



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

SSM LSI SREP Methodology

2019 edition

2019 update

Methodology developments and implementation in the SSM

- All NCAs started to implement the LSI SREP methodology in 2018 and will continue to roll it out progressively to all less significant institutions (LSIs) by 2020 at the latest.
- From 2019:
 - ✓ the parallel run of the liquidity assessment methodology will no longer take place, as the SSM LSI SREP methodology will be applied more consistently.
 - ✓ NCAs are expected to implement the Pillar 2 Guidance (P2G), in line with the revised EBA Guidelines on SREP.
- In general, in coming years supervisors will also gradually put more **focus on IT risk** in their SREP assessments, consistent with applicable international supervisory standards and in line with SSM supervisory priorities.
- The ECB and NCAs will continue to develop and maintain a **fully-fledged training programme** for supervisors in the SSM.

External communication

- In 2018 the ECB **met with European banking associations** in order to present the general framework for the LSI SREP methodology, to convey supervisory expectations and to collect feedback from the industry. In future the ECB will continue to have regular exchanges of views with the industry on the LSI SREP methodology.
- ECB Banking Supervision published the LSI SREP booklet on its website and shared an article on the LSI SREP methodology in its newsletter.

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Background of the SSM LSI SREP

Background

- National competent authorities (NCAs) have the responsibility, as direct supervisors, to decide on capital, liquidity and qualitative measures for the less significant institutions (LSIs).
- Since 2015, the ECB and the NCAs have been working together to develop a common SREP methodology for LSIs, based on the EBA SREP Guidelines and building on the significant institutions (SIs) methodology and national SREP methodologies in place.
- NCAs started to implement the harmonised methodology in a staggered approach in 2018, and will roll it out to all LSIs by 2020 at latest.

- The SSM LSI SREP is an **ongoing process** and the methodology will continue to evolve in the future.

