POSITION PAPER

ESBG third draft response to the EBA consultation on the SREP and supervisory stress testing procedures and methodologies

ESBG (European Savings and Retail Banking Group)

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ESBG

Dear Sir/Madam,

Thank you for the opportunity to comment on the European Banking Authority (EBA) consultation on the Supervisory Review and Evaluation Process (SREP) and supervisory stress testing procedures and methodologies. We would like to share with you the following reflections that we hope will be considered by the EBA.

A. General comments:

ESBG welcomes the opportunity to comment on the review of the SREP Guidelines. Before setting out our comments in detail, we would like to make a few general comments on the draft version of the Guidelines:

In general, we welcome both the decision to update the SREP Guidelines and the overarching objectives pursued, namely:

- To increase convergence of practices followed by competent authorities across the EU, including their supervisory stress testing processes pursuant to Article 100 CRD, and
- To align the SREP Guidelines with other relevant EBA guidelines and technical standards and to update the Guidelines by incorporating tried-and-tested procedures and by taking account of current supervisory practice.

Nevertheless, the draft version of the Guidelines contains specific provisions that go further than the EU Directive (CRD). In addition, the fact that the scope of provisions set out in the Guidelines has been expanded yet again gives rise to fears that proportionality aspects under Pillar 2 will be pushed further into the background. The detailed requirements, particularly those set out in Titles 5, 6 and 8, in conjunction with the other Pillar 2-related EBA guidelines referred to, which are themselves becoming increasingly extensive and prescriptive, make the catalogue of requirements to be checked too complex overall, especially for smaller to medium-sized institutions. This will likely not only serve to increase the workload for supervisory authorities disproportionately, but will also have an indirect impact on institutions, for example due to increased documentation/reporting requirements, more intensive reviews or the even more frequent use of surveys.

With the adjustments made in Title 2 and the isolated opening clauses in the other Titles, the Guidelines provide only inadequate information on how a streamlined SREP could be structured for smaller institutions that have less complex business activities and are exposed to lower risks. In our view, the mandate set out in Article 97(4a) CRD V, namely the need to specify criteria regarding how supervisory authorities can implement adapted (harmonised) procedures for institutions with a similar risk profile, has also not yet been considered.

Regarding the new requirements in Title 7 on the P2R/P2G leverage ratio, we would like to request in general that the supervisory authorities be permitted to address these aspects in a pragmatic and proportionate manner. In our view, the vast majority of institutions do not have any risks of excessive leverage associated with their business models and business activities. As a result, defining a P2R-LR and/or a P2G-LR should only be required in singular cases. Consequently, the additional requirement for the SREP should not produce any unnecessary additional work for supervisory authorities and institutions. Additional information requirements, a separate supervisory leverage ratio stress test or similar measures should only be necessary – if at all – for institutions if the supervisory assessment conducted in accordance with Title 7.3.1 flags up material indications pointing to risks of excessive leverage. At all other institutions, the new requirements should be implemented as part of a process that is as streamlined as possible. We recommend clarifications to be included to this effect.

B. Consultation's questions:

Question 1: How could the guidelines be further simplified in a way that appropriate focus of assessment is allowed while preserving the comprehensiveness of the assessment and ensuring that all aspects are sufficiently covered?

ESBG welcomes the EBA initiative to revise the SREP GLs in order to align them with the existing regulations. The current structure of the guidelines should be preserved as it is in line with the SREP process. However, ensuring the consistency and compatibility of all introduced changes with the logic of the guidelines would be highly appreciated.

The draft version of the Guidelines, however, does not yet meet the objective of strengthening proportionality set out in the "Risk Reduction Package Roadmaps" of 21 November 2019.

More specifically, initial starting points for a more streamlined SREP approach are mentioned primarily in paragraphs 54, 56 and 58. These are not sufficient, however, particularly as Table 1 requires an "Assessment of all SREP elements (at least)" every three years, even for smaller institutions. It remains unclear which of the numerous individual aspects set out, inter alia, in Titles 5, 6 and 8 (which are expanded even further by references to further EBA guidelines), supervisors are permitted to disregard or consolidate, for example, when assessing category 3 and category 4 institutions. At the very least, clarification should be included that this refers to the main elements of the SREP and not to all of the individual criteria mentioned in the Guidelines.

