EUROPEAN CENTRAL BANK
BANKING SUPERVISION

SSM SREP Methodology Booklet

- 2018 edition – to be applied in 2019 -

Level playing field - High standards of supervision - Sound risk assessment

SREP – Key achievements

- **Level playing field:** SREP is currently being executed for **the fourth time** according to:
  - a **common methodology**
  - a **common decision-making process** allowing for peer comparisons and transversal analyses on a wide scale

- **High standards of supervision:**
  - follows the **EBA guidelines on SREP** and draws on leading practices within the SSM and as recommended by international bodies
  - **proportionality, flexibility and continuous improvement**
  - supervisory decisions – **not only additional capital but also additional measures** tailored to banks' specific weaknesses

- **Sound risk assessment:**
  - **combination of quantitative and qualitative elements**
  - **holistic assessment** of institutions' viability taking into account their specificities
  - **forward-looking perspective**, e.g. European stress tests performed in 2018

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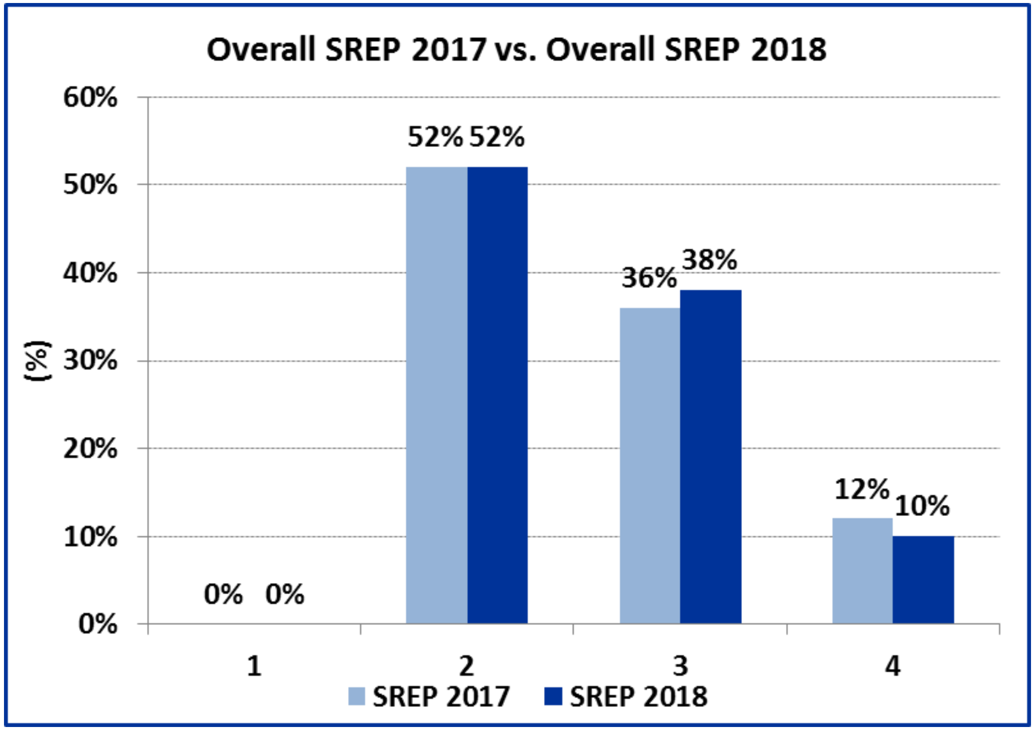
1.1. SREP – 2018 Outcome – Key facts: Overall assessment

In 2018 the SSM carried out its fourth SREP cycle for SIs in 19 countries

- Overall stable aggregate risk profile compared to last year but:
  - Profitability remains an issue
  - High Level of NPL is still a point of attention
  - ICAAPs and ILAAPs need to be further improved

SREP Outcome 2017/2018



Notes:

- *SREP 2018 values based on 107 banks with SREP 2018 decisions finalised as of 31 January 2019.*
- *SREP 2017 values based on 105 banks with SREP 2017 decisions finalised as of 30 November 2017 and presented in the SSM SREP Methodology Booklet – 2017 edition*

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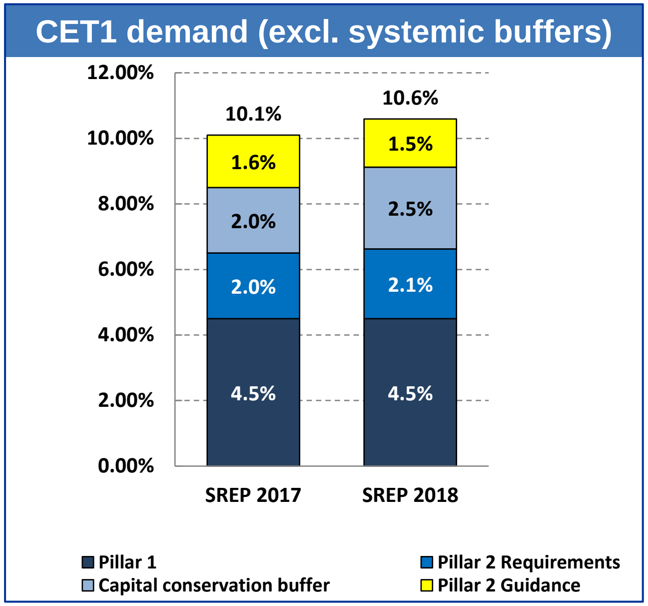
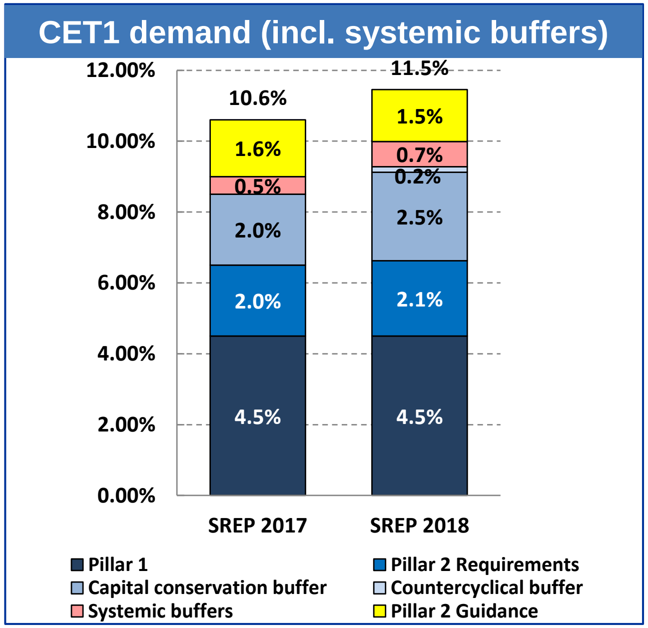
1.1. SREP – 2018 Outcome – Key facts: Capital measures (1/2)

The overall CET1 demand (excl. systemic buffers) increases slightly from SREP 2017 to 2018

The overall SREP CET1 demand (excluding systemic buffers) slightly increases compared to last year :

- The phase-in of the CCB counts for on average +50 bps
- The P2R increases by 10 bps
- The P2G decreases by 10 bps





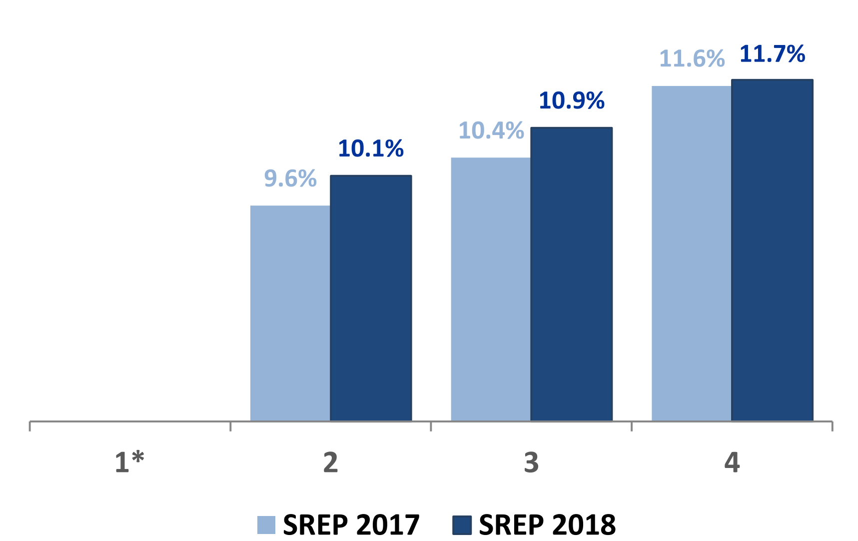
Notes:

- *Simple averages. Using RWA weighted averages, CET1 demand, excl. systemic buffers, increases by 40 bp, from 9.6% to 10.0%.*
- *CET1 demand is computed without taking into account the need to cover also Pillar 1 AT1/T2 in case of shortage of AT1 and T2.*
- *SREP 2018 values based on SREP 2018 decisions finalised as of 31 January 2019.*
- *SREP 2017 values based on 105 banks with SREP 2017 decisions finalised as of 30 November 2017 and presented in the SSM SREP Methodology Booklet – 2017 edition*

SREP CET1 demand per score comparable to 2017

- In line with SREP 2017 achievements, SREP 2018 CET1 demand increases consistently with worse SREP scores

SREP CET1 demand[1] by overall SREP score



Notes:

- *SREP 2018 values based on SREP 2018 decisions finalised as of 31 January 2019.*
- *SREP 2017 values based on SREP 2017 decisions finalised as of 30 November 2017 and presented in the SSM SREP Methodology Booklet – 2017 edition*

** No institution with SREP overall score of 1 in SREP 2017 and SREP 2018.*

Notes:

[1] Pillar 1 + Pillar 2 Requirement + Capital conservation buffer + Pillar 2 Guidance. Excludes systemic buffers (G-SII, O-SII and systemic risk buffer) and countercyclical capital buffer.