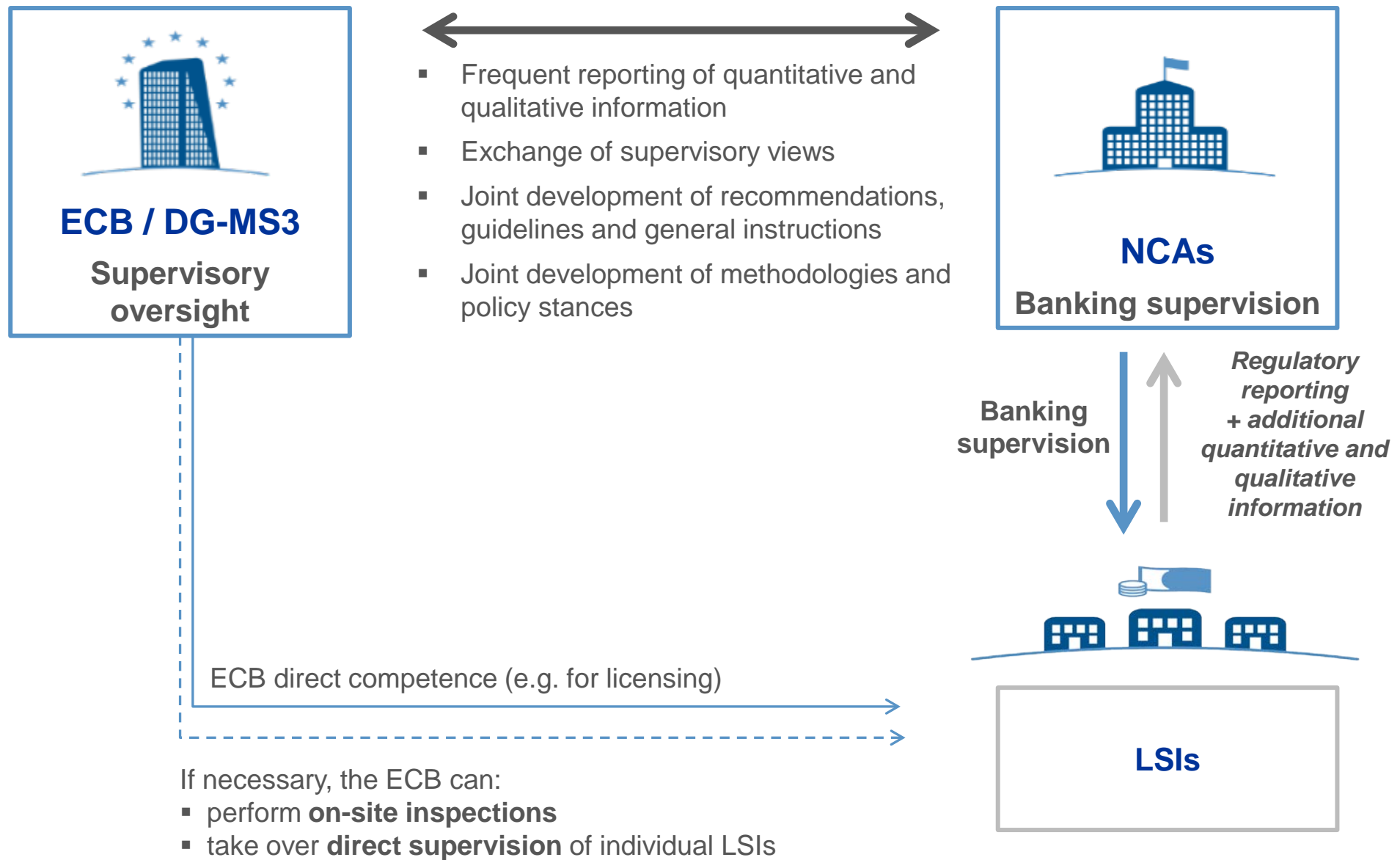


The underlying principles of the SSM LSI SREP methodology

Principles

- To promote convergence in the way NCAs conduct the SREP, to support a minimum level of harmonisation and a continuum in the assessment of SIs and LSIs
- SSM LSI SREP methodology developed under the umbrella of the SSM methodology applicable to SIs
- Proportionality and flexibility to take into account LSI specificities
- National specificities are considered (e.g. accounting standards, regulation)
- Based on existing pillars of sound risk assessment:
 - ✓ combination of quantitative and qualitative elements
 - ✓ holistic assessment of institutions' viability taking into account their specificities
 - ✓ forward-looking perspective

Competences of NCAs and ECB



The SSM 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.



Scope of application – CRD IV and SSM (F) Regulation

Article 110 of CRD IV – NCAs as competent authorities are required to carry out a SREP and to decide on supervisory measures for LSIs within the level of application. Hereby NCAs should apply the methodology without prejudice of national laws and regulations.

Article 39 of the SSM Framework Regulation establishes the criteria and rules for classifying a credit institution as significant or less significant. This classification determines whether a credit institution is supervised directly by the ECB or the NCA.



EBA Guidelines

Guidelines on common procedures and methodologies for the SREP (EBA/GL/2018/03), etc.