In addition, paragraph 54 merely refers to Article 97(4a) CRD V. The EBA was, however, mandated in that Article to define criteria on how supervisory authorities could implement adapted (harmonised) procedures for institutions with a similar risk profile. In our view, this is currently not reflected in the Guidelines.

Question 2: Do you think that the proposed overall framework for setting additional own funds requirements appropriately incorporates the ICAAP information and estimates?

Based on the current draft, we believe that unfortunately only a loose connection between the ICAAP, as the basis for the supervisory analysis, and the final P2R would remain. The idea currently is for the ICAAP to also serve as a quantitative basis for the SREP. From our perspective, this sort of fundamental approach still makes sense (see also our additional comments on Title 6).

Most banks have been investing in the reliability of their ICAAPs for decades. Strengthening the institutions' ICAAPs has always been an important goal for the supervisors, which is why the ICAAP should remain the main starting point for the quantification of individual risks and the determination of the P2R. Only overall inadequate and unreliable ICAAPs should be supplemented by supervisory benchmarks. In all other cases, the imprecise nature of benchmarks would lead to overly conservative measures if they were to be introduced. The EBA should therefore describe in detail when ICAAPs are deemed to be generally unreliable and when, as a result, benchmarks are to be introduced, while in all other cases the ICAAP should be the main starting point for the determination of the P2R. As a result, we take the view that the sources of information referred to in paragraph 369 should only be used as supplementary sources; the primary role of the ICAAP should be retained.

Question 3: Do you agree with the proposed clarifications on the assessment of the risk of excessive leverage?

We agree only partly with the proposed clarifications on the assessment of the risk of excessive leverage. We recommend that the supervisory authorities adopt a pragmatic approach to assessing risks of excessive leverage. In our view, the business models and business activities of the vast majority of institutions do not entail such risks and imposing a P2R-LR and/or a P2G-LR should ultimately only be necessary in singular cases. Additional information requirements, a separate supervisory leverage ratio stress test or similar measures are only likely to be necessary – if at all – for institutions if the supervisory assessment flags up material indications pointing to risks of excessive leverage. For all other institutions, the requirements relating to the leverage ratio should be implemented as part of a system that is as streamlined as possible so as not to produce any unnecessary additional work for supervisory authorities and institutions alike. The reference in paragraph 397 to the fact that available sources of information should be used should be positioned more prominently within the text and, where appropriate, further information should be added on proportionate implementation options.

In addition, the requirements should make it clearer that a P2R-LR and P2G-LR that is greater than zero does not need to be set by default (e.g. by adding "where necessary / applicable" in paragraphs 394, 398, 404 b, 409 b, 411 and 424).

Paragraph 393:
We do not agree with the vast majority of the proposed examples. Letters a. to d. of paragraph 393 mention a number of "aspects" that are to be taken into account when assessing the "risk of excessive leverage", even though these aspects have no legal basis. In the relevant Article 4(1) no. 94 CRR, this risk is defined relatively narrowly as follows: "risk of excessive leverage" means the risk resulting from an institution's vulnerability due to leverage or contingent leverage that may require unintended corrective measures to its business plan, including distressed selling of assets which might result in losses or in valuation adjustments to its remaining assets.

This definition is based on the central assumption that the observed institution-specific leverage ratio includes the risk that corrective action will be required due to a potential breach of the minimum leverage ratio requirement of 3%, which could lead to additional (fire sale) losses. Situations in which the institution operates close to the lower limit or has to tolerate a very volatile leverage ratio due to the nature of the business model can therefore be identified as causes of the "risk of excessive leverage". These situations are covered by c. and d. In our opinion, however, neither the three aspects mentioned under a. nor the aspects in point b. can be summarised under the level 1 definition set out above, meaning that they have to be removed.

Furthermore, Article 429a CRR explicitly provides for exemptions for authorised exposure. We fear that the exceptions provided for by the legislator will be undermined by these Guidelines. The use of those exceptions cannot be regarded as evidence of a risk of excessive leverage per se. In this context, it must only be verified that the prerequisites for making use of an exception are met. The leverage ratio is a non-risk sensitive measure by nature and the SREP Guidelines should not try to make it risk sensitive by introducing adjustments that were deliberately not taken into account when establishing the leverage ratio.

Question 4: Do you think that the assessment of dimensions and indicators described in this explanatory box would also be relevant for the assessment of the risk of excessive leverage? Are there any other elements / indicators that you are using in the assessment of this risk?