1.1. SREP – 2018 Outcome – Key facts: Other measures

Liquidity measures*

45 banks with **liquidity related measures** have been identified

- There are 42 banks with only qualitative liquidity SREP requirements. The requirements are diverse and relating to a broad area of topics within liquidity risk management e.g. improvement of the ILAAP, including the stress test framework, the funding plan, intraday liquidity
- There is 1 bank with both qualitative and quantitative liquidity SREP requirements (e.g. FX-denominated liquidity buffers)
- There are 2 banks with only quantitative liquidity SREP requirements

Other qualitative measures*

83 banks with **qualitative measures**

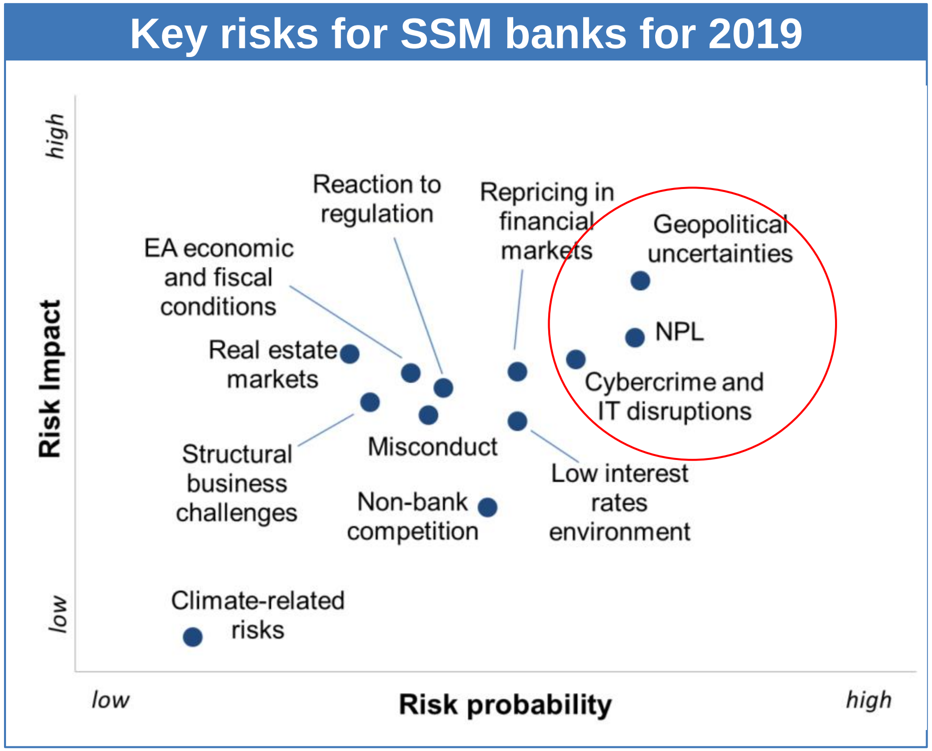
- Qualitative measures are applied for most banks scored 4 in SREP 2018, while other supervisory actions have been implemented for the remaining banks
- They cover a wide range of weaknesses (regarding Internal Governance and Risk Management (including ICAAP and ILAAP), NPL, IT and data quality)

** Communicated via SREP decisions. On top of these qualitative measures , JSTs often apply various supervisory actions such as operational acts or follow-up letters, e.g. on IRRBB*

1.2. SREP – 2018 Outcome: Key risks (1/2)

SSM Risk Map highlights geopolitical uncertainties, NPL and cybercrime & IT disruptions as top three risks

- **Geopolitical uncertainties** and risks of **repricing in financial markets** have increased.
- Political uncertainty around **Brexit** continues and creates a number of challenges, including business and contract continuity risks.
- Euro area banks made significant progress with **NPL** reduction over the past years, however aggregate level of NPLs remains elevated by international standards.
- Ongoing search for yield along with still subdued profitability might result in an excessive risk taking and **future NPLs**.
- Progressing digitalisation requires banks to continue efforts to modernise their infrastructure to shield against **cybercrime and IT disruptions**.



Source: ECB and NCAs.

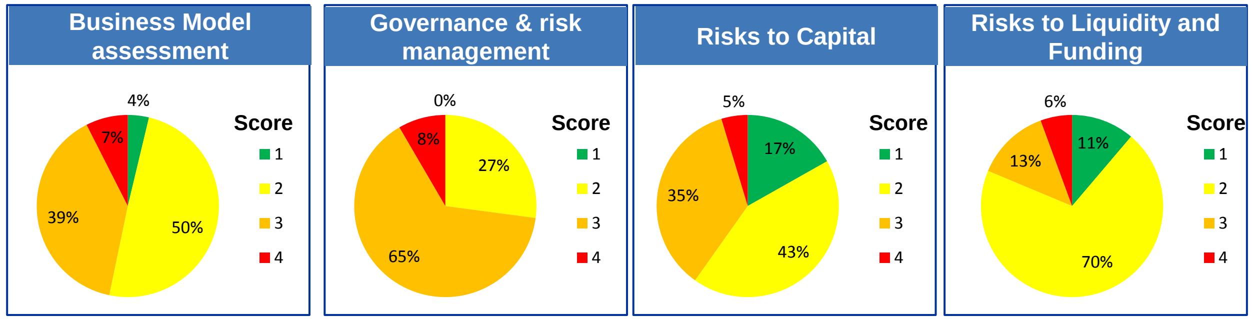
Note: Risks are not independent and might trigger or reinforce each other.

1.2. SREP – 2018 Outcome: Key risks (2/2)

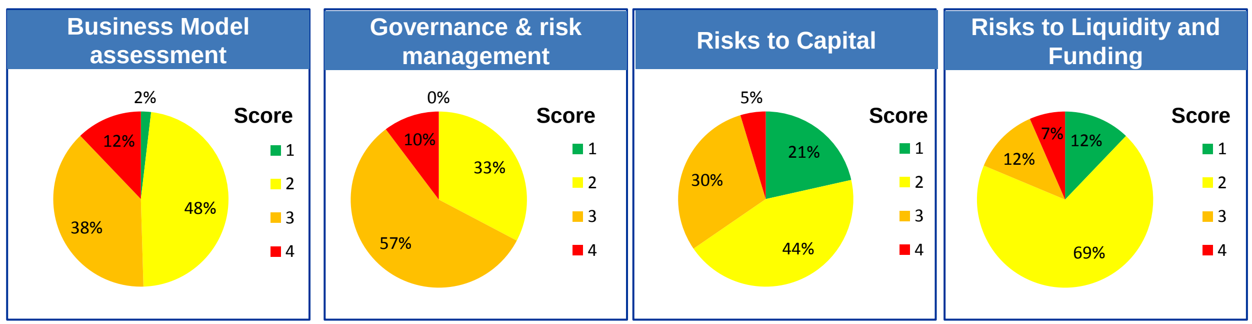
Evolution of SREP scores per element 2017 and 2018

- **Profitability remains an issue**
- **Many institutions face with challenges in risk management**
  Especially in risk infrastructure, data aggregation and reporting capabilities, and internal audit
- **In terms of Risks to Capital high Level of NPL is still a point of attention**
- **In terms of Risks to Liquidity and Funding, the risk management framework of a number of banks should continue to improve**

SREP Elements scores
SREP 2018



SREP Elements scores
SREP 2017



Notes:

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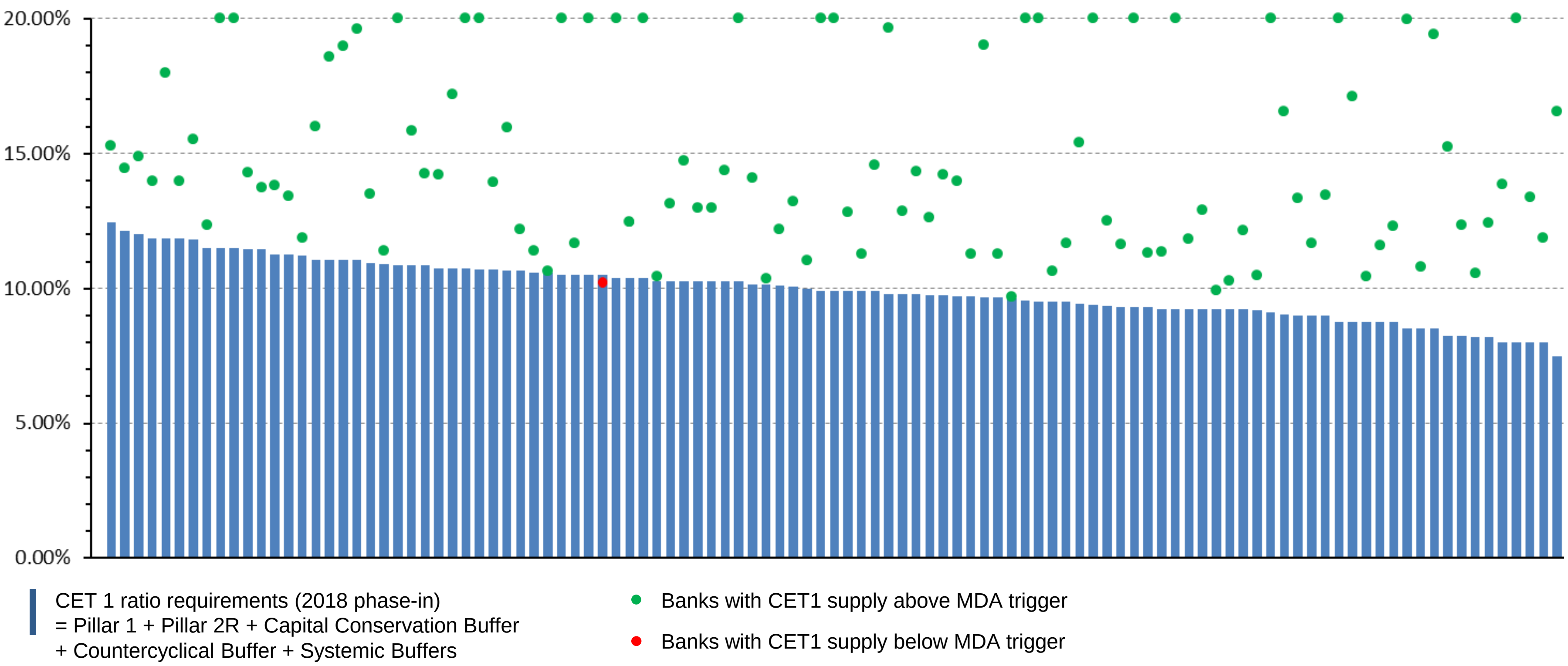
- *SREP 2017 values based on SREP 2017 decisions finalised as of 30 November 2017 and presented in the SSM SREP Methodology Booklet – 2017 edition*

Most significant institutions currently have capital levels above CET1 requirements and buffers*

Capital supply compared to MDA trigger



Notes:

* Based on capital supply in Q3 2018 (CET1 after covering shortfall of Pillar 1 AT1/T2 shortages).

- *SREP 2018 values based on 107 banks with SREP 2018 decisions finalised as of 31 January 2019.*
- *Updated with scale October 2019.*

For 2017 results please refer to the 2017 SREP Booklet on the web site: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.srep_methodology_booklet_2017.en.pdf

2. Legal Basis

The SSM SREP methodology implements Union law, EBA Guidelines and supervisory best practices

SREP in CRD IV – Article 97

...the competent authorities shall review the arrangements, strategies, processes and mechanisms implemented by the institutions and evaluate:

(a) risks to which the institutions are or might be exposed;

(b) risks that an institution poses to the financial system; and

(c) risks revealed by stress testing taking into account the nature, scale and complexity of an institution's activities.

