EBA/Op/2025/01

21/01/2025

Opinion of the European Banking Authority on interaction between Pillar 2 requirements and the output floor

Introduction and legal basis

1. The European Banking Authority (EBA) views set out in this opinion highlight how competent authorities referred to in Article 4(2)(i) of Regulation (EU) No 1093/2010[1] ("competent authorities") should account in their Supervisory Review and Evaluation Process (SREP) for the application of Article 104a(6) of Directive 2013/36/EU[2] on 11 January 2026 to institutions bound by the output floor already on 1 January 2025.

2. Pending the adoption of the guidelines referred to in the mandate of Article 104a(7) of Directive 2013/36/EU (hereafter referred to as "the mandate") with which the EBA will further specify how the requirements set out in Article 104a(6) of that Directive on interaction between the output floor and Pillar 2 requirements should be operationalised, and given the need to incorporate these guidelines in the SREP Guidelines[3], which are about to be comprehensively reviewed for many other purposes covering a wide range of topics from the new Banking package (and other newly enacted or amended legislation), there is a need to harmonise the approach on this narrow interaction, and accordingly it is appropriate to issue this opinion.

3. This opinion is without prejudice to the mandate, in accordance with which the EBA shall issue guidelines, in accordance with Article 16 of Regulation (EU) No 1093/2010, to further specify how to operationalise the requirements set out in paragraph 6 of Article 104a of Directive 2013/36/EU regarding the interplay between the Pillar 2 requirements and the output floor.

[1] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

[2] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

[3] EBA Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing under Directive 2013/36/EU.

4. For this opinion, the EBA has held a roundtable discussion with industry stakeholders and sought advice from the Banking Stakeholder Group (BSG) to gather additional perspectives.

5. The EBA competence to deliver this opinion is based on Article 29(1)(a) of Regulation (EU) No 1093/2010. In accordance with Article 14(7) of the Rules of Procedure of the Board of Supervisors of the EBA[4], the Board of Supervisors has adopted this opinion which is addressed to competent authorities.

General approach

6. Under Article 104a(6) of Directive 2013/36/EU the nominal amount of additional own funds required by the institution's competent authority in accordance with Article 104(1), point (a) to address risks other than the risk of excessive leverage (hereinafter, "Pillar 2 Requirement" or "P2R") is not to increase as a result of the institution becoming bound by the output floor (referred to in this opinion as a "temporary cap"). Additionally, the competent authority shall, without undue delay, and in any event no later than by the end date of the next SREP cycle, review the P2R and remove any parts thereof that would double-count the risks already fully covered by the fact that the output floor has become binding. After this review, the temporary cap on P2R ceases to apply.

7. First, this opinion explains how to operationalise the temporary cap of Article 104a(6)(a) of Directive 2013/36/EU (hereafter "temporary cap") that ensures that P2R does not increase due to an institution becoming bound by the output floor, particularly by applying previously communicated P2R expressed in percentage terms (%P2R) on unfloored total risk exposure amount (hereinafter, "TREA"). In addition, it considers how to facilitate the supervisory review process of Article 104a(6)(b) of Directive 2013/36/EU (hereafter "review on double counting" is referring to this review).

8. Second, this opinion provides clarity on how competent authorities examine, in the review on double counting possible double counting of risks already fully covered by the bindingness of the output floor. The EBA came to the view that, to eliminate double counting effects, supervisors should offset any potentially existing P2R add-on stemming from the "regulatory model deficiencies" category referred to in paragraph 386 of the SREP Guidelines.

9. Third, this opinion reflects on how in the review on double counting competent authorities may need to consider arithmetic increases of the P2R requirement due to the increase in TREA when an institution becomes bound by the output floor. This should be seen in the context of paragraph 361 of the SREP Guidelines, which clarifies that competent authorities, when performing the SREP capital assessment, should determine and set the quantity (amount) and quality (composition) of the P2R, which is then communicated to institutions as a % of the TREA in accordance with paragraph 410.

[4] Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 22 January 2020 (EBA/DC/2020/307).

Specific approach regarding temporary cap on P2R

Approach for temporary cap on P2R based on unfloored TREA

10.The EBA considers that the temporary cap on P2R will apply only once[5], at the time an institution first becomes bound by the output floor. Where an assessment has been made by the competent authority that no part of the P2R would double-count the risks that are already fully covered by the fact that the institution is bound by the output floor, the temporary cap on P2R does not apply. A renewed application of the temporary cap would not be triggered for a second time in a subsequent period of time, for instance because of a higher transitional factor of the output floor.