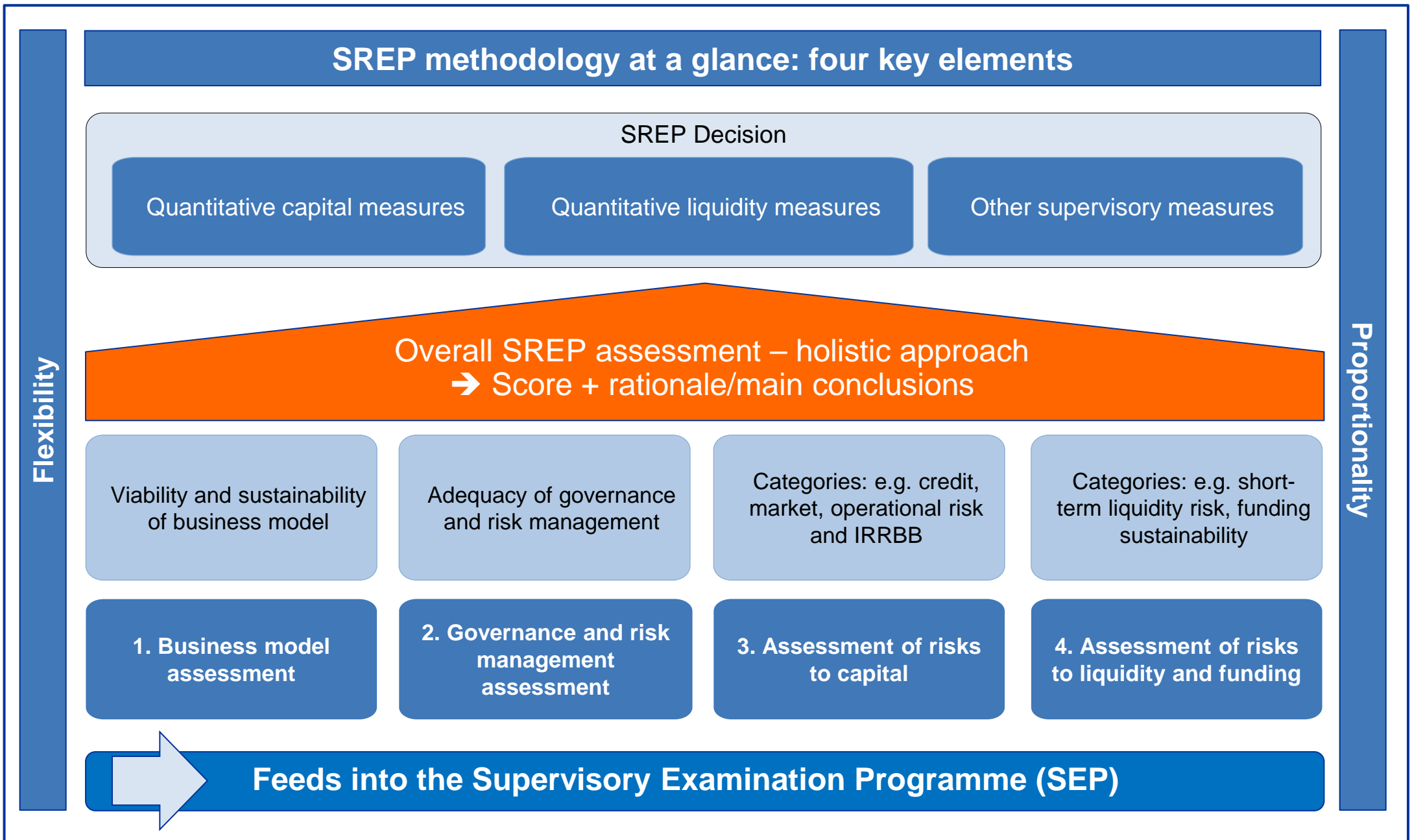
BCBS and FSB Principles



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Structural elements and building blocks of the SSM SREP methodology preserved



A proportionate approach

- Minimum supervisory engagement model based on SSM prioritisation methodology which classifies LSIs as **high-priority** or **non-high-priority** institutions according to their risk situation and their potential impact on their domestic financial system.
- This classification is the starting point for NCAs to decide on the **intensity** of the SREP assessment (frequency, scope, granularity), **supervisory expectations**, **information needs**, etc.

Examples

Intensity of assessment

- Annual frequency for the **full** SREP assessment for HP LSIs, but lower minimum frequency for non-HP LSIs; for all LSIs: annual **update** of the SREP
- For every LSI, the risk (sub)categories are assessed only if deemed **material**

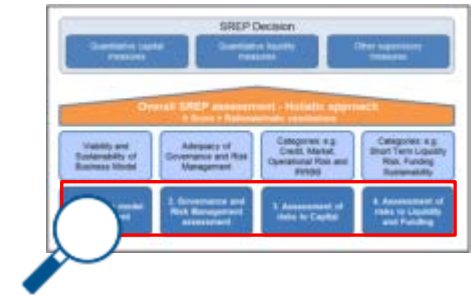
Supervisory expectations

- For instance, depending on the nature, size and complexity of the institution and its businesses, the risk management methodologies and processes (in particular for non-HP LSIs) can be **less** complex

