EACB Comments

EBA draft GL on Revised common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing

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General comments

The members of the EACB welcome the opportunity to comment on the EBA draft GL on the revised common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing.

While in principle we appreciate the idea to perform a consistency check and update of the SREP framework, we believe that the timing of this is not the most appropriate. In fact, in consideration of the ongoing Review of the CRD/CRR, we believe that the review of the Guidelines should be postponed until the legislative process is concluded to avoid any misalignments and consequent readjustment of the GL. This would avoid unjustified additional implementation burden for institutions.

Moreover, within the draft GL there are many references to regulatory products which are either not finalised or not yet implemented: for instance while the EBA GL on internal Governance and EBA/ESMA GL on fit and proper have been published compliance by the competent authorities is not clarified yet. Furthermore, the elements in chapter 5.10 indicate at least a reference to the content of the BCBS new GL on step-in risk which are currently not yet part of the EU framework (para. 134(e)). The same would be for interest rate risk in the banking book (IRRBB): while the EBA draft GL are under consultation the CRD review is tackling the same issue with a Level 1 legislative process. The draft GL also refer to the fact that EBA will review the CEBS Guidelines on outsourcing without giving further details. Finally, also the draft GL on stress testing (2017/17) are still under parallel review at EBA level.

If however the review process of the SREP GL were to be concluded now, it would be necessary to envisage a sufficiently long implementation period of at least 18 months.

Answers to specific questions

Q.1 What are the respondents' views on the overall amendments and clarifications added to the revised guidelines?

Overall we see that there is still a need for certain clarifications. In various instances throughout the consultation paper it is indicated that institutions should be expected to meet P2R (or more at large the TSCR) at all times. However, it should be considered that if a supervisory decision regarding additional capital requirements is taken and additional capital needs arise or the quality of additional own funds is a higher one (e.g. CET1 from AT1), institutions will not be able to meet the requirements immediately (i.e. they would not "comply at all times"). Therefore, we believe that it is necessary to provide institutions with a clear and adequate timeframe, at least six months, to fulfil the new requirements.

Also, the use of P2G should not lead to determine additional capital guidance to an inadequate and disproportionate extent.

With regard to the assessment of recovery plans and market conduct, if they lead to a capital add-on, it must be determined to which extent the capital add-on results from weaknesses of the recovery plans. This is particularly relevant in the context of MREL. When setting the MREL quota the resolution authority must assess the capital need of the business which may remain after the resolution action has been taken. Depending on the preferred resolution action the remaining business may differ significantly from the current institution's business. The identified weaknesses in the recovery plan should not be there any longer after the resolution action has been taken and therefore any additional need for own funds resulting from recovery plan should not be included in the MREL recapitalisation amount. In this light, it is necessary to demonstrate which amount of the additional own funds requirement results from the weaknesses of recovery plans.

Finally, consumer protection considerations should not be part of the SREP. These issues differ significantly across Member States, as such they would lead to market disadvantages for institutions in Member States where the consumer protection is stricter than in other ones. Additionally, risks resulting from consumer protection are covered through accruals to the legally required extent. As accruals, these positions have already reduced the CET1 of the institution. Therefore, these risks which have already been covered through accruals should not be subject to any additional capital requirements since they would lead to a legally not justified double counting of the same risks. Institutions should at least be provided with the amount of capital needs which the authority considers as not being covered through accruals and the corresponding reasoning. The reasoning is necessary to enable the institution's assessment on whether any needs of dedicating an additional amount to the accrual may arise concerning the relevant risk for accounting and perhaps tax purposes too.

Q.2 What are the respondents' views regarding 'the interaction between SREP and other supervisory processes, in particular assessment of recovery plans' provided in the 'Background and rationale' section?

With regard to recovery plans, it should be clarified that according to the EBA GL on triggers for use of early intervention measures (EBA/GL/2015/03) the indicators for early intervention measures should consider minimum and additional requirements, i.e. minimum own funds requirements as specified in Article 92 CRR and additional own funds requirements applied pursuant to Article 104(1)(a) CRDIV, but without taking into account any buffer requirements set out in Chapter 4 of Title VII of CRDIV.