11.When the output floor becomes binding and in the absence of an assessment having been made by the relevant competent authority about the absence of any double counting as explained in paragraph 10, the applicable %P2R, previously communicated to the institution by the competent authority following the last SREP cycle, will be applied to the unfloored TREA as set out in Article 92 of Regulation (EU) No 575/2013. The institution will apply this calculation throughout the period in which P2R is capped. This cap on P2R will stay in place until the review on double counting has been concluded in accordance with Article 104a(6)(c) of Directive 2013/36/EU (hereafter “the lift of the temporary cap”).

12.The stylised example in the table below illustrates how the cap on P2R would be effective in practice. It refers to a hypothetical institution with a P2R equal to 2% in 2025 (nominal EUR 2.56 P2R and EUR 128 unfloored TREA) which is first bound by the output floor on 1 January 2026, when the transitional output floor factor changes from 50% to 55%. Despite an increase of floored TREA to EUR 137.5, by applying the 2% P2R on unfloored TREA during the period of the application of the temporary cap, which translates to a 1.89% P2R compared to floored TREA.[6]

Table 1: Temporary freeze of P2R

			OF			P2R		
Year	**TREA SA**	**TREA IM**	**%**	**Limit**	**Effect**	**%**	**EUR**	
2024	250	100	*0%*	NA	NA	2.00%	2.00	No OF
2025	250	128	*50%*	125	0	2.00%	2.56	Not bound by OF - normal situation
2026	250	130	*55%*	137.5	7.5	1.89%	2.60	Bound- Old P2R (ie. 2%) on new unfloored TREA (ie. 130) instead on new floored TREA (ie. 137.5)

13.In summary, the temporary cap on P2R does not mean that the P2R amount cannot change. Instead, the P2 amount can vary during the period in which the temporary cap applies, where

[5] Possibly, in exceptional cases, such as if an institution ceases to be bound by the output floor and subsequently becomes bound again, the process could be repeated if material.

[6] This is given the relation between the 130 unfloored TREA and 137.5 floored TREA at that point in time, which means that until the conclusion of the supervisory review on double counting process the P2R % floored TREA can vary depending on the fluctuation in the relation between unfloored and floored TREA. It is to be noted that in 2026 unfloored TREA is assumed to be EUR 130 (e.g. due to an increase of 2 in balance sheet growth). This means that for example in Q2 if the supervisory review on double counting process is still ongoing, the 2% of unfloored TREA can imply a P2R % floored TREA that is different from the 1.89% calculated for Q1 2026.

changes in unfloored TREA result from changes in the balance sheet or from changes in (unfloored) TREA calculation other than the output floor.

Facilitating the review process

14. The cap on P2R is a temporary solution and based on a simplified approach. For this reason, the EBA considers that the review on double counting should be completed without undue delay. In this regard, it is to be noted that the review on double counting can be ad-hoc, which means that instead of waiting for the fully-fledged next SREP cycle to conclude, the competent authority may take a targeted ad hoc SREP decision which can lead, when necessary, to a revised P2R to be applied by the institution at a certain date. This possibility aligns fully with the framework outlined in the SREP Guidelines[7], which allow for more frequent and targeted assessment of specific SREP elements, potentially occurring even on an intra-annual basis, as needed.

15. The EBA encourages institutions to inform their respective CAs when they foresee that they may become bound by the output floor. Institution should provide estimates of the impact of the output floor on TREA and how this, based on the applicable P2R percentage, would affect the nominal amount of P2R. In addition, in the information submitted the institution should clarify the impact on the P2R amount of the temporary cap on P2R. Timely information from the institution to the competent authority, before the supervisory reporting, will allow the competent authority to start the supervisory dialogue on this specific aspect and prepare appropriately for the review on double counting, including interactions with other competent authorities in the context of the college of supervisors.

16. Annex I illustrates the process envisaged by the EBA with a decision tree graph. It incorporates the use of the unfloored TREA during the application of the temporary cap as indicated in paragraph 11, and how after the conclusion of the review on double counting the P2R applies to floored TREA.