Information needs

- Methodology tailored to information reporting requirements applicable to LSIs, e.g. FINREP (which, when compared with FINREP for SIs, is **significantly reduced** in terms of scope), but also any other supervisory data available at NCA

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
<p>Main sources:</p> <ul style="list-style-type: none"> regulatory reporting other documents 	<ul style="list-style-type: none"> Scoring risk level Formal compliance checking of risk control 	<p>Adjustments based on additional factors and considering banks' specificities and complexity</p>

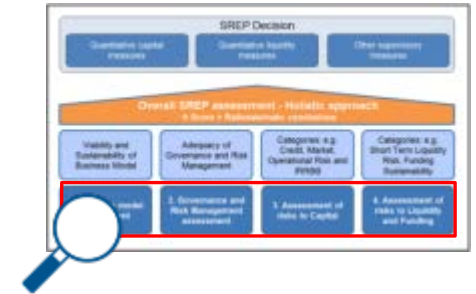
Risk level (RL) vs. risk control (RC)

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

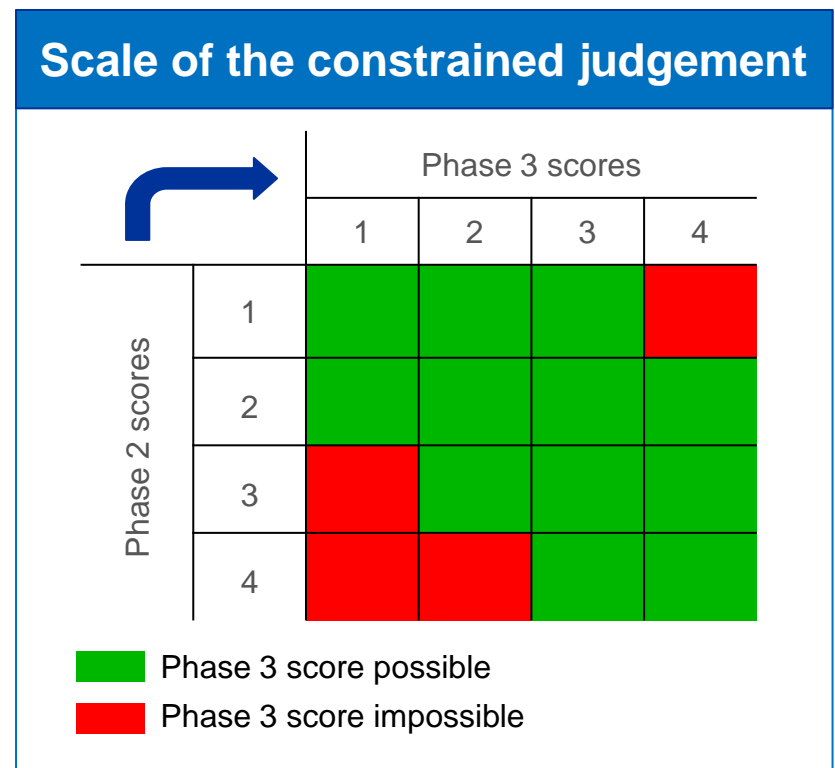


n/a: not applicable

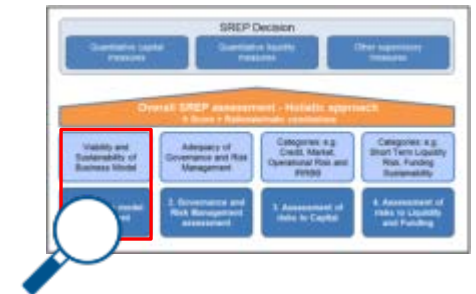
Constrained judgement



- Fair flexibility in a four-grade scale where Phase 2 scores 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 the LSIs and defining an anchor point
 - ✓ the necessary supervisory judgement, to take into account the specificities and complexity of an institution
- Adjustments go in both directions and need to be fully documented
- Departing from constrained judgement may only be allowed in justified cases, given that deviations should be the exception rather than the rule (e.g. because of data quality)



