Committee of European Banking Supervisors

June 2005

Feedback on the comments received on the first version of the Consultation Paper on the supervisory review process (CP03)

1. CEBS published its third consultation paper on high level principles (now guidelines) on supervisory review ("CP03") in May 2004. The consultation period ended on 31 August 2004. Sixteen responses were received, all but two of which were published on the CEBS website. In general the responses were very positive. The industry as a whole was grateful for CEBS' willingness to share views on how Pillar 2 will operate at Level 3, so far in advance of adoption of the final text of the recast Capital Requirements Directive (CRD). There was also a good deal of support for the very clear messages in CP03, e.g. that the ICAAP is the sole responsibility of the institution to define, develop and own; the concept of dialogue between the institution and supervisory authority inherent in the ICAAP-SREP process; and the concept of proportionality both for ICAAP and SREP.

2. This paper presents a summary of the key points arising in the consultation and the changes made to address them. It includes an annex reflecting CEBS' views on the industry comments.

3. It should be noted that since the launch of CP03, CEBS has continued its work on the supervisory review process, developing many of the issues in CP03 that have were the subject of industry comments. The results of this work have been compiled in a new version of CP03 that is now submitted to public consultation, according to CEBS' consultation practices.

Criteria for Analysis of Comments

4. For the purposes of assessing the comments received, CEBS has distinguished between:
   - Comments on key issues relating to the concept and content of the supervisory review process (e.g. the possible use of higher capital requirements), and comments which might be more incidental in nature (e.g. definition of "management body").
   - Comments which have been made by many respondents (e.g. regarding the taxonomy in the list contained in Annex B), and comments which have been raised by only one or two respondents.

5. Taking the above criteria into account, CEBS considered that the following issues were sufficiently important to be taken into consideration.

Home-host

6. The importance of home-host issues is raised by many respondents in the consultation. This is a general matter, but also one of great importance in relation to the supervisory review process. CEBS fully recognises the importance of the home-host issue and is working very actively in this area.

7. Three specific initiatives could be mentioned in this respect. The first of these initiatives relates specifically to the relationship and division of tasks between home and host supervisory authorities. The other two initiatives demonstrate the efforts being made by the supervisory community to ensure a higher degree of convergence in supervisory rules and practices, which will in turn facilitate home-host relations and reduce the administrative burden on institutions.

8. The initiatives are:

   - Guidelines for co-operation between home and host supervisors. The basis for this work is the CRD proposal, which provides for the host supervisor to retain responsibility for subsidiaries within its jurisdiction. Within this context, however, CEBS has developed principles for home-host collaboration, which should help to meet industry concerns, for example by ensuring that the home supervisor provides host supervisors with adequate information on the ICAAP at the group level. Where the group ICAAP contains a well-conceived system of capital allocation to individual entities this should at least be considered as an important input for the supervisory evaluation of local ICAAPs.
   - CEBS' proposals for a reduction in the number of national discretions in the CRD, in order to enhance the level playing field and reduce the potential for home-host discrepancies.
   - CEBS' development of a common reporting framework for the solvency ratio under Basel II, to minimise duplicative efforts especially for internationally active banks. A full consultation on this matter started at the end of January.

Level of application

9. Several respondents called for the SREP and ICAAP to be applied only at the consolidated group level, and not at individual level. Although this is a legal matter for the Directive rather than for CEBS guidelines, CEBS notes that its guidelines reflect the Directive proposal. The ICAAP should be applied at the (sub)consolidated level in a Member State and at the individual level where the credit institution which is neither a subsidiary in the Member State where it is authorised and supervised, nor a parent undertaking, or where the credit institution is not included in the consolidation.

Supervisory actions and capital

10. Many respondents argued that additional capital requirements should be the exception rather than the rule, that this supervisory tool should be at the bottom of the list of options, and that Pillar 2 is about management rather than capital. However, CEBS is clear that the SRP is intended to ensure that institutions have adequate capital to support all the risks in their business. Capital targets must be set by the management to be commensurate with the institution's risk profile and control environment. Explicitly including capital

requirements as supervisory tools in the SRP also reflects the principle that "institutions are expected to operate above the minimum level of capital requirements".

11. CEBS considers that the document already sufficiently captures the idea that additional capital requirements are only one of many supervisory tools and will not necessarily be the normal outcome.

Ownership of ICAAP

12. Some respondents argued that Pillar 2 must be an institution-driven process, with the onus on the institution to assess and manage its own risk. CEBS has consistently acknowledged this. The institution must indeed fully 'own' its assessment and risk management processes.

13. However, the supervisory review process is also about dialogue and challenge. The interaction of the ICAAP and SREP must be a balanced process, with each having been able to inform the other. But it should be for the supervisory authority (not the institution) to challenge the institution, to determine when the dialogue should start, and how intensive it will be. CEBS guidelines on this issue are included in the new version of the guidelines.

