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FRENCH BANKING FEDERATION RESPONSE TO EBA CP/2014/14 ON GUIDELINES FOR COMMON PROCEDURES AND METHODOLOGIES FOR THE SUPERVISORY REVIEW AND EVALUATION PROCESS (SREP)

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to comment the Consultation Paper on draft guidelines for common procedures and methodologies for the supervisory review and evaluation process (SREP).

General comments

1 - We support the process of supervisory convergence, especially with regards to Pillar 2 which has often been treated heterogeneously across different EU jurisdictions. However we have some reservations in relation to the opportunity offered on p. 12 to National Competent Authorities to "*apply stricter requirements to cover risks if they believe that appropriate*". We are concerned this may open the door to a potential regulatory escalation leading to market fragmentation.

2 - It is also important to define the appropriate communication channels for the SREP. Since the process is expected to be more harmonised and transparent, we would appreciate clarification on what feedback will be provided to banks (at which level of granularity, on the basis of which findings, etc…), and whether some information will be made public (either by NCAs, or by banks which may consequently have to abide to communication requirements when publicly listed).

3 – We would like to emphasise the importance of the dialogue that currently exists between institutions and their supervisors as part of the SREP, especially since there are specificities of business models and national markets which need to be rightly understood and taken into account to achieve a fair and comprehensive SREP assessment. The proposed guidelines on the SREP procedures and methodologies are remarkably silent on this dialogue and on the framework supporting it, except for a brief reminder at paragraph 35 ["when planning SREP activities competent authorities

should adhere to a minimum level of supervisory engagement (e.g. in the form of a dialogue…)"]. It is our view that EBA's guidelines should emphasise dialogue as a key aspect of Pillar 2.

4 - This is all the more critical since the use of supervisory benchmarks is strikingly promoted in the guidelines overall, especially to assess the ICAAP reliability, as stated in paragraphs 317 to 329 ("competent authority should further assess the reliability of the ICAAP calculations by comparing them against the outcome of the supervisory benchmarks for the same risks…"). We suggest complementing those paragraphs and clarifying that where an ICAAP calculation is not deemed reliable, supervisory benchmarks and other relevant inputs possibly used to determine potential additional capital requirements will be discussed as part of the aforementioned SREP dialogue. It is indeed of paramount importance that supervisors engage into bilateral discussions with banks so as to facilitate a good understanding of data, assumptions and rationale behind benchmarks and other inputs, as well as their outcomes, before reaching a formal conclusion about potential additional capital requirements. Benchmarks can be of interest in the context of internal models and ICAAP assessments; we however would like to underline that their systematic use, especially if not thoroughly discussed and if mechanically applied, can have massive negative side effects from a supervisory perspective, by fostering poor risk management practices and / or riskier business models while at the same time failing to reward sound risk management and strong business models.

5 – With regards to risk diversification, paragraph 319 states that "diversification between risks… should not be considered as part of the determination of additional own funds requirements". This provision is not compliant with the provisions on the level 1 text. Article 98 of directive CRD IV sets out the criteria that are to be factored in the SREP and clearly provides at paragraph (f) that "In addition to credit, market and operational risks, the review and evaluation performed by competent authorities pursuant to Article 97 shall include… the impact of diversification effects and how such effects are factored into the risk measurement system". It is our view that risk diversification is a key strategic choice for many institutions that has proven to be an effective risk mitigant in the context of the recent financial crisis. It is therefore our view that the benefits of conducting businesses across diversified activities should be fully reflected in the EBA's SREP guidelines both in the BMA (Business Model Analysis) and in the TSCR (Total SREP Capital Requirements) quantification provided for at paragraph 334. With this is mind, it is advisable to clarify the conditions under which diversification should be measured by referring to the CEBS's guidelines on the recognition of diversification benefits in Pillar 2[1].

6 – Similarly, a number of institutions have built their strategy around diversification across geographies. The benefits of diversification and the costs of concentration are actually the two sides of the same concept. They are consequently measured and monitored through the use of internal models which are capable of coherently measuring both. It is standard practice in the industry that both diversification and concentration on geography (or on any other relevant dimension in a portfolio) be factored in a bank's transaction pricing system. If we agree with EBA that diversification should be cautiously assessed and not overestimated, we however strongly disagree that such a key feature of a bank's business model be simply dismissed in the SREP context and in the TSCR quantification. The SREP itself should foster sound risk and capital pricing across the European financial industry. Failing to recognize diversification may paradoxically increase the price of the most diversified loans portfolios.

[1] CEBS's position paper on the recognition of diversification benefits under Pillar 2, 2 sept. 2010.

7 – The EBA's guidelines are appropriately detailed about topics and criteria that should be assessed and taken into account by supervisors in their SREP assessment. However, there is still significant room for further convergence of the SREP assessment, all the more if, in the future, the dialogue between institutions and their supervisors becomes less important than it currently is. We are therefore of the view that more guidance should be provided in the following areas:

- delineation between scoring grades 1, 2, 3 and 4 for the BMA ("Business Model Analysis"), assessment of internal governance and institution-wide controls, assessment of risks to capital, assessment of risks to liquidity and funding. For example, it is unclear whether all bullet points describing a scoring grade or a majority of them should be verified;
- approach according to which the various dimensions should be factored and weighted in the overall SREP scoring assignment;
- the possible relationship between the scoring assignment and possible additional capital requirements as set out in Title 7.