Element 1: Business model assessment



Assessment of business models comprises the following elements:



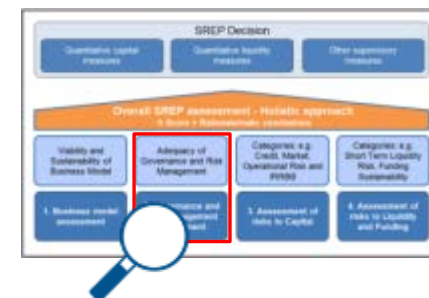
Examples of assessed business models

- Traditional bank
- Wholesale bank
- Specialised finance bank
- Central savings/cooperative bank
- Investment bank
- Financial market infrastructure

Examples of key assessment questions

- Is the institution able to generate acceptable returns from a supervisory perspective over the next 12 months?
- Does the institution’s strategy have the capacity to address identified threats to its viability?
- How does the institution expect to make a profit over the medium/long term?
- Are the assumptions made by the institutions with respect to the strategy and forecasts consistent and plausible?

Element 2: Internal governance and risk management



Areas subject to assessment

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

Risk control assessment

- Check compliance with nationally implemented CRD provisions
- Specific analysis of, for example:
 - ✓ organisational structure
 - ✓ internal audit
 - ✓ compliance
 - ✓ remuneration
 - ✓ risk appetite
 - ✓ risk infrastructure
 - ✓ reporting

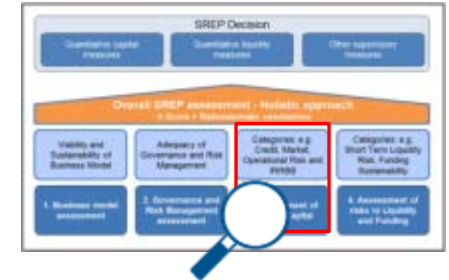
Supervisory judgement

- Comprehensive analysis
- Adjustment of Phase 2 check taking into consideration the bank's specificities

Two examples of key assessment 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?

Element 3: Risks to capital



Three different perspectives (“three blocks”)

Block 1: Supervisory perspective

- Each capital-related risk category is assessed and scored separately through three phases.
- Depending on their materiality, the four relevant capital-related risk categories are:
 - ✓ credit risk
 - ✓ market risk
 - ✓ IRRBB
 - ✓ operational risk

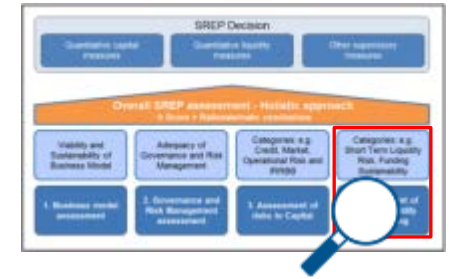
Block 2: Bank’s perspective

- NCAs collect ICAAP information in line with EBA Guidelines and national regulation.
- Scope of ICAAP reliability assessment:
 - ✓ ICAAP governance
 - ✓ capital planning
 - ✓ scenario design and stress testing
 - ✓ internal controls, independent reviews and ICAAP documentation
 - ✓ data and infrastructure
 - ✓ risk capture, management and aggregation
- If ICAAP figures are reliable, they should be a starting point for the SREP capital quantification in Block 2.
- NCAs have flexibility to use national approaches for assessing institution’s quantification of capital.

Block 3: Forward-looking perspective

- Flexibility is introduced by allowing NCAs to apply top-down or bottom-up stress tests, or a combination of both.
- Minimum requirements of the quality assurance should account for the approach taken.
- NCAs have flexibility to translate scenario into shocks.