RTS, ITS and EBA Guidelines

- *Implementing Technical Standards (ITS) on joint decisions on prudential requirements – 16 October 2015*
- *Regulatory Technical Standards (RTS) and ITS on the functioning of colleges of supervisors – 16 October 2015*
- *Guidelines on common procedures and methodologies for the SREP (EBA/GL/2014/13) as revised by EBA/GL/2018/03* – 19 July 2018*
- *Opinion of the European Banking Authority on the interaction of Pillar 1, Pillar 2 and combined buffer requirements and restrictions on distributions – 16 December 2015*

BCBS and FSB Principles

European Commission

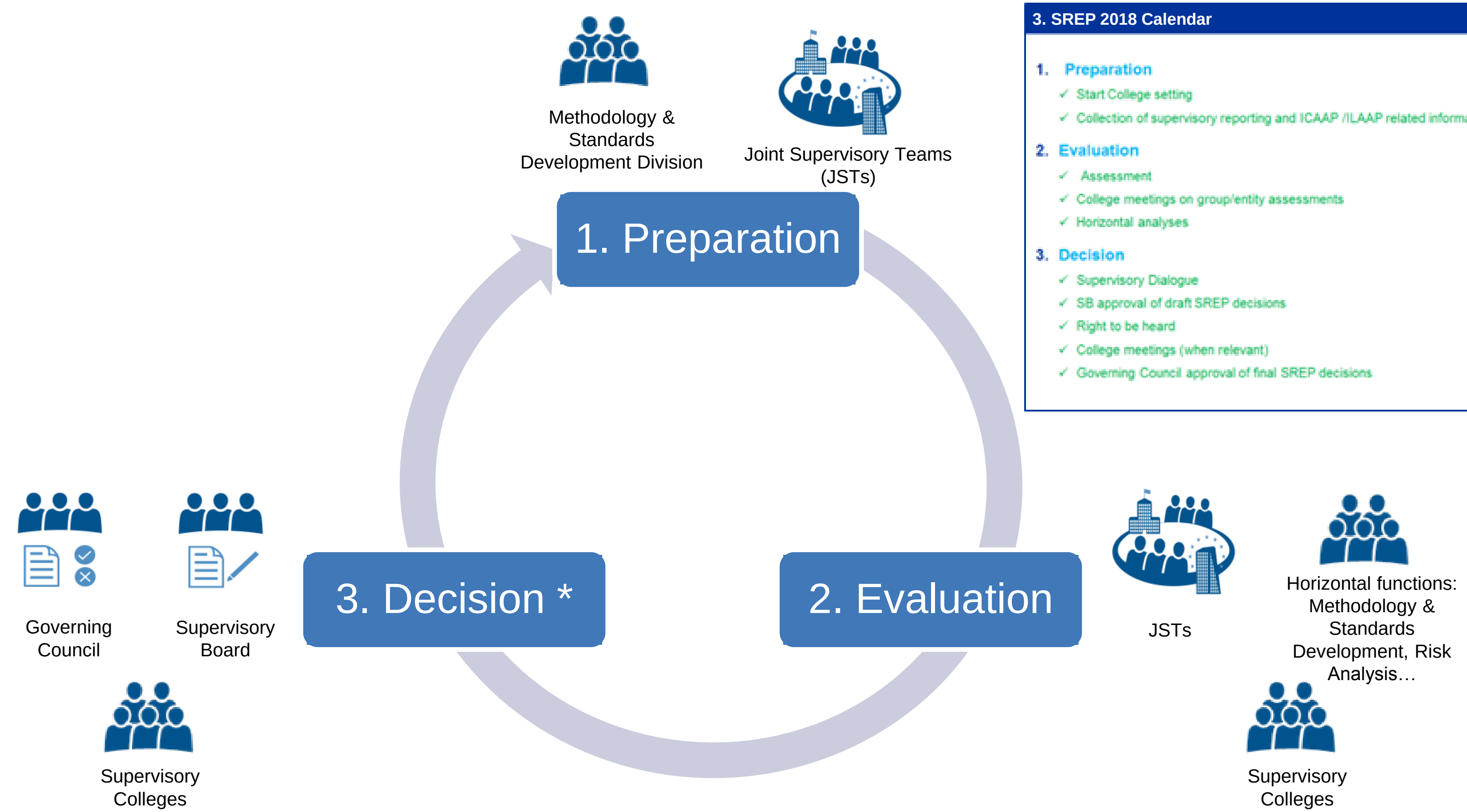
EUROPEAN BANKING AUTHORITY

BANK FOR INTERNATIONAL SETTLEMENTS

FSB FINANCIAL STABILITY BOARD

* For easy of reading, the references are made to the revised EBA Guidelines. However, the GL will be applied for SREP 2019

Supervisors at ECB and in 19 countries jointly prepared SREP decisions for SSM significant institutions through a common process



3. SREP 2018 Calendar

2018

1. **Preparation**
   - ✓ Start College setting
   - ✓ Collection of supervisory reporting and ICAAP /ILAAP related information
2. **Evaluation**
   - ✓ Assessment
   - ✓ College meetings on group/entity assessments
   - ✓ Horizontal analyses
3. **Decision**
   - ✓ Supervisory Dialogue
   - ✓ SB approval of draft SREP decisions
   - ✓ Right to be heard
   - ✓ College meetings (when relevant)
   - ✓ Governing Council approval of final SREP decisions

Q 1 · Q 2 · Q 3 · Q 4

** Note: decision finalised after right-to-be-heard procedure and Governing Council non-objection*

3. SREP – Overview (2/2)

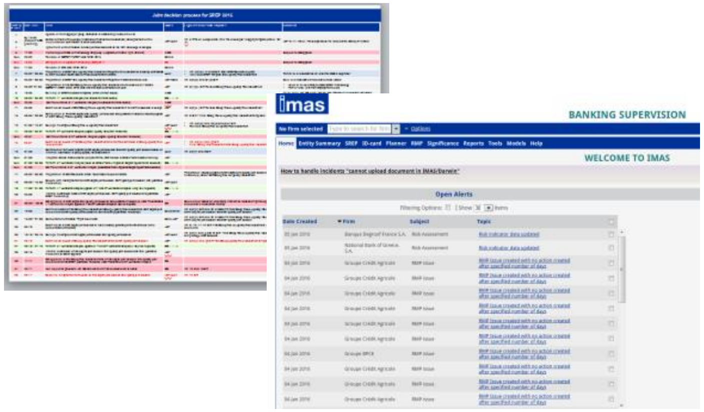
Underlying infrastructure built in less than one year

- common integrated IT system
- secured Information flow between all supervisors
- bank data quality controls at two levels: NCAs and ECB
- full use of NCA and ECB resources
- in-depth field testing of the methodology

Experienced supervisors from the ECB and NCAs:
- **19 Member States involved**
- **26 national authorities involved**

SREP managed as a key project

- common timeline
- steering by Senior Management
- project management, methodology development and horizontal consistency ensured by the ECB's DG MS IV
- full use of ECB and NCA expertise – especially in methodology development – through thematic workshops and dedicated Q&A sessions delivered by DG MS IV



Execution **fully in line** with plan
SREP completed in IT system

4.1. SREP – Methodology: common framework (1/3)

Building block approach in line with EBA Guidelines

SREP methodology at a glance: four key elements

SREP Decision

- Quantitative capital measures
- Quantitative liquidity measures
- Other supervisory measures

Overall SREP assessment – holistic approach

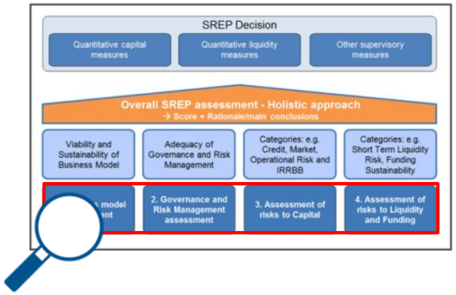
→ Score + rationale/main conclusions

Viability and sustainability of business model	Adequacy of governance and risk management	Categories: e.g. credit, market, operational risk and IRRBB	Categories: e.g. short-term liquidity risk, funding sustainability
1. Business model assessment	**2. Governance and risk management assessment**	**3. Assessment of risks to capital**	**4. Assessment of risks to liquidity and funding**

Feeds into the Supervisory Examination Programme (SEP)

4.1. SREP – Methodology: common framework (2/3)

All four SREP elements follow a common logic ensuring a sound risk assessment



Three phases in on-going risk assessment for each of four elements

Phase 1 Data gathering	Phase 2 Automated anchoring score	Phase 3 Supervisory judgement
Main sources: • quarterly ITS • STE reports	• Scoring risk level • Formal compliance checking of risk control	Adjustments based on additional factors and considering banks' specificities and complexity

Risk level (RL) vs. risk control (RC)

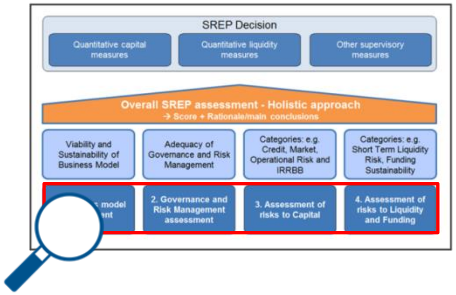
	1. Business model	2. Internal governance and RM	3. Assessment of capital risks	4. Assessment of liquidity risks
RL	✓	n/a	✓	✓
RC	n/a	✓	✓	✓

Combined score (RL + RC)

n/a: not applicable

The intensity of the supervisory engagement is decided based on banks' risk profile and size

4.1. SREP – Methodology: common framework (3/3)



Constrained judgement

- Fair flexibility on a four-grade scale where Phase 2 score can be improved by one notch and worsened by two notches based on supervisory judgement

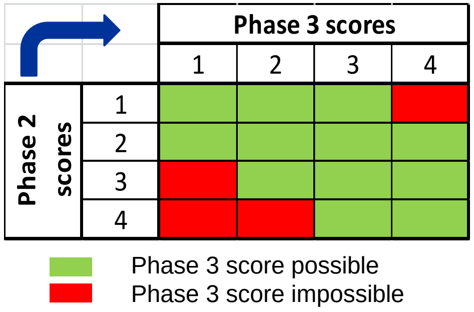
- Ensures the right balance between:
  - a common process, ensuring consistency across SSM banks and defining an anchor point
  - the necessary supervisory judgment, to take into account the specificities and complexity of an institution

- Adjustments go in both directions and are fully documented by the JST in the integrated IT system

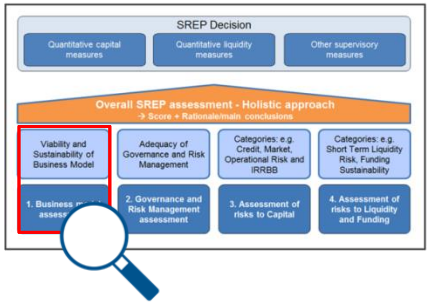
- Departing from constrained judgement not allowed as a rule

- Constrained judgment used ***effectively*** by JSTs for ***all*** risk categories ***in both directions*** – improving as well as worsening Phase 2 scores

Scale of the constrained judgement



Business model



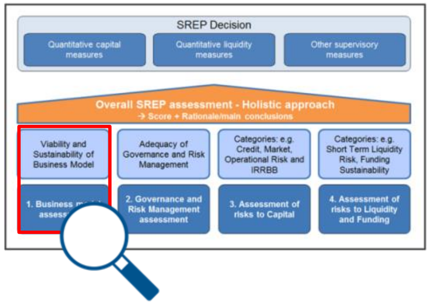
- ➢ Identification of the areas of focus (e.g. main activities)
- ➢ Assessment of the business environment
- ➢ Analysis of the forward-looking strategy and financial plans
- ➢ Assessment of the business model
  - viability (within one year)
  - sustainability (within three years)
  - sustainability over the cycle (more than three years)
- ➢ Assessment of the key vulnerabilities