8 – We would like to point out that the risk of excessive leverage is not clearly defined and can only be understood at this stage with reference to a minimum % level of leverage ratio. In addition, numerous banks share the view that the leverage ratio is not an appropriate metric for a bank's capital adequacy assessment as it is not risk-sensitive. It is absolutely critical that the leverage ratio remains the back-stop indicator it has been originally designed to be[2]. The SREP approach is supposed to be fully dedicated to a thorough understanding of the risks borne by an institution; it would be a paradox indeed if a crude metric such as the leverage ratio became a core element of an institution's SREP assessment and it would even have detrimental effects if it becomes its most stringent constraint. Considering that the Pillar 1 leverage ratio level is being calibrated (the CRR provides for a transitional period until 1 January 2018), we believe there is currently limited scope for considering the leverage risk within the SREP approach, in particular beyond the transitional period. In addition, we strongly believe that the requirement to consider the leverage ratio in a stressed scenario, as provided at paragraph 346, is not appropriate since the leverage ratio should remain a back-stop indicator as aforementioned and should not be dealt with as if it were a risk-sensitive one.

9 – Reconciliation of the TSCR with capital buffers and other macro-prudential measures should be clarified. For example, paragraph 333 states that "competent authorities should reconcile the additional own funds requirements against the risks already covered by capital buffer requirements and / or additional macro-prudential requirements" and paragraph 484 that "where a macro prudential measure, due to its design specificities, does not capture a particular institution… the competent authorities may consider extending the effects of the measure directly to that institution…". We are of the view that macro-prudential measures should be dealt through appropriate coordination between supervisory bodies, as provided by directive CRD IV and the CRR regulation and should not be remediated on case-by-case basis as part of the SREP. This would be detrimental to convergence of supervisory practices in the EU.

10 – If expectations towards supervisors are particularly detailed in the EBA's SREP guidelines, expectations with regard to the ICAAP and ILAAP are only briefly summarised. The ICAAP and ILAAP should be tailored to each institution to appropriately reflect its capital and liquidity needs and should be grounded mostly on internal estimates, methodologies and risk parameters, as

[2] « The leverage ratio is intended to achieve the following objectives: … reinforce the risk-based requirements with a simple, non risk-based backstop measure », BCBS, Basel III: a global regulatory framework for more resilient banks and banking systems, Dec. 2010.

appropriate. Benchmarks could possibly be used only if they are relevant to a bank and should be adjusted to reflect the key features of its activities and portfolios. To foster convergence in the fields of ICAAP / ILAAP, it would be advisable to complement the guidelines in some key areas or, where relevant, to add references to existing guidance and regulations. In particular, it should be clarified how the proportionality principle should apply to institutions of categories 1 to 4, as defined in paragraph 11.

Moreover, the guidelines should state the range of acceptable methodologies by risk categories, specifying where internal modelling and / or economic capital modelling is recommended or required. Last but not least, we would like to point out that the ILAAP is mentioned in various parts of the consultation in spite of not being yet mandated by regulatory requirements.

11 – We are particularly concerned by the operational requirements and costs related to the implementation of detailed quarterly indicators, in particular those contemplated at paragraph 47 (e.g. “financial and risk indicators addressing all risk categories covered by these guidelines”). They could be particularly numerous and not necessarily readily available at such a frequency. Reducing the operational complexity of the evaluation process is paramount to us. Undue complexity may increase operational risk and lead to poor comparability of the outcomes.

12 - We draw attention to the fact that, given strong emphasis put on institutions’ business model and strategy analysis, the guidelines may lead supervisors to exceed their mandate by intervening inappropriately in the strategic management of institutions. While we entirely agree on the need for supervisors to fully understand the business environment and the strategy of institutions in order to support their risk analysis and to understand revenue generation, we think that this must be clearly limited to information and understanding. It should thus be avoided that supervisory findings and recommendations have strategic and business contents, which must remain the responsibility of institutions’ management bodies. We would therefore recommend that the BMA is not scored.

13 - If the outcome of the BMA and/or, more broadly, the overall SREP assessment or scorings are to be disclosed, even partially, this may potentially trigger additional issues in case weaknesses have been identified. So far and in most EU Member States, the SREP dialogue, process and outcomes are entirely covered by legal confidentiality provisions and arrangements. This principle is not clearly stated in the proposed EBA’s guidelines and we therefore suggest that this critical issue be clarified.

14 - We are concerned that confusion is introduced in the proposed SREP guidelines by taking into consideration recovery and resolution issues, potentially crossing the limit between CRDIV and BRRD scopes. We consider that the purpose of the SREP is to assess an institution and its risks on a going concern basis. There are separate and dedicated regulatory measures which deal with recovery and resolution issues, and we think that these guidelines should strictly remain within the Pillar 2 scope.

Please note that there are three papers in the annex to our response dealing with the implementation of SREP guidelines to specific areas, namely: liquidity and funding, IRRBB and operational risk. Please find our responses to EBA consultation paper questions below.

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?

15 - We think that a better harmonisation should be sought with other frameworks already promoted by the European authorities. For example:

- the EBA publishes a quarterly risk assessment of the European banking system, whose risk drivers are not perfectly aligned with those indicated in SREP document and the risk factors requiring capital as per Pillar 1;
- the ECB recently issued methodological documents in the perspective of the Asset Quality Review, and the Comprehensive Assessment Stress Test, which also suggest various metrics to assess the resilience of banking institutions.

To ensure appropriate analysis and synergies between the exercises and publications, we think more coherence can be achieved in this field.

16 - Generally speaking, we think that if the objective is to make the SREP more transparent and comparable, more could be done to define risk levels which would trigger supervisory examination. For instance:

- Which level of credit risk concentration would be considered too high? Would it be the same for larger and smaller institutions? Additional guidance would be welcome. Same point for instance for paragraph 377: how would the "excessive level of asset encumbrance", or "acceptable boundaries for maturity mismatches" be defined?
- Which thresholds may trigger a move from a category to another? The complexity of a given product is linked to the size and sophistication of an institution: blind thresholds should not be used to categorize institutions.