Link between ICAAP-SREP (and RAS)

14. Some comments ask for more guidance and clarification on the link between these two processes. This is, indeed, an issue of great importance. CEBS guidance on this issue is included in the draft new version of CP03, now to be submitted to public consultation.

Proportionality

15. There was a general concern on the part of respondents that Pillar 2 should be applied in a proportionate manner, and that there should be clarification about what the concept of proportionality means. CEBS believes that the principle of proportionality is already very clearly highlighted in the paper. All supervisors are committed to the concept of proportionality. It should be noted, for example, that CEBS is considering developing some guidance for smaller institutions on the ICAAP.

16. However, it is difficult to be more concrete at this stage on what proportionality means. Until further work is done it may require a case-by-case assessment. CEBS is interested to hear views on how to approach proportionality.

On-going convergence

17. Some respondents have argued that CEBS should ensure that there are periodic comparisons of the approaches to national SREPs which have developed in different jurisdictions, especially on areas where there is suspicion of divergence. As a first step to ensure on-going convergence of practice CEBS is considering holding regular confidential discussions between supervisors to promote comparability and consistency and ensure a level playing field in the supervision of large international groups. This will be underlined with a public commitment to ensure ongoing convergence of supervisory practices.

Material risks

18. There was a call from some respondents for greater clarity on the meaning of "material risks" and for consistency on this aspect across the paper. CEBS considers that this concept is already very clear in the consultative paper and that in this case there is no need (no added benefit) to make changes. Under the ICAAP principles, materiality is assessed by the institution. In order to evaluate how material a risk is, the institution needs to consider all its risks. For clarity it should be noted that the objective is not to minimise the burden, but to adopt a risk-based approach.

Outsourcing

19. Some respondents have commented that there should be explicit guidance on which parts of the ICAAP can be outsourced (especially with respect to smaller institutions). CEBS believes that the standards on outsourcing issued for consultation in April 2004 provide sufficient guidance on this matter.

20. The key issue for smaller institutions is that they must have the capacity to bear the ultimate responsibility for the ICAAP and the supervisory dialogue (regardless of whether parts of it are outsourced).

Annex B of CP03

21. There was a general concern that the original list of risks (in Annex B: Business Risks and Control Factors in the Supervisory Review and Evaluation Process) was too prescriptive and could lead to the SREP becoming a "box-ticking" exercise.

22. For clarity it should be noted that the list was for guidance only and was not in any way intended to be either exhaustive or prescriptive. Indeed, the list was included in the consultation paper to be helpful to the industry, by giving information about the kinds of areas to be reviewed by the supervisor.

Diversification

23. With respect to the ICAAP, some respondents have commented that the positive impact of diversification should be recognised, and that Pillar 2 should not simply "sum the areas of capital deficiency and disregard the areas of capital surplus".

24. CEBS wishes to stress that Pillar 2 does recognise diversification effects, as has been clearly indicated on several occasions, but that Pillar 1 sets minimum capital requirements which may not be breached. In addition, institutions should be aware that the Pillar 1 minimum requirements are already designed for a well-diversified institution, and it is up to the institution to accurately (and quantitatively) demonstrate to its supervisor that any diversification effects should be taken into account.

Stress-testing

25. Some respondents have questioned the meaning of references to stress testing in the paper. This is indeed an area which warrants clarification, as the term stress-testing is currently being used in different contexts with different meanings. CEBS will carry out further work on this issue, including confirming the principle of proportionality (how stress-testing can vary in sophistication according to the institution concerned).

Summary

26. The attached annex summarises the main comments and concerns raised during the consultation exercise, CEBS' analysis, and the decisions taken. In some cases, alternative drafting has been suggested on certain paragraphs of CP03. But due to the fact that the revised 2005 version of CP03 is a very substantial redraft, it has not been possible to highlight the new text exactly reflecting all the comments.

Draft Text CP03	Received Comments	CEBS Analysis	New text (proposal)
	General issues		
	CEBS should keep its level 3 standards at a high level for clarity of intention and consistency, and not get bogged down in detail. CEBS should promote these principles globally. Additional capital requirements under P2 should be the exception not the rule. Pillar 1 is designed to deliver adequate capital; Pillar 2 should be about the quality of management. CEBS should elaborate on a complaint mechanism for banks: if a supervisor reaches different conclusions than the institutions, would the bank be given insight into the analysis performed by the supervisor? An additional principle is needed (to spell out Basel principle, para 746) on the respective responsibilities of supervisors' and management's (so as to underline management's primary role in managing the institution's risk strategy).	Whether of not complaint mechanism for banks would be set up will mainly depend on the national legislation. Complaint mechanisms for credit institutions at EU level raise legal issues.	