The EBA expects competent authorities to encourage institutions to inform them at an early stage when they foresee (based on estimates) that they may become bound by the output floor, with a view to ensure that institutions correctly calculate the temporary cap on P2R using unfloored TREA, and the review on double counting can be facilitated to the extent possible. After the conclusion of the review on double counting, P2R applies to floored TREA.

[7] The minimum engagement model (section 2.4 of SREP Guidelines) only represents a minimum.

Specific proposals regarding the review on double counting of Article 104a(6)(b) of Directive 2013/36/EU

Analysis of P2R potentially overlapping with the output floor

17. Identifying underlying overlaps between risks covered by the P2R and those that are already fully covered by the fact that the institution is bound by the output floor requires as a first step a deep understanding of what is captured in P2R currently.

18. In this context, the EBA considers that the main source of overlaps between P2R and output floor potentially would arise from the possibility for competent authorities to impose P2R add-ons to cover "model deficiencies" that could lead to underestimation of the minimum own funds requirements set by Regulation (EU) No 575/2013 (i.e. regulatory model deficiencies).

19. It is worth noting, however, that the use of P2R as a tool to cover for such deficiencies by supervisors is already expected to be residual in the SREP Guidelines. In fact, these guidelines in paragraph 386 state that *"competent authorities should only set additional own funds requirements to cover these deficiencies, where it is not possible to address them under Pillar 1 own funds requirements through other supervisory measures, such as requiring institutions to adjust their models or apply an appropriate margin of conservatism to their estimates. Such additional own funds requirements should only be set as an interim measure while the deficiencies are addressed*".

20. In line with this expectation, analysis carried out by the EBA on the main risk drivers of the P2R confirmed that P2R is rarely used to cover for the regulatory "model deficiencies" category.[8] To support this observation, the EBA used EBA Basel III monitoring data to examine whether institutions that are expected to be bound by the output floor in the future are more likely to be subject to certain P2R add-ons. This showed that institutions that are likely to be bound by the output floor do not have a higher P2R, of any category, compared to their peers using internal regulatory models that are not expected to be bound by the output floor nor compared to institutions using the standardised approach for the determination of the own funds requirements.

21. Apart from the "model deficiencies category" that could be capturing any modelling deficiency potentially overlapping with the output floor, the EBA sees no evidence that currently supervisors require any P2R add-on in other categories that could be overlapping with the output floor. In this context, competent authorities are reminded that the SREP Guidelines do not allow for the possibility for competent authorities to impose P2R with a model risk character and categorise it as different from model risk (e.g. such as credit or market risk).

[8] See section "1.2 Convergence of supervisory practices in the context of Pillar 2 and liquidity measures" of the "EBA/REP/2024/13 - REPORT ON CONVERGENCE OF SUPERVISORY PRACTICES IN 2023" for further details.

Conditions for possible offsets based on overlaps

22. Considering the rare occurrence of relevant P2R add-ons indicated in the analysis (as explained in paragraph 21), the EBA is of the view that the only off-sets to the P2R that could be considered would be those cases where there is an explicit add-on stemming from the "regulatory model deficiencies". Moreover, the add-on would have to be related to a model used in determining Pillar 1 RWAs, and the amount which can be offset must not exceed the amount of the impact of the output floor on TREA (multiplied by 8%).

The EBA expects competent authorities to only consider offsets in the review on double counting regarding P2R add-ons in relation to "regulatory model deficiencies". The add-on would have to be related to a model used in determining TREA, and the amount which can be offset must not exceed the amount of the impact of the output floor on TREA (multiplied by 8%).

Considerations on arithmetic effects in the review on double counting

23. Consistent with how the current SREP Guidelines state that P2R should be determined in terms of "*quantity (amount) and quality (composition)*"[9], before being communicated to institutions as percentages, the EBA considers that competent authorities may need to reflect on how, in the review on double counting, they could ward off undue arithmetic effects from the output floor on the nominal EUR amount of P2R.

24. In substance, it appears that competent authorities that use a methodology that determines P2R amounts based on a multiplication by TREA (e.g. a bucketing approach based on the SREP scores with a prescribed add-on % TREA associated to each bucket to calculate P2R) may need to be particularly attentive to automatic arithmetic increases. As also illustrated in the table below (and Annex II), if a competent authority determines a P2R based on a x% of TREA, for example based on an overall SREP scoring of the institution (which in terms of amount should otherwise generally not be expected to change because of an increase in TREA, from EUR 100 unfloored TREA to EUR 150 floored TREA as below), it may have to be considered that an increase in TREA due to the output floor automatically increases the resulting nominal P2R amount, without any change in the underlying risk.