Element 4: Risks to liquidity



Three different perspectives (“three blocks”)

Block 1: Supervisory perspective

- Each liquidity-related risk category is assessed and scored separately through three phases.
- The two liquidity-related risk categories are:
 - ✓ short-term liquidity
 - ✓ funding sustainability

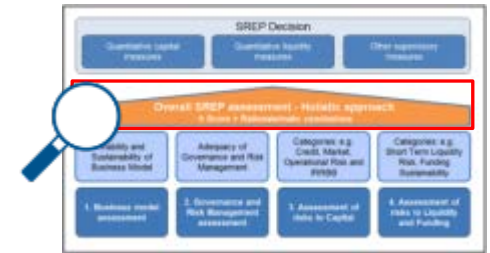
Block 2: Bank’s perspective

- NCAs collect ILAAP information in line with EBA Guidelines and national regulation.
- Scope of ILAAP reliability assessment:
 - ✓ ILAAP governance
 - ✓ funding strategy and liquidity planning
 - ✓ scenario design, stress-testing and contingency funding plan
 - ✓ internal controls, independent reviews and ILAAP documentation
 - ✓ data and infrastructure
 - ✓ risk capture, management and aggregation
- Flexibility for NCAs to use national approaches for assessing institution’s liquidity needs.

Block 3: Forward-looking perspective

- The assessment uses top-down sensitivity analysis based on prudential reporting (COREP).
- Output examples:
 - ✓ LCR higher than the regulatory minimum
 - ✓ specific minimum survival period
 - ✓ minimum amount of liquid assets

The overall SREP assessment



- Provides a synthetic overview of an institution's risk profile:
 - ✓ based on the assessment of all four elements
 - ✓ 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**

SREP decisions are made by NCAs as they are directly responsible for supervising LSIs



Institution-specific SREP decisions made by NCAs may include:

Own funds requirements

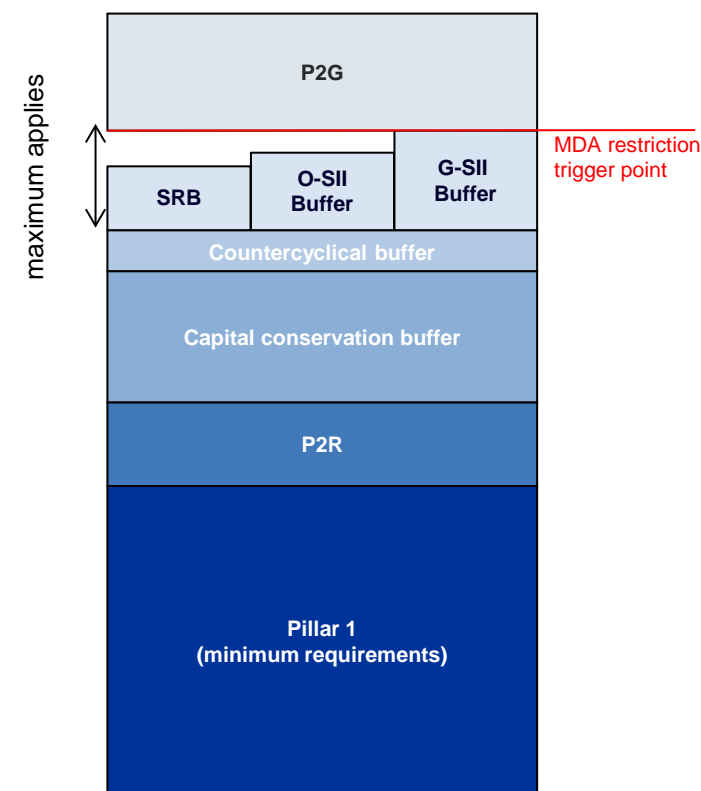
- Total SREP capital requirement (TSCR) composed of minimum own funds requirements (8%) and additional own funds requirements (P2R)
- Combined buffer requirements (CBR)

Quantitative liquidity requirements

- LCR higher than the regulatory minimum
- Higher survival periods
- Other measures

Other qualitative supervisory measures

- Additional supervisory measures (e.g. the restriction or limitation of business, the requirement to reduce risks and the imposition of additional or more frequent reporting obligations)
- NCAs are expected to implement the P2G, in line with the revised EBA Guidelines on SREP.