In line with EBA SREP Guidelines, § 61-87

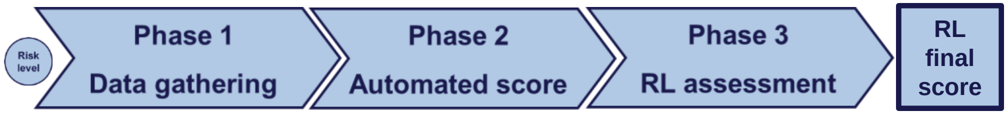
Examples of identified business models

- ➢ G-SII
- ➢ custodian
- ➢ diversified lender
- ➢ retail lender
- ➢ small universal bank
- ➢ specialised lender
- ➢ universal bank

4.2. SREP – Methodology: Element 1 (2/2)



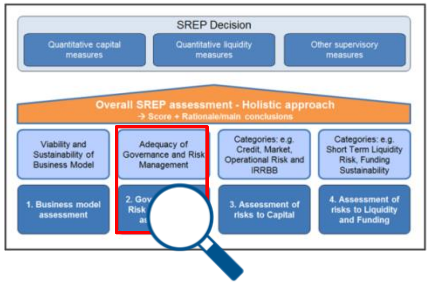
Business model



Phase 1	Phase 2	Phase 3
➢ Information gathering and understanding materiality of business areas	➢ Automated anchoring score based on indicators, such as ROA, cost-to-income ratio, etc.	➢ Comprehensive analysis ➢ Used to adjust Phase 2 score taking into consideration the bank's specificities

4.3. SREP – Methodology: Element 2 (1/2)

Internal governance and risk management



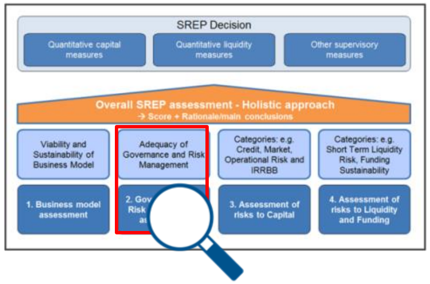
- Internal governance framework (including key control functions such as risk management, internal auditing and compliance)
- Risk management framework and risk culture
- Risk infrastructure, data and reporting
- Remuneration policies and practices

In line with EBA SREP Guidelines, § 88-136

Two examples of key questions

- Is there a compliance function in place that is hierarchically and functionally separate and operationally independent from any business activity responsibilities?
- Are there mechanisms in place to ensure that senior management can act in a timely manner to effectively manage, and where necessary mitigate, material adverse risk exposures, in particular those that are close to or exceed the approved risk appetite statement or risk limits?

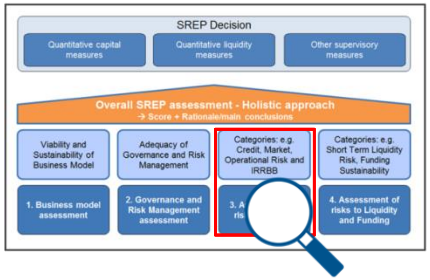
4.3. SREP – Methodology: Element 2 (2/2)



Internal governance and risk management

Phase 1	Phase 2	Phase 3
➢ **Information gathering e.g. through the thematic review on risk governance and risk appetite (RIGA)**	➢ **Check compliance with CRD provisions** ➢ **Specific analysis of, for example:** • organisational structure • internal audit • compliance • remuneration • risk appetite • risk infrastructure • reporting	➢ **Comprehensive analysis** ➢ **Adjustment of Phase 2 check taking into consideration the bank's specificities** ➢ **Use of findings from thematic review on risk governance and risk appetite**

4.4. SREP – Methodology: Element 3 Overview



Risks to capital

Three different perspectives ("3 Blocks")

Block 1 Supervisory perspective	Block 2 Bank's perspective	Block 3 Forward-looking perspective
Four risk categories: credit risk, market risk, operational risk, IRRBB ✓ Information gathering ✓ Anchoring scores on risk categories ✓ Comprehensive analysis	✓ Information gathering: e.g. ICAAP reports ✓ Anchoring assessment: in line with the EBA Guidelines* ✓ Comprehensive analysis	✓ Information gathering: bank internal stress tests ✓ Anchoring assessment: supervisory stress tests ✓ Comprehensive analysis

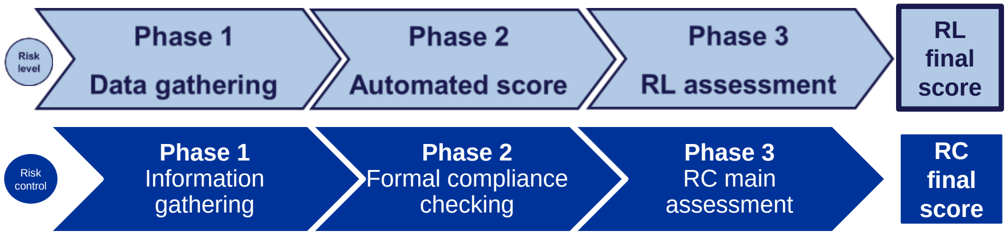
For SREP 2018

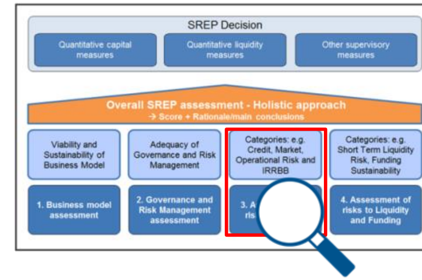
- ✓ Supervisory stress tests complemented the SREP tools
- ✓ ICAAP submission still very heterogeneous

See also EBA SREP Guidelines

** For instance using SSM proxies which implement the concept of supervisory benchmarks set out in the EBA Guidelines on SREP (§ 357)*

Risks to capital – Block 1





Deep-dive into a given risk factor: **credit risk** (example)

Phase 1

- **Risk level**
  - subset of pre-defined indicators calculated from ITS and STE data
- **Risk control**
  - information gathering

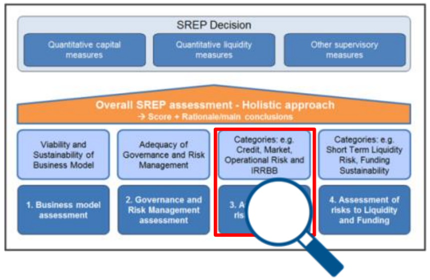
Phase 2

- **Risk level**
  - automated score given through different dimensions, such as:
    - quality (e.g. non-performing loans ratio)
    - coverage (e.g. provisions)
- **Risk control**
  - compliance checks relating to internal governance, risk appetite, risk management and internal audit of credit risk in particular

Phase 3

- **Risk level**
  - **comprehensive analysis, e.g.:**
    - current risk position and trend
    - forward-looking view
    - peer comparison
  - **in-depth analysis of various sub-categories, e.g.:**
    - non-financial corporate portfolios
    - household portfolios
- **Risk control**
  - deeper analysis, notably thanks to dedicated meetings with the bank

4.4.2. SREP – Methodology: Element 3 Block 2 (1/3)



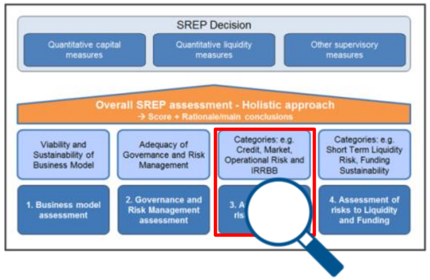
Risks to capital – Block 2

- ➢ The SSM multi-year plan on the ICAAP and the ILAAP has led to publication of the final "*ECB Guide* to the internal capital adequacy assessment process (ICAAP)*", which was published on 9 November 2018.
- ➢ ICAAP reliability assessment

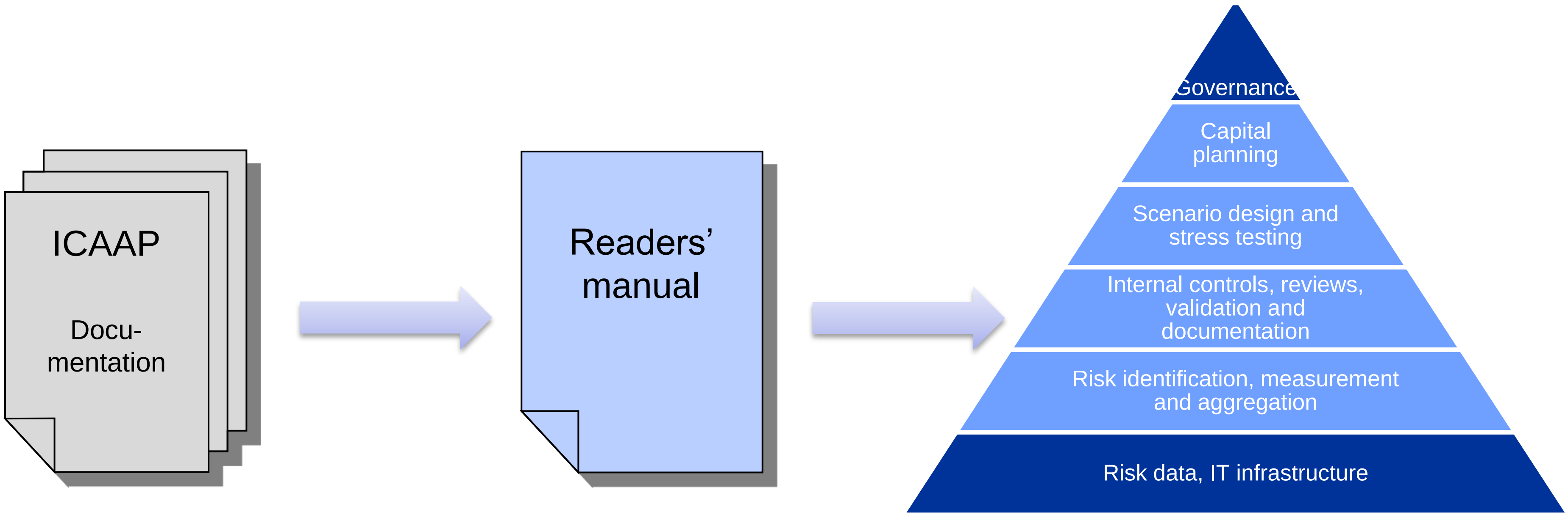
ECB ICAAP expectations

- Content as described in EBA Guidelines on ICAAP and ILAAP information
- Internal documentation together with a "readers' manual"
- Risk data template
- Reconciliation between Pillar 1 and ICAAP figures
- Conclusions in form of capital adequacy statements supported by analysis of ICAAP outcomes and signed by management body

* *The expectations: applied in 2018 - see* https://www.bankingsupervision.europa.eu/ecb/pub/pdf/170220letter_nouy.en.pdf. *The ICAAP Guide and other relevant documents - see* https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/icaap_ilaap.en.html



ICAAP – Qualitative assessment



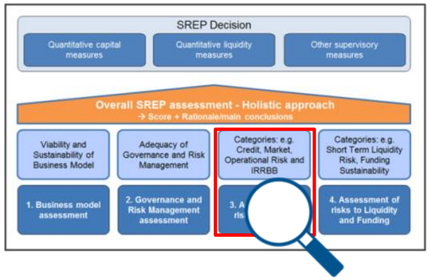
Bank-internal documents as set out in EBA GL*

Mapped to EBA GL* structure to facilitate JST access to bank-internal information

JST assessment

→ Decision on ICAAP reliability

* Guidelines on ICAAP and ILAAP information collected for SREP purposes (EBA/GL/2016/10)



ICAAP – Quantitative assessment

ICAAP risk data

Risk definition and ICAAP estimates according to banks' own risk taxonomy

Mapping of internal risk categories to SSM risk map and information on internal capital

Please provide the information and data only as internally available. Do not change or produce internal numbers only for filling column 1.5 of the template. If the cell is not applicable to the institution, please complete as "na" for not applicable. Only white cells can be filled in.

