 8, para. 55:

The draft guidelines mention in section 8, para. 55 that competent authorities 'receive from institutions conclusions on the findings of the internal capital and liquidity adequacy assessments and their impact on the risk and overall management of an institution'.

In ESBG's members' experience, there have been cases when the observations of the competent authorities regarding ICAAP and ILAAP are done at very high level and consist of rather vague terms, making any follow-up rather difficult.

Therefore, we suggest that the EBA's guidelines provide guidance to competent authorities regarding a clear and uniform formulation of their observations in a manner that can be easily followed and acted upon by the institutions.

Section 8, para. 57:

The draft guidelines mention in section 8, para. 57 that competent authorities should 'receive from institutions adequate explanation of how institutions ensure that the ICAAP and ILAAP frameworks and models used provide reliable results (validation concepts, validation reports) and a description of both the validation approach (process, frequency) and the validation content'.

It is not entirely clear to us what, in the ICAAP and ILAAP context, is required from a validation perspective above and beyond the regular validations of the internal models used for Pillar I and Pillar II purposes, which are performed by the independent validation unit. As a matter of fact, validation reports and validation concepts are submitted on a regular basis to the competent authorities.

If the EBA had any additional expectations towards what is required, ESBG would appreciate a clear description thereof. Particularly, it would be helpful to lay down in the guidelines what is meant by 'internal validation/reviews of ICAAP and ILAAP methodologies'.

Moreover, the phrase 'performed by independent validation function' does not indicate which specific requirements there are in regard to independence. The independence of the validation function is not specified in the SREP guidelines as a criterion for the supervisory review process. A new supervisory requirement seems thus to be introduced here, too. We do not consider this to be appropriate.

Section 5 – Accompanying documents:

Section 5.1:

The projected costs and benefits are vague and kept purely qualitative. It would be more convincing to quantify the additional burden for the individual categories of financial institutions.

When assessing this, a distinction could be made between whether the documentation is already available to the required extent in financial institutions and whether it has still to be produced in part. Even for institutions which already have comprehensive documentation available, producing and regularly updating a 'reader's manual' (including the change status of every single document since it was last delivered to the competent authority) is likely to impose a considerable additional burden. This will be compounded by the requirement to aggregate data and make it available annually in a single, consolidated package.

About ESBG (European Savings and Retail Banking Group)

ESBG brings together savings and retail banks of the European Union and European Economic Area that believe in a common identity for European policies. ESBG members support the development of a single market for Europe that adheres to the principle of subsidiarity, whereby the European Union only acts when individual Member States cannot sufficiently do so. They believe that pluralism and diversity in the European banking sector safeguard the market against shocks that arise from time to time, whether caused by internal or external forces. Members seek to defend the European social and economic model that combines economic growth with high living standards and good working conditions. To these ends, ESBG members come together to agree on and promote common positions on relevant matters of a regulatory or supervisory nature.

ESBG members represent one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of €6,702 billion, non-bank deposits of €3,485 billion and non-bank loans of €3,719 billion (31 December 2014).

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