17 - We appreciate the definition of risk drivers set out in the guidelines. However, we think additional details should be given regarding the combination and weighting techniques of the various scores and criteria, as pointed out in the general comment sections. We are indeed concerned that subjectivity may still reign when aggregating grades, which would cast a shadow on the objective of transparency and comparability of the process and its outcomes to the detriment of the level playing field. Paragraph 124 states that "Under the national implementation of these guidelines, different methods may be used by competent authorities to derive individual risks scores." We think that further harmonisation in this field would also be desirable. As an example, paragraph 144 shows that the EBA is ready and able to suggest common methodologies ensuring good coordination and comparability of practices across the European Union.

18 - It is our view that supervisors should refrain from judging the ICAAP reliability based on supervisory benchmarks only (or predominantly on such benchmarks), as suggested at paragraphs 322 and 329. The ICAAP control and governance frameworks implemented by a supervised institution as well as the rationale behind the methods and assumptions used by an institution should have prominent roles in that judgment. The internal capital requirement calculated by peers might not always be relevant to another bank and therefore benchmarks should be cautiously used. It is our view that this should be clearly stated at paragraphs 326 or 327. Indeed it would be useful if supervisors shared their methodology and the data sources used in building benchmarks: banks would welcome an open dialogue and more transparency.

As part of the ECB's Comprehensive Assessment stress tests, supervisory benchmarks have been imposed to banks with limited scope for discussion and for amendments to identified shortcomings. Mindful of this experience and in order to ensure consistency and usefulness of benchmarks, dialogue and transparency are critical to banks.

19- It appears to us that the proposed guidelines provide supervisors with discretionary assessment with respect to liquidity and funding. We think that the SREP liquidity guidelines need to be put in perspective with recent regulatory developments and ensuing enhanced supervisory requirements (Pillar 1) as well as increased mandatory reporting for liquidity and funding. Given the lack of perspective we have on the EU liquidity supervisory tools and metrics, we are concerned that the proposed guidelines tend to establish an unnecessary parallel between approaches to capital and to liquidity/funding in the Pillar 2 context. In addition, liquidity supervisory reporting includes funding plans and various liquidity monitoring tools with a forward-looking perspective. At the current early stage of the EU-wide liquidity supervisory framework, we have limited experience of the combined effects of supervisory metrics, tools and reporting requirements. The LCR itself already factors in significant stressed assumptions; it is therefore questionable whether an additional layer of stressed assumptions should be applied as part of Pillar 2. We are of the view that the liquidity/funding risk assessment should rely on indicators and reports already available to supervisors. Furthermore, the idea to impose capital add-ons against a possible increase in funding spreads, as stated at paragraph 332, is questionable since capital is not the primary effective approach to protect a bank against such a risk, which should rather be measured through the liquidity assessment. Further comments on liquidity and funding risk assessment are set out in the annex.

As mentioned in the general comments section, we would like to point out that the ILAAP is mentioned in various parts of the consultation in spite of not being yet defined nor mandated by regulatory requirements.

20 - We note that peer comparison only implies that with European institutions. We understand that peer review of European institutions with those belonging to other economic areas (US or Asia for example) is not foreseen (such as impact of Regulation and competitive advantage). While this may be relevant for most European banks, it is not appropriate for international banking groups that are also active outside Europe.

21 - In the same vein, the application of SREP to cross-border groups (Part 11.1) seems to ignore the non-EU component of cross-border groups by focusing primarily on EU processes and requirements.

22 – As pointed out in the general comments section, we strongly advise that the SREP dialogue, process and outcomes, including bank scores, be entirely covered by legal confidentiality provisions and arrangements.

23 - For sake of clarity and consistency, we think that a clear separation must be established between matters within the scope of the SREP as described by Directive 2013/36/EU, and matters relating to the implementation of BRRD directive.

In particular, we consider that the orientation of the Overall SREP assessment is not entirely adequate; as a matter of fact, by introducing an "F" score (defined as "the institution is considered as "failing or likely" to fail), the consultation exceeds the remit of SREP analysis, while it gears SREP analysis towards the question of the "viability" of the institution, therefore departing from a going-concern approach to focus on a gone-concern probability assessment.

We consider that an "F" score is neither appropriate nor relevant in the context of the SREP.

The SREP approach only allows to determine circumstance (a) describe in article 32(4) of Directive 2014/59/EU, as specified in the "Draft guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under Article 32(6) of Directive 2014/59/EU" (EBA/CP/2014/22); in addition, determination of an institution being failing or likely to fail must be made after consultation between the competent authority and the resolution authority. Such process is not provided for in the SREP approach nor suggested in the proposed guidelines. As a result, we consider that the "F" score is inappropriate. We would thus suggest that EBA revisits the articulation of the Overall SREP assessment scorecard, with a view to removing the "F" score.

24- As far as level of application, when considering a banking group, the following three principles should apply:

- SREP should always be considered at the highest level of consolidation,
- analysis at sub-levels should be done with reference to this highest level, including in the case of cross-border groups,
- in all instances, a subsidiary must not be considered as a solo entity if it is itself head of a subgroup. The concept of group and subgroups must prevail in all situations as part of SREP.

We would thus suggest that EBA clarifies the recommended approach for treatment of groups, including some specific “proportionality” considerations which could be granted to subsidiaries within consolidated groups in the context of the SREP.

It should also be emphasized that for subsidiaries with minority interests, given the haircut calculations, the minimum requirements of Pillar 2 (if any) should always be produced on the three levels: CET1, Tier 1 and Tier 2.

2. Do you agree with the proportionate approach to the application of the SREP to different categories of institutions? (Title 2)

25 – For a banking group, if the SREP process has to be implemented at the subsidiary level (as contemplated in title 11), we also suggest a rotation of periodic examinations conducted at the subsidiary level (some of them being conducted every three years, according to § 35) to smooth operational requirements over time, and obtain a continuous update of the consolidated group profile, instead of one-off updates which may result in abrupt jumps in the consolidated risk profile.