SSM Risk Map		ICAAP information				
1.1 Risk categories	**1.2 Risk sub-category** (thereof: ...)	**1.3 Name of internal risk category as currently covered in ICAAP** (please use categories and sub-categories as available internally and map them to the given risk categories and sub-categories as possible; for risk categories or sub-categories not covered in the SSM risk map please use the rows named "other")	**1.4 Short description of internal Risk category** (including sub-categories that may be included)	**1.5 ICAAP estimate - internal capital needed (ly view) in EUR** (please only provide numbers as internally available)	**1.6 Have there been material changes in scope or quantification methodology for this risk category / sub-category since the last reporting date? (y/n)**	**1.7 Pl link t docu quant meth** the do of the in the a packag
Credit risk						
	credit risk (please use this row in case several sub-categories are quantified together, i.e. no separate estimates are available)					
	default risk					
	credit concentration risk					
	FX lending risk					
	Securitisation risk					
	Country risk (includes transfer & other risks)					
	settlement and delivery risk					
	residual risk					
	migration risk					

Proxies*

- Give rough quantification of capital demand
- Allow JSTs to put institutions' estimates in perspective and underpin supervisory dialogue
- Do not provide a single risk figure, but indicative ranges for JSTs to derive risk-by-risk capital figures based on their judgement

** Concentration risk (single name and sectoral), market risk, credit risk, IRRBB*

Assessment

Internal capital-adjusted figure (capital requirements)

- Pillar 1 as floor
- No inter-risk diversification

Dialogue with banks

4.4.3. SREP – Methodology: Element 3 Block 3 (1/4)

ECB/SSM performed two supervisory stress test exercises for significant institutions (SIs) in 2018

EU-wide EBA stress test

- **33** SSM SIs (“EBA banks”)[1,2]
- **4** Greek banks underwent the same stress test under the EBA scenario and methodology
- **Public disclosure** of bank-specific results
- EU-wide exercise under **EBA coordination**, in cooperation with ESRB, ECB and NCAs

SSM SREP stress test

- **54** other SSM SIs (“SREP banks”)[1]
- Under **ECB/SSM coordination**
- **Public disclosure** of aggregate results
- **EBA methodology applies** with reduced complexity (i.e. proportionality)

Objectives

- Assess the **resilience of financial institutions** to adverse market developments.
- **Contribute to the overall Supervisory Review and Evaluation Process (SREP)** to ensure institutions’ capital and liquidity adequacy, as well as sound risk coverage and internal processes.
- Ensure a **consistent treatment** of all SSM SIs.

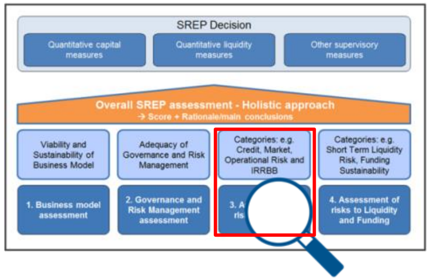
The results of both exercises fed into the SSM SREP

[1] Combined number of SIs included in EBA and SSM SREP stress test samples does not equal total number of SIs under SSM supervision, as some exceptions apply (e.g. banks that were subject to a comprehensive assessment in 2017 or will be in 2018; or SIs that are subsidiaries of other SSM SIs, already covered at the highest level of consolidation).

[2] The results for the EBA and total sample shown on the following pages include the 33 SSM SIs but not the results for the four Greek banks, whose results were published on 5 May 2018

4.4.3. SREP – Methodology: Element 3 Block 3 (2/4)

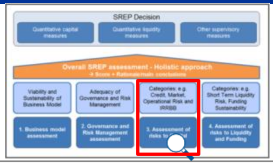
Risks to capital



As communicated by the EBA on 1 July 2016, SREP decisions since 2016 are composed of a **Pillar 2 Requirement (P2R)** and **Pillar 2 Guidance (P2G)**

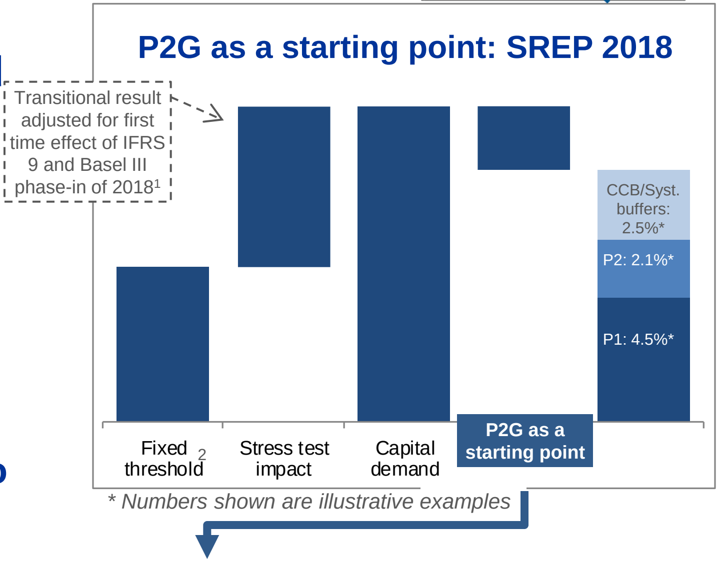
- Banks are **expected to meet the P2G**, which is set **above the level of binding capital** (minimum and additional) requirements and on top of the combined buffers
- If a bank **will not meet its P2G**, this will **not result in automatic action of the supervisor** and will **not be used to determine the MDA trigger**, but will be used in fine-tuned measures based on the individual situation of the bank
- In order to assess the final measures taken, the **Supervisory Board will assess every case of a bank not meeting its P2G**

4.4.3. SREP – Methodology: Element 3 Block 3 (3/4)

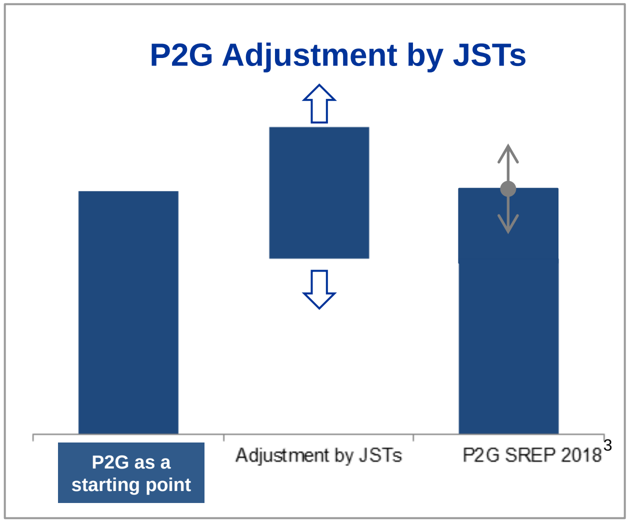


Continuity with the 2016 methodology

- **Qualitative outcome** of the Stress Test are **included in the determination of the P2R**, especially in the element of risk governance;
- The **stress test is not a pass/fail exercise**
- When setting P2G different elements are taken into account in a **holistic view**, for example:
  - The starting point for setting the P2G is in general the **depletion of capital** in the hypothetical **adverse scenario (quantitative outcome, see top chart on the right)**;
  - JST take the **specific risk profile** of the individual institution and its **sensitivity towards the stress scenarios into account (see bottom chart on the right);**
  - **Also, interim changes in its risk profile** since the cut-off date (31.12.2017) and **measures taken by the bank** to mitigate risk sensitivities such as relevant sale of assets etc. are considered

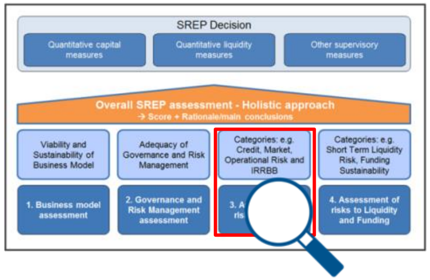


* Numbers shown are illustrative examples



[1] As these effects cannot happen in the future again
[2] CET1 ratio of 5.5% + G-SII Buffer if applicable
[3] Irrespective of the phasing-in of the CCB, banks should also expect to have positive P2G in the future.

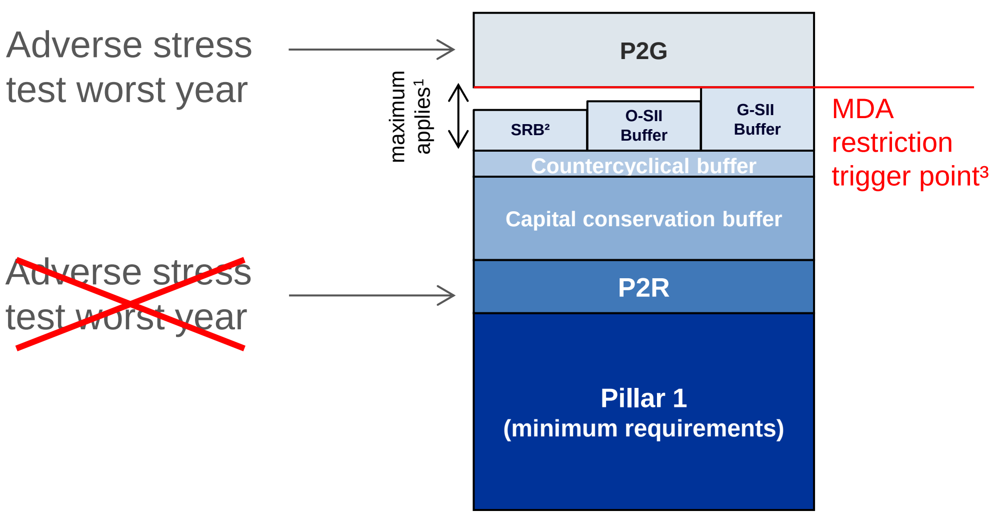
4.4.3. SREP – Methodology: Element 3 Block 3 (4/4)



In years of large EBA stress test exercise (2016 and 2018), implement adverse stress test results for the worst year only in P2G

Adverse stress test results for the worst year only in P2G

** Scale not meaningful*



Approach used in years of EBA stress test exercises
(so it was used in 2016 and 2018)

1 Most common case; specific calculation may occur depending on implementation of CRD IV Article 131(15) by Member State

2 Systemic risk buffer

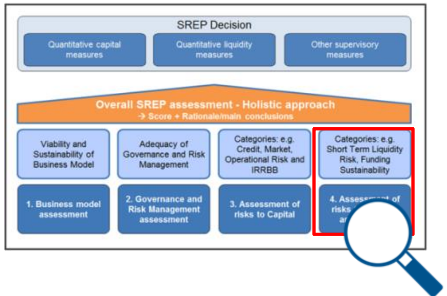
3 The ECB draws attention to the following:

- Under Regulation (EU) No 596/2014 of the European Parliament and of the Council (MAR), those institutions that have publicly traded securities are expected to evaluate whether Pillar 2 requirements meet the criteria of inside information and should be publicly disclosed
- The EBA opinion of 16 December 2015 which says "Competent Authorities should consider using the provisions of Article 438 (b) of the CRR to require institutions to disclose MDA-relevant capital requirements […], or should at least not prevent or dissuade any institution from disclosing this information"

In the light of the above, the ECB neither prevents nor dissuades institutions from disclosing MDA-relevant capital requirements.