No. In our view, further indicators do not seem to be appropriate. As a result, we welcome the fact that the examples discussed in the explanatory box are not included in the draft SREP Guidelines, as none of them can be summarised under the authoritative definition of "risk of excessive leverage" provided in Article 4(1) no. 94 CRR. In our opinion, a link to "leverage risk" based on the CRR definition cannot be

meaningfully drawn in these examples. What is more, the aspects mentioned are already taken into account elsewhere.

Question 5: Can you provide examples of situations which in your view might require CET1 instead of other capital instruments to cover potential losses in relation to P2R and P2R-LR?

The proportion of CET1 for the P2R specified in Article 104a CRD V and the requirements for the P2R-LR comply with the requirements set out in Article 92 CRR. In our opinion, more stringent requirements (i.e. higher CET1 ratios) are generally not necessary and should be limited to justified individual cases, as provided for in the wording of the Directive. We do not believe that there are any generally applicable examples of situations or that there is any need for more detailed regulations.

Question 6: Would you consider the introduction of a standardised template for the communication to the supervised institution of the outcome of the SREP to be beneficial?

ESBG believes that competent authorities should be encouraged to provide a structured template for the communication of P2R, P2R-LR, P2G and P2G-LR. The main driver of the structure of such templates should be transparency. Institutions need detailed information on the basis/methods for determining the Pillar 2 capital requirements imposed so they can address them appropriately. That is, institutions must be informed which risk types, deficiencies, benchmarks, etc. contribute to the given determination of P2R, etc. and to what extent. In this context, a list of all items/risks examined (including references) would increase comparability and traceability for institutions. Overall, benchmarking across institutions, where performed, and benchmarking results should be made more transparent.

Setting standardisation objectives aside, however, it is crucial to maintain the individual assessment and diversity of the institutions and business models. Since these can differ from country to country, and to allow National Competent Authorities (NCAs) to adopt a proportionate approach for the smaller institutions they supervise, no standardised EU-wide template should be imposed as a requirement and the transparency requirements should be tightened up instead. Best practice examples could also be provided where appropriate to work towards greater convergence and comparability of the SREP throughout the EU.

Question 7: What are your views on the guidance for setting P2G and P2G-LR? Is it sufficiently clear?

The guidance is not sufficiently clear for P2G-LR. Within paragraph 436 only P2G setting is mentioned (to be met with CET1 eligible own funds) while P2G-LR is not mentioned. In paragraph 440 both P2G and P2G-LR are mentioned as CET1 denominated while in the explanatory text box for Pillar2 guidance it is mentioned that "keeping consistency within the leverage ratio stack based on a Tier 1 composition of P2G-LR would leave the calculation coherent and straightforward. Nonetheless competent authorities may still need to require institutions to cover P2G-LR with CET1 eligible own funds based on institution-specific considerations."

Furthermore, in the event that an entity is excluded from the supervisory stress test exercise, or does not participate due to its categorisation, how is the consistency of the methodology ensured? How is the P2G determined, is it done through ICAAP?

Moreover, we would like to add the following comments:

Title 7.7.1:
When it comes to P2G-LR it is rather unclear how the static balance sheet assumption as given in the EU-wide stress test could form a proper basis for the exploration of a leverage ratio under stress, which would already be misleading from a theoretical point of view.

There is no clear guidance for setting a P2G-LR. We suspect that the LR-related risk is overestimated and that, in consequence, the P2G-LR is set too high. Paragraph 423 states that the "level of P2G-LR should protect against the breach of TSLRR in the adverse scenario". On the other hand, paragraph 429 sets out that the P2G should cover at least the maximum stress impact. Regardless of how far the starting point was above the minimum requirements or how far the minimum requirements were exceeded in the stress scenario, the outcome would be very different.
We ask that it be clarified that there is generally no room for (non-institution specific) minimum (floor) P2G and P2G-LR.

Paragraph 437:
In our view, keeping the provision introduced in 2018, stating that the P2G is to be met using CET1, is not permissible. The wording of Article 104b CRD V adopted in 2019 only focuses on own funds overall. Working papers on the CRD review reveal that the majority of member states had favoured the introduction of a "soft" recommendation with regard to the P2G. As a result, an expectation to meet P2G with CET1 only within the SREP Guidelines is not consistent with the intention of the EU legislator and is lacking any legal basis. This tightened requirement should be deleted and the wording should be based on own funds in line with the CRD V.