26 - The text does not mention any information about how

- the SREP elements will be updated when assessments are performed on a multi-annual basis,
- the overall SREP will then be updated (as well as articulation with the SREP elements).

27 – It seems that the definitions of institutions categories are mainly driven by considerations on systemic importance / total asset size / types of businesses conducted by the supervised institution. It is our view that category I institutions should include both institutions that pose systemic risks, which is not exclusively a question of having been categorised as a G-SII or as an O-SII, and institutions for which significant weaknesses or risks are identified.

28 - A thorough follow-up of the indicators is a key element in the proposed categorisation process: it is the starting point to identify deteriorations and anomalies or changes in institutions risk profile and financial conditions. Therefore, such a system could allow a fair monitoring of all the institutions, provided that the key indicators are relevant and well adapted to institutions.

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)

29 – Some bank analysts take into account the following drivers when assessing bank robustness. After careful examination of the EBA text we are unsure whether they have been included in the other risk drivers. We therefore suggest considering the following:

- The extent to which pension liabilities may materially impact the resilience of the institution (presence of Defined Contribution / Defined Benefit schemes, etc.): even if deficits are already deducted from capital, assessments of the likely deviation from expected risk profile, or volatility of the surplus/ shortfall, may beneficially be taken into account.
- Business model diversification as aforementioned in the general comments section, including in terms of "bancassurance": it has been proven that diversified and significant presence in both the insurance (life, non-life) and the banking industry can increase the overall resilience of the institution (owing to increased consumer retention and satisfaction, cross-selling opportunities, optimization of the liquidity profile, etc.).
- Historical perspective of the institution strategy. It can indicate whether the strategy continues along the same lines or how some strategic changes have taken place (under which constraints and with which results). This could be an indicator of its actual feasibility.

30 – With regards to the BMA, the guidelines provide that "areas for analysis by competent authorities should include… profit and loss, including trends… [relating to] the breakdown of income streams, the breakdown of costs… balance-sheet, including trends, …concentrations in the P&L and balance-sheet, including trends… related to customers, sectors and geographies". Those provisions might pave the way to additional layers of reporting obligations that are not required by level 1 text and will lead institutions to modify significantly their budgetary processes and management control IT systems, so as to store detailed data that could potentially be required by supervisors but that are not necessarily used internally. It would be worth clarifying that only existing data will be used as part of the SREP and that institutions are not specifically required to implement new reporting and budgetary IT systems to respond to potential requests as part of the SREP.

31 – With regards to the analysis of the strategy and financial plans, the guidelines provide at paragraph 72 that "competent authorities should form or update their view on the sustainability of the institution's strategy on the basis of its ability to generate acceptable returns… over a forward-looking period of at least three years based on its strategic plans and financial forecasts". It should be clarified that those provisions apply when new strategic plans are adopted and consequently that they do not apply quarterly or yearly, as suggested in paragraph 47 (a).

32 - The BMA is not an end in itself for supervisors but a tool allowing them to have better understanding of the various risks and vulnerabilities faced by institutions. In this spirit, the findings resulting from this approach should be used to feed the analysis of other areas of SREP and contribute to the assessment of other scores. We therefore consider that the BMA component of the SREP should not be assigned a specific score; as a consequence, we request that the relevant scoring part (chapter 4.10) is removed from the guidelines.

4. Does the breakdown of risk categories and sub-categories proposed provide appropriate coverage and scope for conducting supervisory risk assessments? (Title 6)

33 – By way of introduction, we believe that Pillar 2 examination have to be comprehensive, and require a wide knowledge of the institution, its structure, business profile etc. We think that each and every risk driver cannot necessarily be quantified, and that NCAs should always offer the opportunity of a constructive dialogue with banks to discuss SREP results before potential actions be decided as already pointed out in the general comments section.

34 - We are concerned with operational requirements linked to the proposed risk categories breakdown. As mentioned in the general comments section, the envisaged quarterly computation and monitoring of key indicators is likely to require a significant investment in systems, without necessarily improving the quality of the evaluation. The indicators listed in paragraph 47 are numerous, and not necessarily readily available at the required frequency. Reducing the operational complexity of the evaluation process is paramount to us. For instance, we are concerned that the suggestion in paragraph 373a that "competent authorities may extend the scope of their assessment by exploring risks within 30 days as well as over 30 days, and altering the LCR assumptions to reflect risks not adequately covered in the LCR", may lead to counterproductive results, hence should be removed.

35 - In terms of workflow, the industry favours the idea to start from existing regulatory procedures, reports and requirements (such as COREP, etc.) and then to identify which variables may be added in order to produce documents and data suggested by EBA. This would minimize the number of additional regulatory work, and leverage on previous developments (for instance the recently updated COREP). The industry would be willing to contribute to a mapping exercise (from existing formats to target SREP format), should EBA agree that such a gap analysis is a good starting point.

36 - The breakdown of risk categories, and their relative importance, is likely to differ between small institutions (or at the subsidiary level of a larger group) and a large consolidated group. We do not understand the need to implement a complete SREP approach at solo level for entities of consolidated groups (as contemplated in title 11). Indeed all risk drivers may not be available at solo level, and risk appetite / ICAAP / stress-testing processes may not be rolled out extensively in some subsidiaries; we doubt of the relevance of their conclusions at solo level since the resilience of a diversified group will be higher than the resilience of its subsidiaries thanks to diversification effects. More particularly, we have an issue with paragraph 100, which we read as the requirement to have stress-testing capabilities at the local subsidiary level. Within large financial groups, all individual entities do not have the same level of maturity on such topics: the proportionality principle has to remain key in this area. We would like to express our concerns with a recent growing interest from supervisors covering small subsidiaries and ICAAP approaches where the latter cannot be considered relevant at solo subsidiary level.