Note: Implementation of EBA opinion on MDA and 1 July 2016 press release

4.5. SREP – Methodology: Element 4 Overview



Risks to liquidity

Three different perspectives (“3 Blocks”)

Block 1 Supervisory perspective

Short-term liquidity, funding sustainability

- ✓ Information gathering
- ✓ Anchoring scores on short-term liquidity and funding sustainability risks
- ✓ Comprehensive analysis

Block 2 Bank’s perspective

- ✓ Information gathering: e.g. ILAAP reports
- ✓ Anchoring assessment: challenge the institution’s internal estimates
- ✓ Comprehensive analysis: e.g. of ILAAP reliability

Block 3 Forward-looking perspective

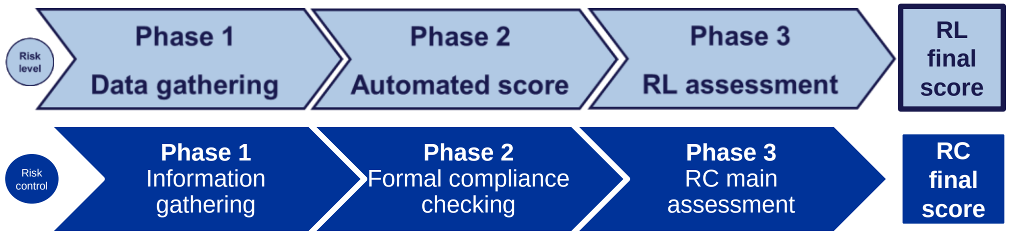
- ✓ Information gathering: bank internal stress tests
- ✓ Anchoring assessment: supervisory stress tests
- ✓ Assessment of supervisory stress test results and of bank’s internal stress tests

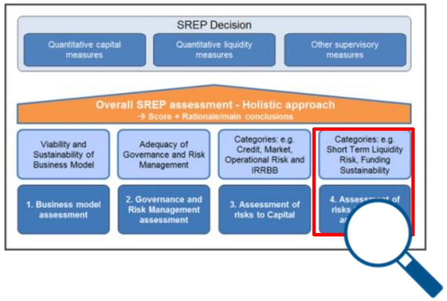
For SREP 2018

- ✓ Strongest weight on Block 1
- ✓ Block 2 – a lot of heterogeneity in ILAAP
- ✓ Block 3 not yet fully fledged

In line with EBA SREP Guidelines, § 409-492

Risks to liquidity – Block 1





Deep-dive into a given risk factor: **short-term liquidity** (example)

Phase 1

- **Risk level**
  - subset of pre-defined indicators based on ITS and STE data
- **Risk control**
  - information gathering

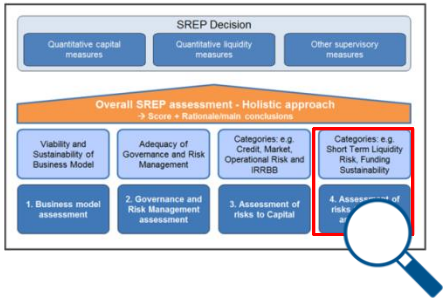
Phase 2

- **Risk level**
  - automated score given through several indicators, such as:
    - liquidity coverage ratio
    - short-term funding/total funding
- **Risk control**
  - compliance checks relating to internal governance, risk appetite, risk management and internal audit

Phase 3

- **Risk level**
  - **deeper analysis:**
    - short-term wholesale funding risk
    - intraday risk
    - quality of liquidity buffers
    - structural funding mismatch
- **Risk control**
  - deeper analysis, notably thanks to dedicated meetings with the bank

4.5.2. SREP – Methodology: Element 4 Block 2 and 3 (1/2)



Risks to liquidity – Block 2 and 3

- The SSM multi-year plan on the ICAAP and the ILAAP has led to publication of the final "*ECB Guide* to the internal liquidity adequacy assessment process (ILAAP)"*, which was published on 9 November 2018.

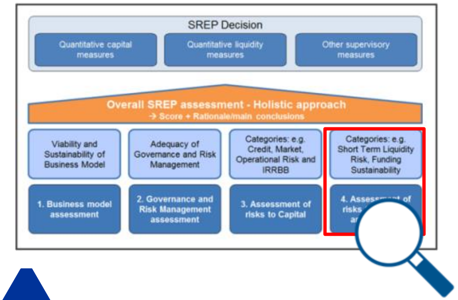
- ILAAP reliability assessment

ECB ILAAP expectations

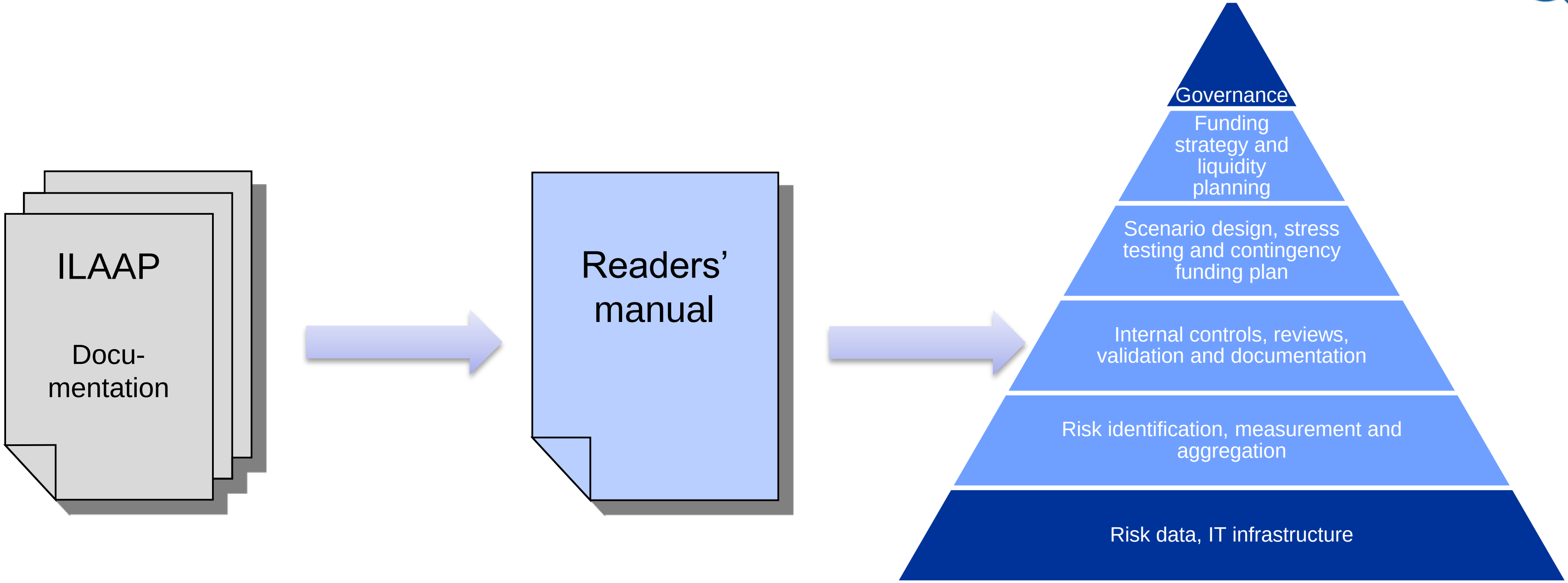
- Content as described in EBA Guidelines
- Internal documentation together with a "readers' manual"
- Conclusions in the form of liquidity adequacy statements supported by analysis of ILAAP outcomes and signed by management body

** The expectations: applied in 2018 - see https://www.bankingsupervision.europa.eu/ecb/pub/pdf/170220letter_nouy.en.pdf. The ILAAP Guide and other relevant documents - see* https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/icaap_ilaap.en.html

4.5.2. SREP – Methodology: Element 4 Block 2 and 3 (2/2)



ILAAP – Qualitative assessment



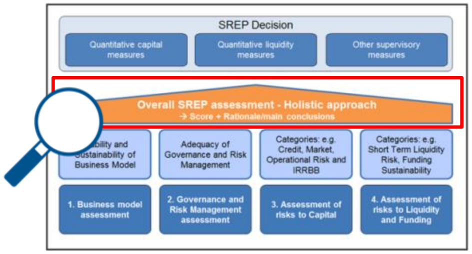
Bank-internal documents as set out in EBA GL*

Mapped to EBA GL* structure to facilitate JST access to bank-internal information

JST assessment

→ Decision on ILAAP reliability

** Guidelines on ICAAP and ILAAP information collected for SREP purposes (EBA/GL/2016/10)*



The overall SREP assessment (holistic view)

- Provides synthetic overview of an institution's risk profile:
  - based on the assessment of all four elements (not the simple sum)
  - as a starting point, the four SREP elements are considered equally important
- Takes into account:
  - the institution's capital/liquidity planning to ensure a sound trajectory towards the full implementation of CRD IV/CRR
  - peer comparisons
  - the macro environment under which the institution operates

In line with the EBA SREP Guidelines (table 13, pp. 184 and 185), the overall SREP score reflects the supervisor's overall assessment of the viability of the institution: higher scores reflect an increased risk to the viability of the institution stemming from one or several features of its risk profile, including its business model, its internal governance framework, and individual risks to its solvency or liquidity position

An institution's risk profile is necessarily **multi-faceted**, and many risk factors are **inter-related**