Question 8: What are your views on possible disclosures, which may be attached to P2G and/or ranges of buckets in case they are identified?

It is not clear from the question which type of disclosure is meant here. As a result, we will address several potential aspects:

- The disclosure of buckets or "ranges of P2G add-ons" by the supervisory authority could make sense in principle as a way of communicating to the markets. Such publications by the supervisory authorities should, however, be limited to large, capital market-oriented institutions. In any case, we do not encourage that individual results of single institutions be published.
- Our view is that extending the disclosure requirements for institutions with regard to individual P2G would clearly not make sense, which is why we reject such a proposal. The disclosure requirements have only just been revised extensively and in full as part of the CRR II in conjunction with Implementing Regulation 2021/637, meaning that they reflect the current needs from a Pillar 3 perspective. Small and non-complex, as well as non-capital market-oriented other institutions were granted considerable relief by law as part of this process, as the disclosed data is generally not accessed (cf. EP, 2016/0360A(COD) of 11 December 2017). With this in mind, we also consider the disclosure regulations in the CRR II to be entirely sufficient.

Question 9: What are your views on the capital instruments potentially used to cover losses in relation to P2G-LR? Please provide the rationale or specific examples for your views.

The structure of the leverage capital requirement as a Tier 1 requirement should also be applied for the purposes of the P2G-LR. The purpose of the leverage ratio requirement is to have a safety barrier to the existing risk-sensitive capital requirements and to limit banks' borrowing as a proportion of their Tier 1 capital. A stress test-related capital need is not at the core of any of these purposes and does not constitute a good reason for parts of the requirement to be met with Common Equity Tier 1 capital.

C. Additional comments:

Title 2. The common SREP:

Title 2.1.1 (Categorisation of institutions):
The complexity criteria pursuant to Article 4(1) no. 145 CRR II were defined primarily for the purposes of granting reporting and disclosure relief and are not necessarily significant/suitable with regard to Pillar 2 aspects. With this in mind, consideration should be given as to whether this classification can be used without restriction for the purposes of the SREP. It would make sense to include an opening clause so that the supervisory authority can also apply other, potentially more relevant criteria and classify an institution as a category 4 institution even if single CRR criteria are not met. Relevant criteria could include those referred to in the "EBA discussion paper on proportionality assessment methodology", such as the institution's business model.

We read the guidelines as though all small and non-complex institutions should be assigned SREP-group 4. The EBA emphasizes that more companies will be moved to category 4 meaning that the thus the purpose of the proportionality provisions introduced into the guidelines would be fulfilled, and consistency would be ensured in the scope of the application of proportionality for the small and non-complex institutions across the different Pillars[1].

Title 5. Assessing internal governance and institution-wide controls:

Paragraph 101(e):
Based on the draft version of the Guidelines, the authorities are to assess whether a selection and suitability assessment process for the members of the management body and key function holders has been implemented. This means that key function holders are included in the scope of application of the fit and proper requirements – something that we already criticised in the context of the EBA/ESMA Guidelines on the assessment of the suitability of members of the management body and key function holders. Our opinion, however, is that there is no legal basis, especially not in the CRD, for treating key function holders in the same way as members of the management body. As a result, the reference to key function holders should be removed from the SREP Guidelines.

Paragraph 102(c):
The draft states that an assessment is to be performed to determine whether a diversity policy has been implemented and whether the SIs have set quantitative targets for the representation of the underrepresented gender. Institutions that cannot exert any influence over the composition of the supervisory body (especially public-law institutions) cannot ensure any other degree of diversity than that resulting from election outcomes, appointments or by virtue of office. As a result, no requirements that extend beyond existing national requirements should be imposed on institutions and their supervisory body members. Accordingly, a diversity policy cannot be implemented for supervisory body members in such cases.

A general recruitment policy that differentiates based on the aspects defined in the diversity policy (e.g. age) in order to achieve the most diverse workforce possible is also likely to conflict with national and European anti-discrimination regulations. The wording following the half sentence "the management body has implemented a diversity policy to promote diversity on the management body" should therefore be deleted, simplifying the Guidelines at the same time.