Table 2: Output floor impact on P2R – arithmetic effect where %P2R results from the scoring framework

Overall SREP P2R					
Scores	P2R buckets	TREA	P2R amount (max)	TREA after OF	P2R amount after OF
1 - low	0%	100	0	150	0
2 - low/medium	0%-0.5%		0.5		0.75
3 - medium	0.5%-1.0%		1		1.5
4 - high	1.0%-2.0%		2		3

[9] SREP Guidelines paragraph 361.

25. For clarity, the possible need to raise specific attention to arithmetic increases does not relate to those authorities that fully focus on a nominal amount already when determining P2R (in those cases it is reasonable to assume that the P2R amount may, all else equal, not increase as a result of the institutions' becoming bound by the output floor). In addition, there may be cases in which an increase in P2R amount may be appropriate.

The EBA advises competent authorities with a methodology that calculates P2R amount based on a multiplication by TREA, to consider how they could ward off undue arithmetic effects from the output floor in the one-off review on double counting.

Considerations on Pillar 3 disclosure

26. For the sake of transparency, since the temporary cap on P2R and the results from the review on double counting affect the P2R that is required to be disclosed under Pillar 3 (in accordance with Article 438(b) of Regulation (EU) No 575/2013), competent authorities in the course of their supervisory dialogues with institutions should encourage approaching institutions to include in their Pillar 3 disclosure the impact of either the temporary cap or review on double counting, as applicable for the reference date, on the P2R disclosed.

Conclusion

27. As mentioned, this opinion advises competent authorities on how to operationalise the interplay between Pillar 2 requirements and the output floor. This opinion builds on the current SREP Guidelines and prepares the ground for the adoption of the guidelines referred to in the mandate with which EBA will further specify how the requirements set out in Article 104a(6) of Directive 2013/36/EU on interaction between the output floor and Pillar 2 requirements should be operationalised, an adoption that is currently planned within the context of the comprehensive review of the SREP Guidelines covering a wide range of topics from the new Banking package.

This opinion will be published on the EBA's website.