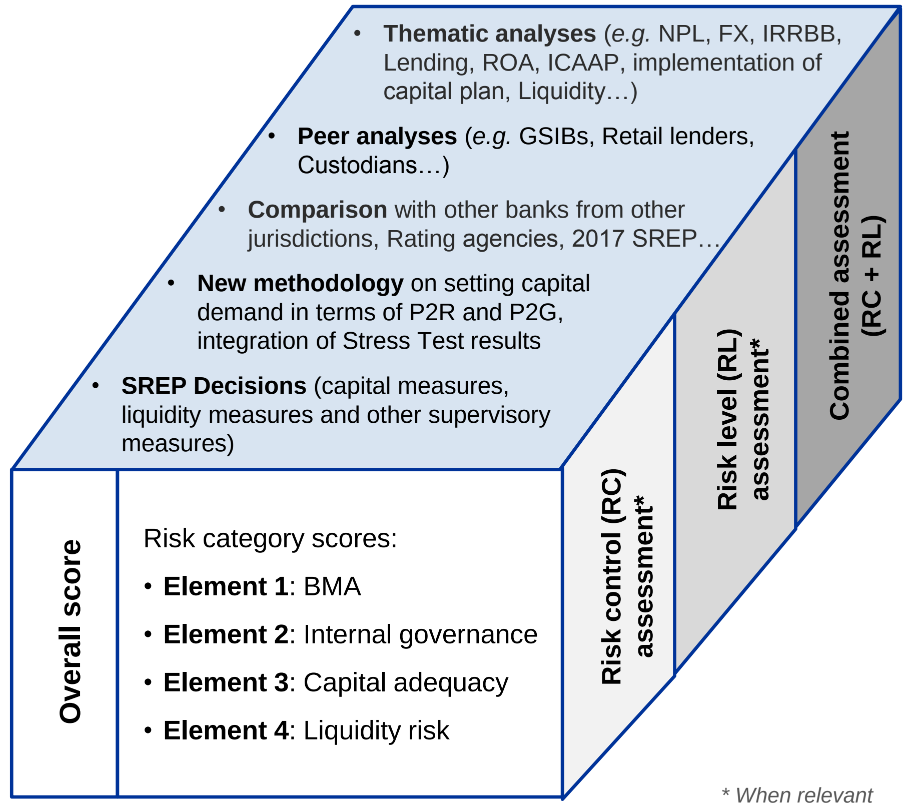
4.7. SREP – Methodology: Horizontal analyses

Consistent and fair treatment

➢ **High number of horizontal analyses** performed when preparing assessments and decisions in order to provide:

- additional perspectives to JSTs
- support for policy discussions and the decision-making process

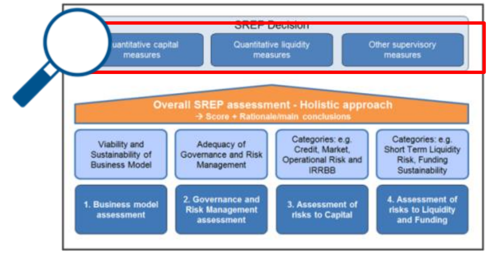
SREP Horizontal Analysis: multi-dimension analyses



** When relevant*

Extensive peer comparisons and transversal analyses were possible on a wide scale, allowing all institutions to be assessed in a **consistent manner** and thus promoting a **more integrated single banking market**.

4.8. SREP – Methodology: SREP decision (1/5)



The overall SREP is the basis for assessing capital and liquidity adequacy and for taking any necessary supervisory measures to address concerns

- SREP decisions by the Supervisory Board (followed by Governing Council non-objection procedure)
- SREP decisions may include:

Own fund requirements

- total SREP Capital Requirement (TSCR) composed of Pillar 1 minimum own fund requirements (8%[1]) and additional own fund requirements (P2R[2])
- combined buffer requirements (CBR[2])

Institution-specific quantitative liquidity requirements

- LCR higher than the regulatory minimum
- higher survival periods
- national measures

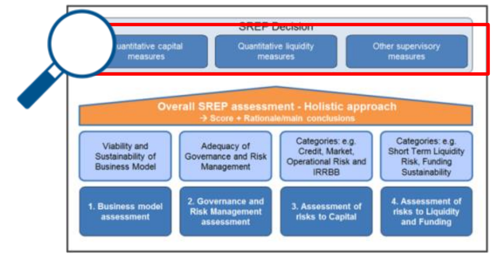
Other, qualitative supervisory measures

- additional supervisory measures stemming from Article 16(2) of the SSM Regulation include, for example, the restriction or limitation of business, the requirement to reduce risks, the restriction or prior approval to distribute dividends and the imposition of additional or more frequent reporting obligations

- SREP communication also includes P2G expressed as CET1 ratio add-on

[1] At least 56.25% in CET1
[2] CET 1 only

SREP decision – capital measures

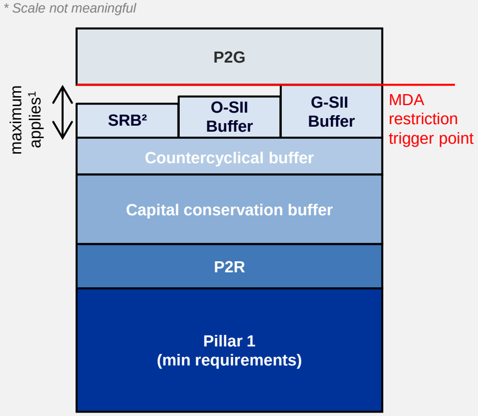


No changes

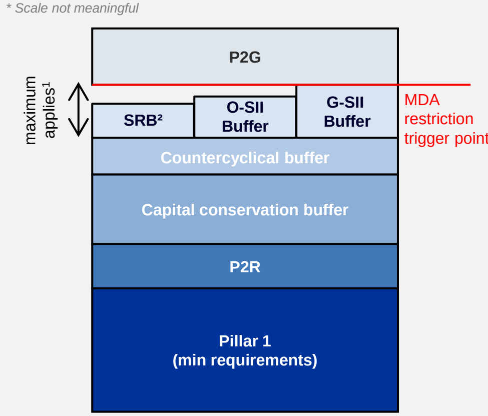
	SREP 2017	SREP 2018
Pillar 2	• Pillar 2 Requirements (P2R) (MDA relevant) • Pillar 2 Guidance (P2G) (not MDA relevant)	• Pillar 2 Requirements (P2R) (MDA relevant) • Pillar 2 Guidance (P2G) (not MDA relevant)
Capital Conservation Buffer (CCB)	• No overlap with Pillar 2	• No overlap with Pillar 2

CET1 Stacking order

SREP 2017



SREP 2018



	SREP 2017	SREP 2018
Capital composition	• P2R & P2G: 100% CET1	• P2R & P2G: 100% CET1
SREP decision	• P2R: CET1 ratio and Total SREP Capital Requirement (TSCR)[3] • P2G: CET1 ratio add-on	• P2R: CET1 ratio and Total SREP Capital Requirement (TSCR)[3] • P2G: CET1 ratio add-on

1 Most common case; specific calculation may occur depending on implementation of CRD IV Article 131(15) by Member State
2 Systemic risk buffer
3 If there is a shortfall of Pillar 1 (AT1/T2) requirement, this has to be covered by additional CET1 in P2R (but, for 2017 and in 2018, not in P2G). In view of the ongoing work of the EBA, it is expected that this stance will be amended. Please see also next slide.

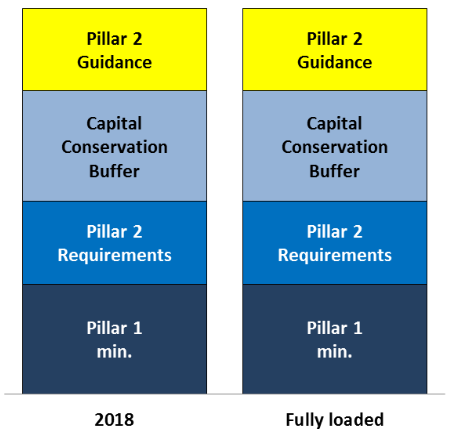
Note: Implementation of EBA opinion on MDA and 1 July 2016 press release

4.8. SREP – Methodology: SREP decision and capital planning (3/5)

All things being equal, the current capital demand in the system also provides an indication for the future

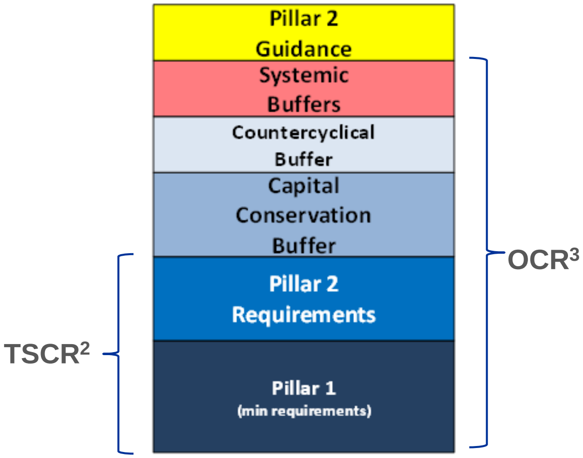
- All other things being equal, the capital demand can be expected to remain broadly stable[1]
- If a credit institution operates or expects to operate below Pillar 2 Guidance it should immediately contact its joint supervisory team
- Banks also need to take into account the systemic buffers (G-SII, O-SII and systemic risk buffers) and the countercyclical buffer that are part of the capital stack
- The ECB considers that those components of the own funds requirements which, pursuant to Article 92(1) of Regulation (EU) No 575/2013, are not required to be met with Common Equity Tier 1 [i.e. CET1 held by banks used to meet Pillar 1 AT1/T2 requirements] can be counted also towards the Pillar 2 capital guidance to the extent that these components are, in fact, met in the form of Common Equity Tier 1. In view of the ongoing work of the EBA, it is expected that this stance will be amended[4]

SREP CET1 demand[1]



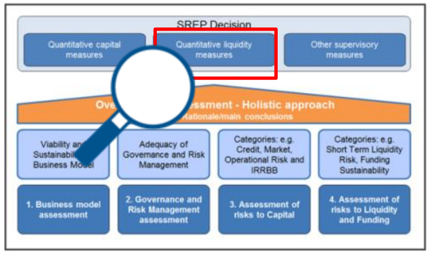
* Scale not meaningful

Capital Stack



* Scale not meaningful

[1] *Capital demand means Pillar 1 plus P2R, CCB and P2G. Irrespective of the phasing-in of the CCB, banks should also expect to have positive P2G in the future.*
[2] *TSCR: total SREP capital requirements*
[3] *OCR: overall capital requirements*
[4] *EBA SREP GLs (EBA/GL/2014/13) as revised by EBA/GL/2018/03, §399: Competent authorities should also communicate to the institutions that own funds held for the purposes of P2G cannot be used to meet any other regulatory requirements (Pillar 1, P2R or the combined buffer requirements), and therefore cannot be used twice: to cover P2G and to cover for any shortfall of AT1 or T2 instruments to cover TSCR revealed by the outcome of the stress test."*