Paragraph 107(b):

[1] *"Among the 79 institutions of the sample that account with consolidated assets below EUR 5 bn as of December 2020, 71 of them have their SREP categorization informed. Of these, 70% are classified in categories 1 to 3, with category 3 appearing as the most predominant. Therefore, these institutions, which would be mainly classified in category 4 will benefit from a more proportionate approach for Pillar purposes and thus the purpose of the proportionality provisions introduced into the guidelines would be fulfilled, and consistency would be ensured in the scope of the application of proportionality for the small and non-complex institutions across the different Pillars."*

The risk management function is supposed to ensure that the risk strategy is complied with. In our view, this is not something that can be ensured by the risk management function alone. Rather, compliance with the risk strategy is also the responsibility of the management body and the senior management team, in particular. We therefore request that the word "promotes" be used instead of "ensures".

Paragraph 129(a), paragraph 137 inter alia:
The requirements could be misinterpreted as meaning that there always has to be a link between a bank's internal stress test results and its risk appetite and limits. In our view, this would go too far. Institutions should check their stress test outcomes to identify potential impetus for their risk management. The results are generally not, however, suitable for overall bank management in normal periods, and stress effects resulting from internal bank processes do not have to be backed by internal capital in the ICAAP. In this respect, a distinction is to be made between risk measurement and management on the one hand, and stress testing on the other. With this in mind, it would generally make more sense to use the wording "internal stress tests done in the context of capital and liquidity risk management" instead of "stress tests done for ICAAP and ILAAP purposes".

Title. 5.8 (Information and communication technologies and business continuity management):
The consultation paper stipulates that institutions should at least be able to "143. a. generate accurate, complete, meaningful and reliable aggregated risk data for business units and the entire institution". We would appreciate if the term "meaningful risk data" could be clarified as we are not aware of any requirement with this formulation.

<u>Title 6. Assessing risks to capital:</u>

Paragraph 145 (old version) and paragraph 146 (old version):
Unlike the standardised CRR requirements, Pillar 2 and the ICAAP are designed to ensure that risk assessment and management is institution-specific. As a result, we are opposed to the deletion of paragraphs 145 and 146, as we consider it preferable to maintain the flexibility that is necessary and makes sense here. There are various risk sub-categories that cannot be clearly allocated to a specific risk type and whose allocation can also vary from institution to institution. The excessively detailed division of risks into sub-categories does not make sense across the board either. Details and examples of this can be found in our comments on paragraphs 181 and 238.
The SREP should follow the individual risk categorisation for all institutions that implement an ICAAP that is transparent and appropriate overall. Based on the information available to us, this is precisely why the risk taxonomy developed by the EBA is to be used for internal supervisory purposes only and is not to be disclosed to the banking industry.

Paragraph 158
The addition of step-in risk should be dispensed with. The risks described in BCBS 423 are sufficiently covered by the categories previously mentioned (reputational risk, strategic and business risk). As the governance guidelines do not mention step-in risks, they should not be included in the SREP Guidelines either.

Paragraph 181:
The proposed adjustment would create three additional sub-categories of credit risk. Although these categories have an underlying component of credit risk as it is also considered under prudential regulation (CRR), a thorough assessment about whether their introduction would actually make sense would still be needed in light of the following considerations:

- Equity risk in the banking book: While it is currently still possible to obtain IRBA approval for equity risks, this will no longer be possible in the course of the implementation of Basel III in Europe, also because virtually no institutions have made use of this option. This is also because this risk is not a conventional credit risk. Depending on the investment (e.g. listed shares), the

focus from a supervisory perspective could also be more on market risks. It should therefore be possible for the "competent authority" to take this into account in the SREP.

- Real estate risk: In line with the definition provided in paragraph 201, we understand this risk as referring to the investment (price) risk that arises when investing in the institution's own real estate (on its own balance sheet or via subsidiaries). These investments can also be seen as an opportunity to broaden and diversify an institution's earnings and, in doing so, make a business model more sustainable. In this respect, it is not primarily or necessarily a credit risk, but could also be classified as a risk category in its own right ("other risks" in accordance with paragraph 158) or addressed as a sub-category of market risk.
- Model risk for regulatory approved models: In the context of credit risk, this can only refer to IRBA and CCR models under Pillar 1 that have been approved by the supervisory authorities. Scenarios in which risks are underestimated are not to be expected on a large scale due to the ongoing model review process, which also looks at ongoing compliance with the qualitative minimum requirements. As a result, this category can be deleted. In addition, any model deficiencies can already be addressed using add-ons under Pillar 1 (meaning that the additional wording in paragraph 385 can also be dispensed with). It can also be assumed that these risks are already taken into account sufficiently in Pillar 2 by addressing model risks as operational risks.