As such, breaching the capital buffers should not lead to a score to capital adequacy of 4 since such a score could initiate early intervention measures. Therefore, bullet point 2 of score 3 and score 4 in chapter 7.8. should be amended as follows:

Score 3: "*The institution is using its capital buffers. There is potential for the institution to breach its TSCR if the situation deteriorates.*"

Score 4: "*The institution is breaching its TSCR.*"

Article 27 BRRD stipulates that the set of triggers which should be set for the assessment of the need for early intervention measures may include the institution's own funds requirement plus 1,5%. As the wording clearly says, only the own funds requirement should be considered but not any non-binding guidance. The stacking order of own funds requirements and P2G on page 152 clarifies that the P2G is set on top of the buffers. Also, the SREP Guidelines define the P2G as a non-binding guidance which does not set a legal requirement for the institution. Finally, since not even the buffers which are situated below the P2G are included in the own funds requirement according to Article 27 BRRD and the relevant Guidelines on triggers for use of early intervention measures (EBA/GL/2015/03), referring to the legal principle argumentum *a maiore ad minus* the P2G should not be included in the early intervention triggers.

Therefore, we strongly call for an explicit alignment with the above-mentioned acts (BRRD, EBA GL), amending all relevant passages in the SREP Guidelines (e.g. para. 399). This should also include a clarification that the early intervention triggers should only contain the own funds requirements consisting of own funds according to Article 92 CRR and the additional own funds according to 104(1)(a) CRDIV, but not the P2G and the capital buffers.

Q.3 What are the respondents' views on how the assessment of internal governance and institution-wide controls has been aligned with the revised EBA Guidelines on internal governance (Section 5)?

Chapter 5.5. Variable Remuneration

The currently ongoing developments on the review of CRD regarding variable remuneration seem to indicate that institutions may deviate from specific requirements where certain conditions are fulfilled. Therefore, para. 95(d) of the draft GL should also be amended to reflect the relevance of the application of certain provisions, provided that the institution does not use vehicles or practices to circumvent remuneration requirements.

Chapter 5.11., Annex 2

➢ Time commitment

The scoring tables require that the time commitment of the members of the management body is appropriate and that they comply with the number of directorships. According to the wording regarding the relevant scores the calculation of directorships is considered as an additional criteria besides the general time commitment rule. We would like to point out that according to the Fit and Proper Guidelines (paragraph 49, EBA/GL2017/12) the calculation of directorships is only relevant for significant institutions. Additionally, the qualification of an institution as significant depends on the national implementation of the CRD IV provisions. In this light, also the national framework must be considered (e.g. according to the Austrian Banking Act in consolidated groups only the consolidating institution is considered as significant, § 5 Abs 4 BWG. As a result, only the consolidation institution is subject to the calculation of directorships, whereas the affiliated institutions are only subject to the time commitment). Therefore, an amendment of the wording in the score 1 is necessary as follows:

- Score 1: "The time commitment of the members of the management body is appropriate and ***where relevant*** they comply with the ***limitation of the*** number of directorships."
- Score 2: "The time commitment of the members of the management body is largely appropriate and ***where relevant*** they comply with the limitation of the number of directorships."
- Score 3: "There are doubts about the ***largely*** appropriate time commitment of the members of the management body or ***where relevant some members*** do not comply with the limitation of the number of directorships."
- Score 4: "The time commitment of the members of the management body is insufficient or ***where relevant the majority of the members does not*** comply with the limitation of the number of directorships."

The same applies to the scores 2,3 and 4, where the supplement "where relevant" should be added.

Additionally, Annex 2, point 1 refers to relevant Articles of the CRD IV. Since the regulatory requirements do not arise from the CRD IV but from national implemented regulations point 1 in Annex 2 should be amended as follows: "***National provisions implementing*** Articles 73-74, 88, 91-96 and 98 of Directive 2013/36/EU."

- Diversity policy

According to Chapter 12 of the Guidelines on Fit and Proper institutions should set (qualitative or quantitative) targets regarding diversity in the management body. If the targets are not met, significant institution should document the reasons why, the measures to be taken and the timeframe for the measures. The compliance with the targets is specified within the diversity policy. This means that the targets do not have to be achieved immediately but in the way described in the policy. If an institution complies with all the above-mentioned requirements of the Guidelines it should always be provided with a score 1. Any scoring below 1 of institution which comply with the Guidelines would not be legitimate.

Scores 1 and 2 could be amended as follows:

Score 1: "The institution has adopted a diversity policy that fosters a diverse board composition and complies with the targets ***or has set appropriate measures to achieve the targets***."

Score 2: "The institution has adopted a diversity policy that fosters a diverse board composition and largely complies with the targets ***but has not yet set appropriate measures to achieve the targets***.