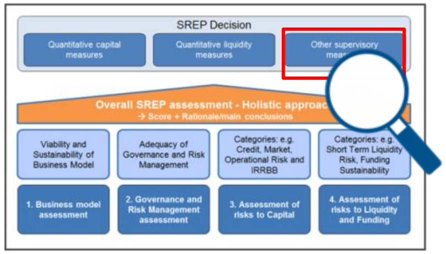


SREP decision – liquidity measures

- LCR requirements came into force on 1 October 2015
- Examples of specific liquidity measures include:
  - LCR higher than the regulatory minimum
  - specific minimum survival period
  - minimum amount of liquid assets

4.8. SREP – Methodology: SREP decision (5/5)

SREP decision – other supervisory measures

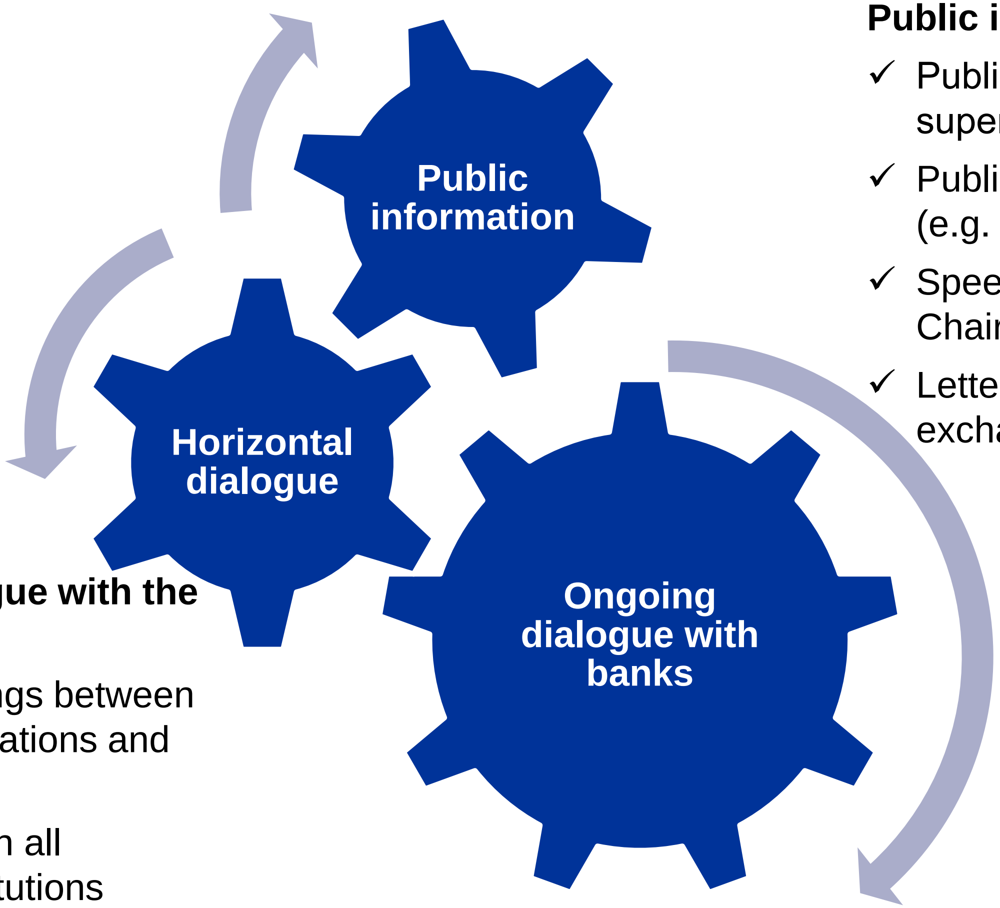


Article 16(2) of the SSM Regulation

The ECB has the following powers:

(a) to require institutions to hold own funds in excess of the capital requirements
(b) to require the reinforcement of the arrangements, processes, mechanisms and strategies
(c) to require institutions to present a plan to restore compliance with supervisory requirements and set a deadline for its implementation (…)
(d) to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements
(e) to restrict or limit the business, operations or network of institutions or to request the divestment of activities that pose excessive risks to the soundness of an institution
(f) to require the reduction of the risk inherent in the activities, products and systems of institutions
(g) to require institutions to limit variable remuneration (…)
(h) to require institutions to use net profits to strengthen own funds
(i) to restrict or prohibit distributions to shareholders, members or holders of Additional Tier 1 instruments where the prohibition does not constitute an event of default of the institution
(j) to impose additional or more frequent reporting requirements (…)
(k) to impose specific liquidity requirements, including restrictions on maturity mismatches between assets and liabilities
(l) to require additional disclosures
(m) to remove at any time members from the management body of credit institutions

4.9. SREP – Methodology: SREP communication and transparency (1/3)



Public information

- ✓ Published "Guide to banking supervision"
- ✓ Publication of ECB stances (e.g. on MDA, remuneration, etc.)
- ✓ Speeches by Supervisory Board Chair and Vice-Chair
- ✓ Letters to MEPs, hearings and exchange of views with MEPs

Horizontal dialogue with the industry

- ✓ Regular meetings between banking associations and DG MS IV
- ✓ Workshops with all significant institutions

Ongoing dialogue with banks

- ✓ Supervisory Examination Programme
- ✓ Meetings between banks and JSTs (especially ahead of SREP decision – supervisory dialogue)
- ✓ SREP decisions (right to be heard)

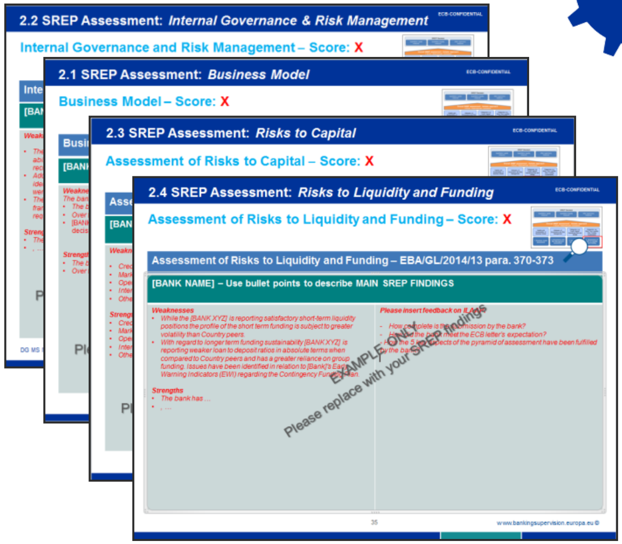
Banks have:

- ✓ the necessary clarity to understand the methodology and risk assessment, and to take the measures required to improve
- ✓ the necessary certainty to perform their capital planning

4.9. SREP – Methodology: SREP communication and transparency (2/3)

Ongoing dialogue with banks

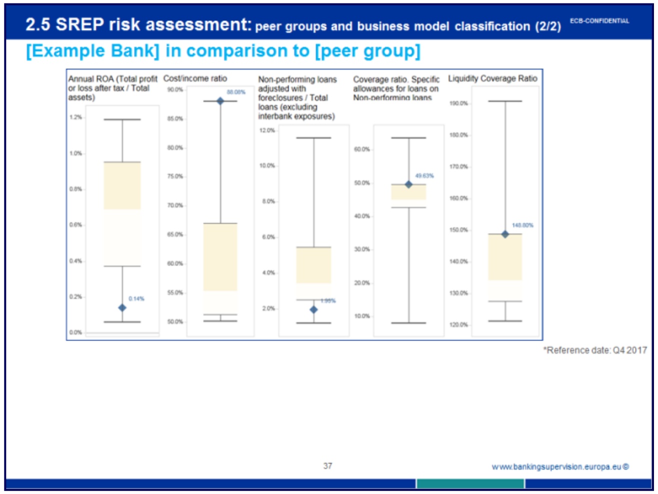
Enhanced ongoing dialogue with banks



SREP communication pack

Shared with all significant institutions to ensure consistency and quality across the euro area:

- indication of the key drivers of the possible decisions (e.g. capital, liquidity and other qualitative specific measures)
- review of the stress test outcomes
- peer comparison of key indicators



4.9. SREP – Methodology: SREP communication and transparency (3/3)

Enriched public communication and horizontal dialogue

During the 2018 SREP cycle the SSM increased the transparency of the process as well as that towards new developments and priorities:

- December 2017: publication of SSM supervisory priorities 2018
- March 2018: ECB launches public consultation on draft guides for banks on their capital and liquidity management which led to the final publication on 9 November 2018
- November 2018: Update on 2018 stress test exercises and 2019 supervisory priorities
- February 2019: SSM-wide stress test 2018 final results
- Throughout the cycle, many meetings with banking associations

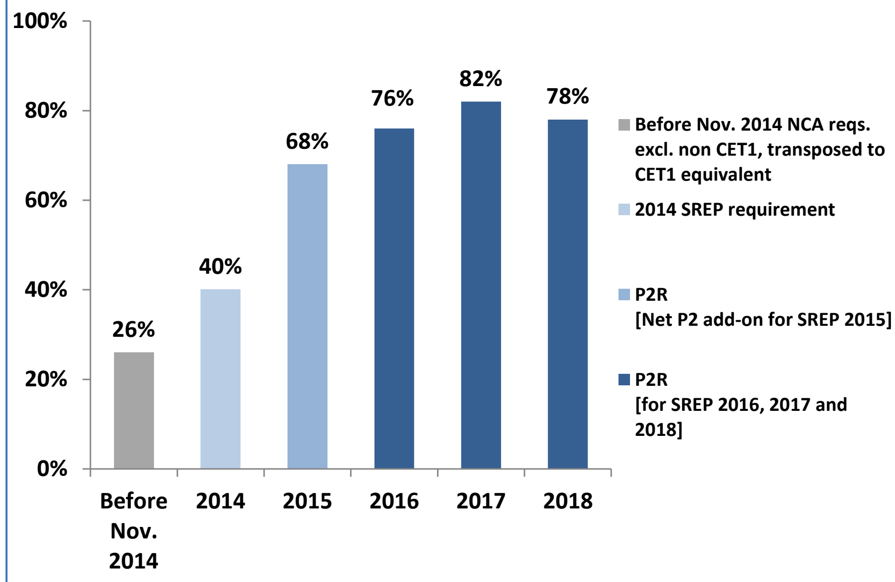
ECB Banking Supervision: SSM supervisory priorities 2018

The supervisory priorities set out focus areas for supervision in 2018. Taking into account the relevant developments in the economic, regulatory and supervisory environment, the supervisory priorities build on an assessment of the key challenges faced by supervised banks.

The fourth SREP cycle continues to perform efficiently and promote a level-playing field

- **Significant harmonisation**
  - constrained judgment was used effectively
  - Strong correlation between risk profile of institutions and capital requirements is fully in line with SSM supervisory expectations.
- **Continuous improvement:**
  - The SREP methodology will continue to evolve so as to adequately monitor banking activities and risks in a forward-looking manner

Correlation between P2R and overall SREP scores



Based on banks with a final SREP 2018 decision as of 31 January 2019

Note:
Correlation cannot reach 100% due to the facts that risks can also be addressed by other measures e.g. qualitative measures