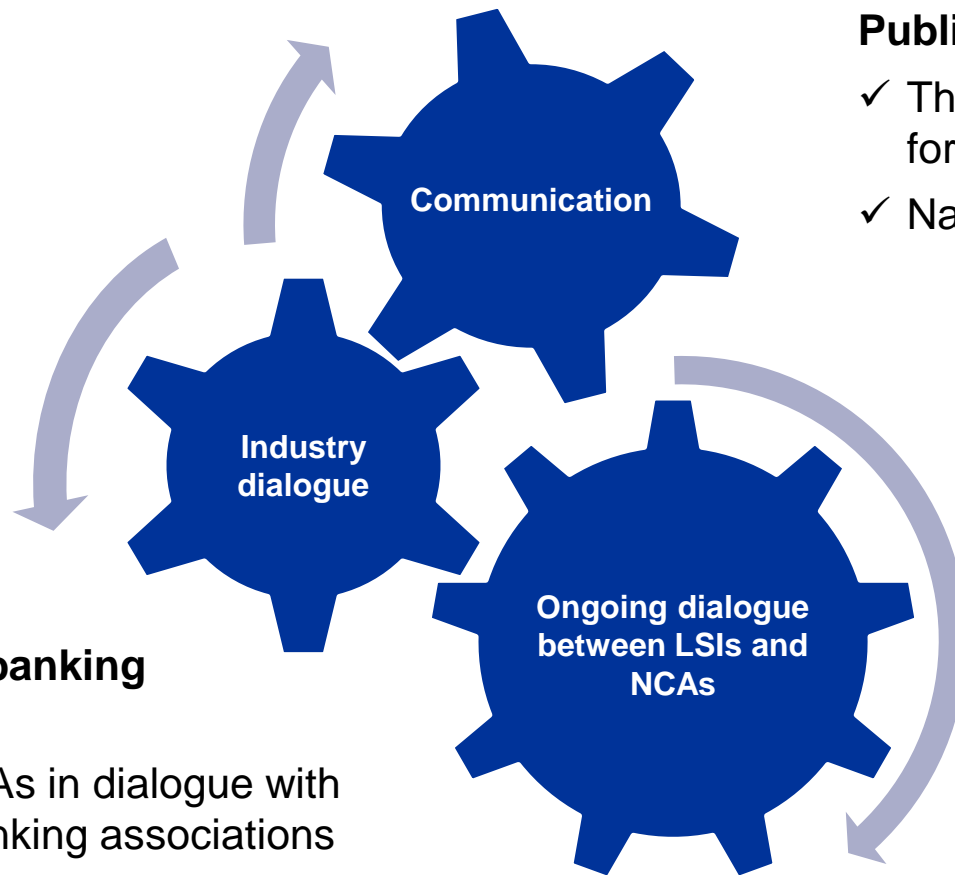
Future steps

Further methodological developments

- The SREP methodology aims to strike a balance between the desired degree of stability and the need to implement enhancements due to ongoing modifications to the regulatory and supervisory frameworks.
- The methodology also considers the feedback from SSM supervisors and the SSM supervisory priorities published by the ECB.
- The ECB together with the NCAs will therefore continue to develop the SREP methodology (e.g. in the areas of RAS, ICAAP/ILAAP and IT risk).

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Public information

- ✓ This presentation, to enhance transparency for the market with regards to SREP for LSIs
- ✓ National regulation and disclosures

Dialogue with banking associations

- ✓ ECB and NCAs in dialogue with European banking associations
- ✓ NCAs in dialogue with national banking associations

Supervisory dialogue between NCAs and LSIs

- ✓ Meetings between NCAs and individual LSIs
- ✓ SREP decisions by the NCAs (right to be heard)

We aim for banks to 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