Q.4 What are the respondents' views on the provisions of the newly introduced Pillar 2 Capital Guidance?

<u>Allocation of additional own funds requirements and P2G</u>

According to current practices institutions are provided with the percentage of additional capital needs and the relevant weaknesses which are to be covered by the SREP decisions. However, the additional capital need is only calculated as a total without any allocation of the add-ons resulting from the single risks/positions. Especially considering that the assumptions of the competent authority as well as the resulting scores lead to significant consequences – which may even lead in extreme circumstances to an institution as being considered as "failing or likely to fail" – there is a strong legal need for more transparency and legal certainty.

Additionally, institutions should have the opportunity to address their weaknesses and should be informed to which extent their efforts would reduce their additional own funds requirements. Such information is essential to enable institution to improve. Also, since the MREL requirement set by the resolution authority is also considering the additional own funds requirement resulting from the SREP, the strong need for more detailed information regarding the allocation of the additional capital need to the situations and risks causing arises. We strongly believe that the additional own funds determined within the SREP decision should be allocated to the single risks or situations which are causing it. Only those elements of the SREP add-on which address risks remaining after the resolution action should be considered in the recapitalisation amount. In this vein, it would be relevant to provide resolution authorities with details regarding the risk allocation to allow for a comprehensive determination of the recapitalization amount as a part of the MREL.

Moreover, the overall SREP assessment as defined in Chapter 10 seems insufficiently transparent for institutions. It is not clear to which extent the findings and scorings of the single viability scores influence the overall SREP Score. It is not evident if they are weighted or equivalent. As a result, the comprehensibility of the SREP decision is deeply constrained and the institution's possibility to improve is limited by this fact. Considering these reflections, we strongly call for the introduction of detailed information regarding the influence of the single scores on the overall SREP score.

Regarding the P2G it is also necessary to demonstrate the allocation of risks covered by P2G for several reasons. Firstly, it is necessary to inform institution whether and to which extent macroprudential risks are addressed with the P2G to avoid any doubling of capital needs. It should be demonstrated within the SREP decision to which extent risks are addresses which are not already covered by all the other macroprudential buffers.

Overlaps between P2G and other applicable macro-prudential measures should be avoided. In this sense, competent authorities should consider the extent to which the existing combined buffer requirements and other applicable macro-prudential measures already cover risks revealed by stress testing. Competent authorities should offset P2G against the capital conservation buffer (CCB) and the systemic risk buffer (SRB), as P2G and CCB / SRB overlap in nature. This would also restore the level playing field and comparability given the different level and methodologies jurisdictions use in setting the SRB. Furthermore, while no overlap is in principle expected between P2G and the countercyclical capital buffer (CCyB), competent authorities should, in exceptional cases, offset P2G on a case-by-case basis against the CCyB based on the consideration of underlying risks covered by the buffer and factored into the design of the scenarios used for the stress tests, after liaising with the macro-prudential authority.

Chapter 7.7.2.

For legal certainty reasons paragraph 387 should be changed as follows:

"Where the quantitative outcomes of the supervisory stress test suggest that the institution is not expected to breach its TSCR under the adverse scenario competent authorities **should** not set P2G.

In terms of ensuring a level-playing-field and for proportionality reasons the P2G **should** (instead of "can") be set every second year (paragraph 392).

Paragraph 393: For the avoidance of any disproportionate burden for institutions the P2R should only be set in situations where the P2G is not an appropriate tool for achieving the relevant goals.

Chapter 7.7.3.

Paragraph 397: According to the wording of the proposed CRD review (Article 104b) the guidance is intended to cover cyclical economic fluctuations. Therefore, overlapping of the P2G and the countercyclical buffer may occur and the need to offset P2G against the CCyB should be assessed in every case.

We are highly skeptical on the intention to use the P2G to cover macroprudential risks. Recital 9 of the current CRD review proposal clarifies that own funds add-ons should not be used to address macroprudential risks. Also, all of the buffers are defined within a directive (CRD IV) which is not directly applicable but rather has to be implemented in national law. Imposing macroprudential buffers trough a directly applicable SREP decision of the competent authority would question the effectiveness of the buffers which are set at national level. Therefore, we believe that the P2G should not be an instrument for addressing macroprudential risks.

Q.5 What are the respondents' views regarding disclosure of P2G (paragraph 403), having in mind the criteria for insider information?

Q.6 What are the respondents' views on the introduction of supervisory stress testing in the revised guidelines (Section 12)?