37- With regards to supervisory expectations relating to the ICAAP, ILAAP, stress testing and risk appetite, we understand that there is a strong common ground based on existing practices. We would rather favour a precise list of references to regulatory texts in this area, which may avoid the risk of subtle incoherent requests; we would then advocate for an explicit list of texts, rules, guidelines etc. applicable to the whole perimeter, in order to promote a homogeneous approach by supervisors. Besides, the supervisory expectations towards the ICAAP and ILAAP should clarify how the proportionality principle applies to institutions of categories 1 to 4, as defined at paragraph 11. In particular, acceptable principles by risk categories should be stated in the guidelines. Those requiring internal modelling or, where appropriate, economic capital modelling should also be stated in the guidelines.

38 – The concepts of risk appetite / risk tolerance are extensively used in the EBA's SREP guidelines. In particular the consultation provides that "competent authorities should consider whether the institution's business model or strategy relies on a risk appetite, for individual risks (e.g. credit, market) or more generally, in order to generate sufficient returns that is considered high or is an outlier among the peer group" and, on p. 44, that "competent authorities should assess… at least… the risk appetite framework and strategy…". However, risk appetite is defined in very broad terms at page 16. The tasks assigned to Supervisors at paragraphs 71, 88 and 91 could therefore prove to be quite challenging and might lead to heterogeneous approach and requests among supervisors, all the more since there might be various understandings in the industry and among supervisors of metrics to be used and monitored as part of an effective risk appetite framework. Prior to referring to risk appetite concepts in the SREP, it would therefore be worth harmonizing definitions and expectations in this area or providing effective and practical references.

39 - We are not clear on the treatment of model deficiencies: we understand the need to identify potential underestimation of own funds requirements, but do not see in the CP how compensation effects between models potentially underestimating risks, and others overestimating risks, would be treated. We do not understand the provisions in paragraph 111 which seems to introduce an alternative approach to the regulatory treatments of assets and risks. We think this opens the way to subjective assessments and to potential double-counting of capital requirements if risks were to be assessed both from a regulatory Pillar 1 perspective and from a different angle under the Pillar 2.

40 – In the consultative paper, market risk would be extended to cover certain risks factors in the banking-book (e.g. credit spread risk, equity exposures in the banking-book, etc.). Paragraph 214 states in particular that "the data, information systems and measurement techniques enable management to measure the market risk inherent… including both trading and banking portfolios". As suggested in the guidelines, we agree that risk factors should be coherently assessed across the banking-book and the trading-book based on the applicable classification of instruments. At many banks, credit spread risk in the banking-book is dealt with as part of the credit risk management framework; equity risk arising from instruments classified in the banking-book is treated as a subcategory of credit risk. Failing to recognize this distinction will give rise to significant risk reporting and communication issues.

41 – Besides, clarification is needed in paragraph 190, where banking book sensitivities are discussed in connection with market risk variables. The scope and nature of such an assessment have to be discussed in detail in order to avoid duplication with other work already launched (for example FRTB) and double-counting of capital requirements (for example Pillar 1 RWA for equity exposures).

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)

42 – We believe additional flexibility would be appropriate in the examination of the level of own funds expected in the analysis. We support the use of standard approach as well as internal models for the articulation of additional own funds requirements to be used by competent authorities.

43 – It is our view that adequate capitalization should not only rely on regulatory definitions of CET1 ratio, Tier-1 ratio, etc. (as described in title 7). External sources of risk appreciation may shed a different light on a bank's profile, such as its market valuation, its CDS spread level, or other market indicators which give a consensus view on its ability to meet not only its regulatory obligations, but also future expectations.

44 - Several regulatory measures have already been implemented in order to increase the resilience of banks, such as the need to hold capital conservation buffer. Adverse macroeconomic situation will be translated in terms of deteriorated earnings perspectives in the financial planning exercise, and ultimately result in lower capital generation. We would welcome clarification on the interaction between Pillar 2 capital requirements and macro-prudential frameworks in the context of SREP. Supervisors should be in a position to justify that Pillar 2 capital add-ons are needed to cover clearly identified institution-specific risks, which are not already covered by other existing capital requirements. Articulation between Pillar 2 capital add-ons and combined buffer requirement would also need to be clarified with respect to practical implementation of art. 141 of CRDIV (capital conservation measures, restrictions on distributions …).

45 – For example, paragraph 333 states that "competent authorities should reconcile the additional own funds requirements against the risks already covered by capital buffer requirements and / or additional macro-prudential requirements" and paragraph 484 that "where a macro prudential measure, due to its design specificities, does not capture a particular institution… the competent authorities may consider extending the effects of the measure directly to that institution…". We are of the view that macro-prudential measures should be dealt with through arrangements and processes ensuring appropriate coordination between supervisory bodies both at national and EU levels and should not be remediated on case-by-case basis as part of the SREP, which would be detrimental to convergence of supervisory practices in the EU.

46- The guidelines set guidance on the composition requirement for additional own funds requirements under Pillar 2 (at least 56% CT1 and 75 % T1), on a risk by risk basis; articulation with overall requirement is not clearly made. This differs considerably with the practices of numerous jurisdictions, where only an overall level of capital ratio is assigned (frequently based on one type of ratio only, e.g. CET1, or total capital ratio). It would be advisable to confirm that all eligible capital under Pillar 1 (even on a transitional basis) will be recognized. We would also like some clarification regarding the extent to which alternative forms of capital may be admitted to cover other types of risks (such as control, governance and other deficiencies, funding risk).

47 – As mentioned in the general section, it is our view that the leverage ratio is not an appropriate tool for assessing a bank's capital adequacy as it is not risk sensitive; the leverage ratio works as a back-stop indicator. It would be a paradox to introduce this element in the SREP approach which is supposed to be fully dedicated to a thorough understanding of risks borne by an institution. Considering that the Pillar 1 leverage ratio level is being calibrated (the CRR provides for a transitional period until 1 January 2018), we believe there is currently limited scope for considering the leverage risk within the SREP approach, in particular beyond this transitional period. In addition, we strongly doubt it is appropriate to consider the leverage ratio in a stressed scenario, as provided at paragraph 346: the leverage ratio should remain a back-stop measure and should not be dealt with as if it were a risk-sensitive one.