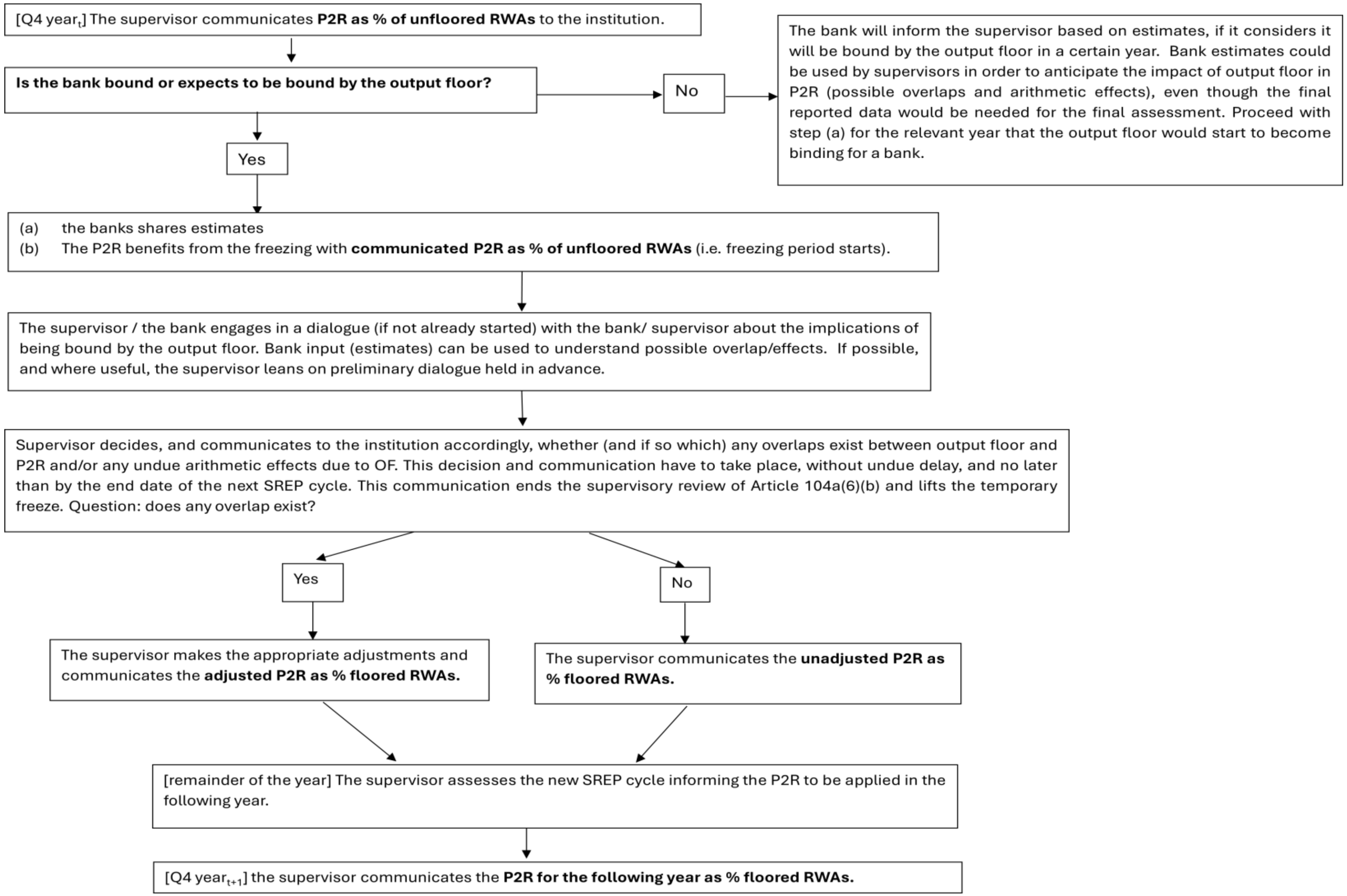
Done at Paris, 21 January 2025

[signed]

[José Manuel Campa]

Chairperson
For the Board of Supervisor

Annex I: Indicative decision tree



Annex II – Stylised example

28. The table below shows a stylised example of a hypothetical bank that becomes bound by the output floor on the 1st January 2026, when the output floor transitional factor changes from 50% to 55%, illustrating the effect of the transitional cap on P2R, the effect of changes in the bank's balance sheet during the year before the P2R review and the removal of the freezing after the next SREP cycle where the P2R adjustment takes place.

29. In the example it is assumed that in 2024 the institution has 250 TREA under SA, 100 TREA under internal model and 2% P2R. In 2025, under the CRR3, the bank observes an increase in TREA under internal model, due to changes in the regulatory framework, sufficient enough to not be bound by the output floor. On 1st January 2026, when the output floor transitional factor changes from 50% to 55%, the bank becomes bound by the output floor and the P2R is frozen by applying the %P2R from 2025 SREP (2%) to the unfloored TREA. Despite an increase of floored TREA to EUR 137.5, by applying the 2% P2R on unfloored TREA during the period of the application of the temporary cap, which translates to a 1.89% P2R compared to floored TREA. The temporary cap on P2R does not mean that the P2R amount cannot change. Instead, the P2 amount can vary during the period in which the temporary cap applies, where changes in unfloored TREA result from changes in the balance sheet or from changes in (unfloored) TREA calculation other than the output floor.

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30. The table below shows a stylised example of the impact the output floor could have on the overall P2R requested to a hypothetical institution, where the supervisor follows an approach that assigns %P2R add-ons (not amounts) based on scores and respective buckets.

31. In the example it is assumed that the methodology that the supervisor uses has four scores of risks and respective buckets to determine the %P2R add-on for an institution. The supervisor assigns the institution to a certain %P2R based on a specific bucket, and assuming the institution has a certain amount of TREA (100), this will lead to a respective P2R amount. If the institution should get bound by the output floor, the floored TREA would increase (150) and applying the same bucketing approach by requiring the institution the same %P2R, would arithmetically lead to a higher P2R amount, without any change in the underlying risk.

Table 2: Output floor impact on P2R – arithmetic effect where %P2R results from the scoring framework

Overall SREP P2R					
Scores	**P2R buckets**	**TREA**	**P2R amount (max)**	**TREA after OF**	**P2R amount after OF**
1 - low	0%	100	0	150	0
2 - low/medium	0%-0.5%		0.5		0.75
3 - medium	0.5%-1.0%		1		1.5
4 - high	1.0%-2.0%		2		3