At the very least, opening clauses allowing the option of individual allocation should be added.

Paragraph 238:
The proposed adjustment provides for the introduction of new market risk sub-categories including non-delta risk, basis risk and market liquidity risk. Without wishing to call the potential materiality of these risks into question, there is nevertheless no need for these separate sub-categories, as they are already covered by the sub-categories a. to e. The separation of these sub-categories is not consistent with practical application within the institutions. As a result, we ask that they be deleted.

Title 6.4 (Assessment of operational risk):
In paragraph 279 on the assessment of operational risk, the EBA has added that the authorities should consider the level of and change in gross income, assets and operational risk losses over the past few years at aggregated level but also for material entities and business lines. We are concerned that this information is not always available on such detailed level for smaller institutions.

Furthermore, the EBA has in point 315 added that the competent authorities in their assessment of the framework for operational risk management should consider the use of forward-looking indicators in their monitoring of operational risk exposures. We believe that this is challenging for smaller institutions. We are also unsure if this will be a useful risk management tool for the smaller institutions.

Paragraph 329:
Based on the proposed provision, it would appear that CSRBB is to be treated as a separate risk category. This is not consistent with predominant industry practice and institutions should not be asked to treat or report it as a separate risk: some institutions, for example, do not treat credit spread risks as a separate type of risk in their internal (market price risk) procedures, but rather as an integral component of interest rate risk and, consequently, of overall market price risk. Other institutions address credit spread risks separately from IRRBB as a component of counterparty credit risk for measurement and management purposes. This means that no specific supervisory requirements should be imposed on where, or using which procedures, institutions have to measure and manage their credit spread risks as a general rule.

<u>Title 7. SREP capital assessment:</u>

Paragraph 368:

While we welcome the opening clause that has been added here, the current wording could be interpreted too narrowly. We recommend that the second sentence be adjusted as follows: "In cases where it is not necessary in view of the institution's risk profile or overly burdensome, especially for small institutions, to meaningfully disentangle the amount of capital considered adequate for two or more types of risk quantified together, competent authorities should comply with the first sentence of this paragraph on a best effort basis, using …".

According to paragraph 368, the risk categories set out in Articles 79 to 85 CRD under Pillar 2 are to be compared with the corresponding Pillar 1 risk categories as part of what is known as the risk-by-risk approach (with Pillar 1 as the floor). We do not consider the aforementioned Pillar 1 floor to make sense, as it fails to take existing excessive risk exposures under Pillar 1 into account, especially when standardised supervisory approaches (for example, the current and the future CRR III credit risk standardised approach) are used, which is why we propose that this requirement be deleted. Apart from this, the risk categories set out in Articles 79 to 85 (credit risk and CCR, residual risk (referring to the reduced effectiveness of CRM techniques), concentration risk, securitisation risk, market risk, IRRBB and OpRisk) also contain individual categories for which this sort of comparison does not make sense, or is not even possible in the first place. It should be dropped for the residual risk and concentration risk categories at the very least:

- "Residual risk" is an intrinsic part of the "credit risk and CCR" category and is already covered adequately by that category in quantitative terms. In addition, it is virtually impossible to separate this risk.
- "Concentration risk" is not a risk category in its own right. Even if it were possible to quantify these risks under Pillar 2, there are no capital requirements for the purposes of a comparison under Pillar 1.

Paragraph 388:
Article 104a(1e) CRD V does not set any deadline by which a P2R should be imposed on an institution after repeated non-compliance with the P2G. There is neither a legal basis nor are there objective grounds for requiring a P2R to be imposed after two years at the latest. The supervisory authorities should be granted a certain degree of flexibility and this specification should be dropped.

Title 7.2.3 (Consequences for breaching the pillar 2 guideline (P2G)):

The guideline distinguishes between three scenarios; (a) the breach is due to materialization of risks that the P2G was aimed at covering, (b) the breach is due to materialization of risks that the P2G was not aimed at covering and (c) the breach was due to the institution disregarding the P2G. The EBA has added in section 10.7, that where the permission to operate below the level of P2G as referred to in point (a) has not been granted and the institution's own funds are repeatedly below the level of P2G, the competent authority should impose additional own funds requirements in accordance with Title 7. We also note that the competent authority is not obliged to grant the institution permission and may also consider adjusting the level of P2G in the case of (a).