48 – Paragraph 330 provides that "*competent authorities should set additional own funds to cover the risk posed by model deficiencies… while the deficiencies are addressed.*" It should be clarified that this provision does not apply if conservative margins have already been required to address those deficiencies under Pillar 1.

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)?

49 - These guidelines should be implemented by January 1, 2016 except for points that are not specified and introduced in the CRR so far. Considering the regulatory adoption planning, the RTS should be applicable in August or September 2015 in all European Member States. Subsequently, there are 4 additional months left for preparing and refining guideline.

The following elements may have an impact on the implementation date:

- Drafting of practical guides if needed and if foreseen ;
- Defining the different scores, tools, and test them on a sample of banks ;
- Aligning the implementation of the joint decision process ;
- Recruitment by competent authorities of required additional staff to perform all the analyses;
- Setting out the required organisation and procedures to perform the analyses.

50 – We believe it would be necessary to clarify the implication of the transition period with respect to diversification assessment. Does the text in paragraph 502 imply that diversification benefits will be admitted by supervisors until 31/12/2018 but will suddenly cease to be accepted afterwards? Such "cliff effect" does not make sense, and is not supported by any Pillar 1 contemplated evolution. We would like to point out that reference in paragraph 502 to paragraph 320 is inaccurate: paragraph 319 deals with diversification.

51 - More generally, considering that the approach contemplated in the CP may represent a significant change in the relationship between banks and NCAs, and require significant works, we favour a long transition period, which would also help compile the data history expected by the EBA and help institutions to adapt to the new requirements included in the guidelines.

The scope of application should be clarified as entities that are subject to LCR (individual or Group consolidated, but not branch level):

408. Where following Article 8 of the Regulation (EU) 575/2013, an institution and/or all or some of its subsidiaries in the Union have been waived from the application of the Part 6 (Liquidity) of the Regulation (EU) 575/2013, and it is supervised as a single liquidity sub-group, competent authorities should conduct their SREP liquidity assessment at the level of the liquidity sub-group.

Comment: the principle to conduct SREP liquidity assessment at the application level of the LCR is a sound principle. We recommend that it is clarified that it is a general principle, notably to clarify that branches in isolation are not subject to this process.

Supervision of the Liquidity Coverage Ratio (LCR) should be consistent with LCR assumption set:

372. Competent authorities should assess the institution's ability to monetise its liquid assets in a timely fashion to meet its liquidity needs during a stress period. They should take into account: […]

> *e. where the institution has **borrowed liquid assets**, whether it has to return them within the horizon of a short-term liquidity stress, which would mean that the institution would no longer have them available to meet its stressed outflows;*

Comment: in the LCR, liquid assets through reverse repo are assumed not to have to be returned since reverse repos are assumed to roll over. It is important not to be penalized twice, once by assuming that the inflow of the reverse repo is assumed not to be received (since assumed to be rolled over) and to assume that the borrowed security has to be returned.

Supervision should not stress the already extremely highly stressed LCR:

374. Competent authorities may assess the likelihood that the institution uses its liquidity buffer and temporary falls below the minimum requirement on the basis of articles 412(3) and 414 of the Regulation (EU) No 575/2013, applying supervisory or institution's liquidity specific stress testing, by using stress scenarios under which they would not expect the institution to fall below the minimum requirements. Supervisors may consider it undesirable for an institution to fall below the minimum requirement under very mild market stress. The scenarios applied for this assessment should typically be less severe (e.g. only market wide stress) than the scenario's used when testing the survivability of the institutions (market wide and systemic).

Comment: it is extreme to envisage a *compounded* stress within which the LCR, which is itself an extremely severe stress test scenario combining idiosyncratic and systemic stress, is envisaged *within* a stress environment. This paragraph should be deleted.

Any additional requirement should be subject to governance that ensures level playing field:

§ 418. When competent authorities conclude that specific liquidity requirements are needed to address liquidity and funding concerns, they should decide on the application of quantitative requirements, as covered in this title, and/or on the application of qualitative requirements, covered in Title 10 of the guidelines.

§ 419. When setting structural, long term supervisory requirements, competent authorities should consider the need for additional short/medium term requirements as an interim solution, in order to mitigate the risks that persist while the structural requirements produce the desire effects.

§ 420. Where competent authorities conclude that there is a high risk that the **institution's cost of funding will increase unacceptably, they should consider measures, including setting additional own funds requirements** (as covered in Title 7) or requesting changes to the funding structure, to mitigate funding cost risk.

§ 428. Below are some examples of the proposed approach:

a. Example 1: Institution with an initial liquidity buffer of 1,200 EUR. Cumulative inflows and cumulative outflows estimated under stressed conditions are projected through a time horizon of 5 months. During this time horizon the institution makes use of the liquidity buffer in each point of time when inflows fall below outflows. The result is that under the stressed conditions defined, the institution would be able to survive 4.5 months, which is above the minimum survival period set out by supervisors (in this example – 3 months):

b. Example 2: The supervisory minimum survival period is set in 3 months. An alternative measure to setting a minimum survival period, which can also address the supervisory concern that the gap between inflows and outflows is unacceptably high, is to **set a cap on outflows**. In the figure below, the mechanism to set a cap on outflows is showed through the black horizontal bar. An institution is required to reduce its outflows to a level below the cap. **The cap can be set on one or more time buckets and on net outflows (after correcting for inflows) or on gross outflows**. **The alternative of adding a buffer requirement instead is shown in the third column**:

§ 429. In order to appropriately articulate the specific quantitative liquidity requirements, competent authorities should use one of the following approaches:

1. Approach 1 - **Require a Liquidity Coverage Ratio higher than the regulatory minimum** (when such a ratio is introduced by national or EU regulation) **of such size that identified shortcomings are sufficiently mitigated**;
2. Approach 2 - **Require a minimum survival period of such length that identified shortcomings are sufficiently mitigated**. The survival period can be set either directly, as a requirement, or indirectly, by setting a cap on the amount of outflows over the relevant time buckets considered. **Competent authorities may require different types of liquid assets (e.g. central bank eligible assets), to cover risks not (adequately) captured by the LCR;**
3. Approach 3 - **Require a minimum total amount of liquid assets or counterbalancing capacity, either as a minimum total amount or as a minimum amount in excess of the applicable regulatory minimum**, of such size that identified shortcomings are sufficiently mitigated. **Competent authorities may set requirements on the composition of liquid assets, including operational requirements (e.g. direct convertibility to cash, or deposit of the liquid assets at the central bank).**

§ 434. Below some examples on the different approaches for the articulation of specific quantitative liquidity requirements:

Example of specific requirements articulation

As of 1st January 2015 and until otherwise directed, Bank X is required to:

a. Approach 1 – ensure that its counterbalancing capacity is at all times equal to or higher than **125% of its liquidity net outflows as measured in the Liquidity Coverage Ratio**.
b. Approach 2 – ensure that its counterbalancing capacity results at all times in a survival period that is greater than or equal to 3 months, measured by the internal liquidity stress test / the Maturity Ladder / specific metrics developed by the supervisor.
c. Approach 3:
   - ensure that its counterbalancing capacity is at all times equal to or higher than EUR X billion; or
   - Ensure that its counterbalancing capacity is at all times equal to or higher than EUR X billion in excess of the minimum requirement under the Liquidity Coverage Ratio.
a. Approach 4 - ensure that its stable funding is at all times equal to or higher than EUR X billion in excess of the minimum requirement under the Net Stable Funding Ratio.

§ 430. Competent authorities may articulate specific quantitative requirements on stable funding by requiring a minimum level of stable funding in terms of the NSFR.

Comment: in all the articles above, quantitative requirements are suggested that would impose even more severe liquidity requirements than the already extremely severe LCR and NSFR. Though those regulatory requirements could need to be adapted to an evolving environment, any potential issue should be addressed globally for the entire industry, and not discretionary applied, without clarified governance, to a specific bank. This would risk creating a non level playing field.

We recommend clarifying the governance on discretionary quantitative measures suggested by competent authority. This applies to Article 420 that suggests adding a requirement on own funds for the risk of funding costs: this should be clarified.

Comments on IRRBB[3] portion of the EBA Consultation on
« Draft Guidelines for common procedures and methodologies for the supervisory review and evaluation process under Article 107 (3) of Directive 2013/36/EU »
published July 7 2014, end consultation period October 7 2014

https://www.eba.europa.eu/documents/10180/748829/EBA-CP-2014-14+(CP+on+draft+SREP+Guidelines).pdf

The scope of application of IRRBB SREP assessment should be clarified, notably to make sure that it does not apply at branch level.

Clarifications and Changes are needed:

*281. Competent authorities should take into account whether the **guidance established in the EBA guidelines on IRRBB** are implemented by the institution prudently. This is particularly true for the calculation of the supervisory shock specified in Art 98 (5)[4] of the Directive 2013/36/EU as well as for the institution's internal interest rate risk identification, measurement, monitoring and control procedures.*

Comment: As of July '14 this EBA guidance does not exist. A google search lead to EBA website[5] () that refers to CEBS guidelines issued on October 3, 2006[6]

290. When analysing the impact on the institution's economic value, competent authorities should first consider the results of a standard shock, as referred to in Article 98(5) of Directive 2013/36/EU, in order to have an initial benchmark to compare how interest rate changes affect the institution. Competent authorities should evaluate compliance with guidance set out by EBA Guidelines on IRRBB and, when performing this assessment, should pay particular attention to the sensitivity of the balance sheet impact to changes in the underlying key assumptions (in particular for customers' accounts without specific re-pricing dates and/or equity capital).

*291. Competent authorities should seek to understand the impact of those assumptions by reviewing the 'outlier' standard test result and then **isolating the economic value risks arising from the institution's behavioural adjustments so that they may, among other things, identify and understand the risks that are arising from earnings stabilisation activity as distinct from those arisen from other aspects of the business model.***

Comment: the meaning of Article 291 is unclear.

293. In addition to using the parallel +/- 200 basis point shock as the standard shock, competent authorities should also 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.).

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[3] Interest Rate Risk in the Banking Book, also refer to in the consultative document as *'interest rate risk from non trading activities'*

[4] Art.98.5. *The review and evaluation performed by competent authorities shall include the exposure of institutions to the interest rate risk arising from non-trading activities. Measures shall be required at least in the case of institutions whose economic value declines by more than 20 % of their own funds as a result of a sudden and unexpected change in interest rates of 200 basis points or such change as defined in the EBA guidelines.*
Article 84 Interest risk arising from non-trading book activities - Competent authorities shall ensure that institutions implement systems to identify, evaluate and manage the risk arising from potential changes in interest rates that affect an institution's non-trading activities.

[5] *https://www.eba.europa.eu/regulation-and-policy/supervisory-review/guidelines-on-technical-aspects-of-the-management-of-interest-rate-risk-arising-from-non-trading-activities-under-the-supervisory-review-process*

[6] *https://www.eba.europa.eu/documents/10180/16094/guidelines_IRRBB_000.pdf*

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 their sensitivity to any standard shock that is prescribed.

Comment: In the current low level rate environment, the +/-200 bp shock does not make sense. Additionally, the EBA Guidelines on IRRBB (cf. below) refers to a shock equivalent to 1st and 99th percentile which, in 2006, was broadly equivalent to 200bp shock. We recommend changing the wording of +/-200bp into 'standard shock'.

> *IRRBB 5*
>
> *Supervisory authorities will set a comparable standard shock as referred to in Article 124(5) of the Directive 2006/48/EC and applicable to the non-trading book of all their relevant institutions. Supervisors may decide to set different standard shocks for different currencies. The following guidelines will be put in place:*
>
> - *A standard shock could, for example, be set so that it will be broadly* ***equivalent to the 1st and 99th percentile of observed interest rate changes (five years of observed one day movements scaled up to a 240 day year)****, This would currently equate approximately to a parallel 200 basis points shock for major currencies as suggested by the Basel Committee (See Annex II below).*
> - *National supervisors will be expected to use this as their starting point when considering at what level to set the shock, but they will also need to 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*
> - *National supervisors will periodically review the size of the shocks in the light of changing circumstances, in particular the general level of interest rates (for instance periods of very low interest rates) and their volatility. Institutions' internal systems should therefore be flexible enough to compute their sensitivity to any standardised shock that is prescribed. Supervisors will not, however, make frequent or minor amendments for the purpose of spurious statistical accuracy.*
> - *National competent authorities commit to discuss periodically the relevance of the 200 basis points as a starting point when considering at what level to set the shock and keep it under review in light of implementation.*
> - *If the required shock (e.g. a 200 basis point shock) would imply negative interest rates or if such a shock would otherwise be considered inappropriate, the national supervisor will adjust the requirements accordingly, and*
> - *Where an institution is a subsidiary of an institution which is authorised in another EU member state, the respective supervisors will, in accordance with the CEBS guidelines on supervisory*
> - *Cooperation for crossborder banking and investment firm groups, seek to coordinate their approaches on the standard shocks to be applied.*

304. Competent authorities should assess whether the institution has an appropriate framework for identifying, understanding and measuring IRRBB, in line with institution's size and complexity. They should consider:

> *[…]*
>
> *c. whether the assumptions underlying internal methodologies take into account the guidance established by EBA guidelines on IRRBB on methods for measuring IRR. In particular, competent authorities should assess* ***whether the institution's assumptions for positions with no contractual maturity and embedded customer optionalities are prudent****.* ***Competent authorities should also assess whether institutions include equity in the calculation of economic value and, if this is the case, analyse the impact of removing equity from that calculation;***

Comment:

- **As interest rate risk is symmetric, there is no prudence-bias that should be referred to IRRBB prudential framework. We recommend substituting 'sound' to 'prudent' in the paragraph above.**
- **As equity needs to be considered in the IRRBB management (cf. 'h' below), removing equity from the standard test creates a significant discrepancy between the actual management (for which equity capital is invested in fixed rate assets to stabilize earnings over time) and the prudential standard test. We recommend that the standard test is calculated so as to be consistent with the IRRBB assumption framework of the bank. Note that this assumption framework is subject to strong governance (independent review, validation of main assumptions by senior management…)**

[…]

*g. whether the institution's risk measurement systems are able to identify possible **IRRBB concentrations**;*

Comment: 'IRRBB concentrations' need to be clarify: what does it mean?

*h. 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**; and,*

Comment: We concur to the fact that equity capital requires an assumption, decided at the highest level of the organization (senior management), to manage IRRBB.

Comments on operational risk of the EBA Consultation on
« Draft Guidelines for common procedures and methodologies for the supervisory review and evaluation process under Article 107 (3) of Directive 2013/36/EU »
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https://www.eba.europa.eu/documents/10180/748829/EBA-CP-2014-14+(CP+on+draft+SREP+Guidelines).pdf

The proposed document consists in a very broad review of the way banks operate. It is a document for the supervisors themselves on which it may be even more difficult to obtain significant changes.

Looking at it through the angle of internal control and operational risk, our key comment is that this document should refer and stick more systematically to existing guidelines or requirements. It should not be the place where to define new concepts, introduce new requirements or change the doctrine that the institutions have to comply with. Should this principle not be applied, it will complexify furthermore a set of rules, guidelines and requirements that is already dense and it may create conflicts of rules, guidelines or requirements. We consider that it should be clearly stated that this document cannot override another document (RTS, ….) from the EBA or substitute to a document or a doctrine that is not yet formalized.

This can be illustrated through the following examples:

- **Title 3 – Monitoring of key indicators.**

Competent authorities already receive many data on a periodic basis, some being quarterly. We would like supervisors to rely on them, as a principle to be put in written.

- **§ 101 – f & g: The compliance function**

The compliance function is deemed to report to the management body when this is not specifically asked for the risk function. This requirement would be new to our knowledge. On the proposal itself, we consider the compliance function should be granted the same level of independence than any independent control function and that the supervisors should not be prescriptive in the way to ensure this independence.

- **§ 225 defines some specific risks and the way the supervisors intend to use them**.

Regarding more specifically model risk, we identify the need for a definition of this risk in other consultations. We think the reference definition of this risk should be in the relevant technical papers.

On the proposed definition of model risk itself, we consider it needs to be worked furthermore with a better distinction between model risk that impairs the assessment of the risks supported by the banks and model risks that impacts the customers of the banks and between fraudulent or non-fraudulent construction or usage of models. Some can straightforwardly be considered as operational risk (fraudulent usage of a model, in some respect, impact on customers), when the other ones should be dealt with the risk they intend to assess.

- **§ 269 c & f – stress testing.**

The SREP process makes reference to stress testing on operational risks which is not a well-defined concept (it is interesting to notice that the document associate stress testing and scenario analysis without clearly defining the difference between these two exercises).

- **Annex 2. Operational risk taxonomy**.

The regulators, and especially the BCBS, have already defined operational risk events types that are commonly used in the industry. The list introduced in this CP is not consistent with these well-established standards that should be kept as the reference.