This could be read as though a breach of the P2G should automatically trigger a form of action from the authorities meaning that the P2G is, in fact, a requirement that must be met at all times, and not a guidance, requiring the institutions to have a significant management buffer on top of the pillar 2 guidance.

We believe the text should be rephrased so that it says the competent authority should consider to, rather than should, impose additional own funds requirements. Furthermore, we believe more guidance should be provided on what the competent authority should consider when considering increasing the capital requirement, e.g. the size and duration of the breach. Imposing an increased capital requirement in the case of the situations in point (b) might be reasonable, but it is worth pointing out that this requires that the competent authority is very clear on which risks the P2G intend to cover.

We also believe the EBA should provide guidance on how long this additional requirement should be imposed after a breach. When the institution has resolved the issue, it should not face an increased requirement for too long. This is potentially an issue for small and less complex banks which get their P2R re-assessed less frequently (3 years).

Title 8. Assessing risks to liquidity and funding:

Paragraph 484:
Related to the concentration / diversification of liquid assets: we request the inclusion of a reference that this analysis of concentration / diversification must be done in accordance with the regulations (article 8.1 of the LCR Delegated Regulation). We consider this is necessary since in the way it is expressed, it can be interpreted as something open and not as something already regulated with already established criteria to exclude everything that is cash, balance in central bank accounts, public debt etc.

Paragraphs 484, 491, 572, 575:
Consistency between the currencies of the liquid assets and the outflows / stable financing available and required: we request that it be referred to significant currencies that are for which the regulation has established these requirements of consistency between liquid assets and outflows. We consider this point is necessary since, in the way it is expressed, it can be interpreted as something open and not as something already regulated where there are already established criteria of applicability for significant currencies (those in which the position is greater than 5% of total liabilities without own resources).

Title 10. Overall SREP assessment and application of supervisory measures:

Title 10.5 (Application of other supervisory measures):
A statement should be added clarifying that any action considered should first of all be reviewed for appropriateness and that, if it is imposed, the institution should be provided with reasons why.

Title 10.7 (Supervisory reaction to a situation where P2G is not met):
The requirements for dealing with P2G non-compliance could unnecessarily complicate flexible action in response to exceptional circumstances (such as the COVID-19 pandemic). It is worth questioning whether there is a need for a general obligation for institutions to notify the competent authority of a revised capital plan and to submit it (paragraphs 582 and 583(a)). There are no corresponding requirements in the CRD. Scenarios in which institutions fail to meet their P2G soon come to light based on the quarterly reporting data (Monitoring of key indicators in accordance with Title 3). The supervisory authority can then check on a case-by-case basis whether the shortfall is acceptable due to general or institution-specific circumstances, and can decide whether it wants to obtain further information, and if so, what further information specifically, from the institution.

10.8 (Interaction between supervisory and macro-prudential measures):
The EBA has removed references to macro-prudential measures as CRD5 clearly states that pillar 2 should be institution specific.

In point 587 the text is changed so that the SREP assessment should determine what macro-prudential measures the institution is subject to adequately address the institution-specific risk profile. In section 7.4 Reconciliation with the capital buffers and any macroprudential requirements the EBA has added that the additional own funds requirement can cover the risks reflecting the impact of certain economic conditions and market developments on the risk profile of an individual institution.

As there are often different authorities responsible for the SREP and macro-prudential measures it is important to ensure to avoid double counting of risk.

Title 10.10 (Interaction between supervisory and AML/CFT measures):
We understand the idea of the integration of the AML risks in the SREP process, however we would expect that the ECB-led SREP process should be clearly coordinated with the AMLA and/or relevant national authorities´ supervisory process in the EU in order to avoid double work-load for the institutions and authorities. The expectation here would be a structured cooperation and information exchange between prudential and AML/CFT supervisors. It should be avoided that the same questions/topics are brought to the attention of the banks via two involved institutions. The various phases of the SREP process should not be hampered due to a lack of effective coordination and timely information exchange between supervisory authorities.

Title 12. Supervisory stress testing:

The guidance should allow for taking into consideration the sometimes-significant differences in the economy of the member states.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.

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