	Home/host		
	The paper should provide regulators with more guidance on how the principles are to be followed where institutions operate in several jurisdictions both within and outside the EC. Several responses on home-host issue: Banks should not face different, conflicting on even incompatible obligations. Coordination and practical approach to supervision demanded. Reduction of national discretions. Most concerns can be resolved by rigorous by supervisors planning, coordination, communication and placing reliance on each. Mechanisms for home-host cooperation should be formal, and in publicly available.	Home-host issue to be determined. CEBS is working on this. See the introduction to this paper	See introduction to this paper and to the second version of CP03
	Scope of SREP		
	Several responses to have SREP and ICAAP applied only on consolidated group level. This is to avoid inconsistent supervisory treatment and double counting of risks. If not applied this way the understanding of firms' overall risk profiles will be also jeopardized. Consistency of application and level playing field across Europe should be more highlighted and weighted against the functioning of the national market. At the same time the role of the consolidated supervisor should not lead to distortions with national markets as local banks and subsidiaries of larger groups could be submitted to diverging standards by different supervisory authorities although competing in the same market. Support for appropriate level of dialogue and	. The scope is decided by the directive. Article 123 (ICAAP) applies on consolidated level in a Member State (art. 68.2) Article 136 applies for all credit institutions: "Competent authorities shall require any credit institution…	See Introduction to the second version of CP03

	feedback between supervisors and institutions but concerns about being subject to SREP both from host and home supervisor. Reference should be made to art 124		
	MS should be permitted to use flexible solutions to address specificities in their national fiscal or legal regime. National authorities must be in a position to fulfil their legal responsibilities for supervision, and this can be delivered by extending the role of the consolidating supervisor to applying the SRP, if (i) there is adequate capital in the group, (ii) group exposure are managed and controlled in an integrated way, (iii) the parent has a policy to support the whole group.	Agree, but no change in the paper is needed. To refer to the Directive.	
	Other introductory issues		
Para 7: Basel principle 1: Banks should have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels.	A similar recommendation should be added concerning minimum requirements on the processes that supervisors should have in place. Banks need a strategy that keeps capital in line with their risk profile and not to an absolute level.	That is already reflected on paragraph 8 of the document when saying "It is the opinion of supervisors that principles 2-4 imply that the supervisory authority should have strong risk assessment capabilities…..control profile" and on last sentence of paragraph 17 and in annex A and B. It is an issue of understanding. It should be understood as the capitals levels appropriate to its risk profile, not a pre-determined capital level	
Para 8: the supervisory authority should have **strong** risk assessment capabilities as part of its review	Change the wording: should have 'appropriate' risk assessment capabilities. Banks should be able to use their proven existing risk management systems and not forced to adopt new requirements.	Appropriate reflects better the concept behind.	The supervisory authority should have appropriate risk assessment capabilities as part of its review (paragraph 11 of under *The purpose of SREP* of the second version of CP03)

Para 9: institutions should hold internal capital which is consistent with their risk profile and strategy	Objective of consistency should be further specified	It could be amended as follows: ..”which is adequate to their risk profile and strategy”	
Para 10: The SRP therefore comprises a set of relationships between supervisors and institutions that hinge on two main elements. The first is the Internal Capital Adequacy Assessment Process which places certain obligations on the institution itself (see ICAAP below). The second is the Supervisory Review and Evaluation Process which places certain obligations on the supervisory authority (see SREP below) and in turn leads to the identification of prudential measures.	SRP must be a firm-driven process. Onus on firm to assess and manage its own risk. The dialogue should not move into areas which are should remain at the firm’s business decision discretion. SREP should not oblige supervisors to take actions. They may not take action at all.	Even if it is common practice that any assessment lead to prudential measures in a broad sense, as few as they can be, the wording could be changed saying “….and in turn would likely lead …. “	See the second version of CP03.
Para 11: It (assessment) also enables the supervisor to determine appropriate prudential measures (including if necessary setting a capital requirement above the Pillar 1 minimum), apply those prudential measures over an agreed supervisory period, and to keep the risk assessment under review in the light of progress in implementing those measures and/or other events which may have a significant impact on the risk assessment.	The supervisor’s ability to demand that banks fulfill greater equity requirements on the basis of the ICAAP should always be coupled to precise and comprehensible conditions.	This is entirely consistent with SREP principle IX.	
12. While expressed as two separate processes, the SREP and ICAAP are in practice closely	CEBS should propose that there are periodic comparisons of the approaches to both ICAAP reviews and SREP which have developed in	Convergence is required and needed on the SREP side to ensure a level playing field. Some kind of	

intertwined and it is intended that there will be a close interaction between them, especially so for the larger, more complex and systemically important institutions. This interaction will generate an important and necessary dialogue, and feedback mechanism…	different jurisdictions. Such reviews could focus on areas where there is suspicion of divergence. More guidance on the interaction between ICAAP and SREP would be helpful to all those involved (regulators and institutions). This guidance should remain high level to give overall guidance but allow risk based systems to take account of specific businesses and local concerns. ICAAP and SREP: the process should flow from the CIs to the supervisors: the institution must 1st design an ICAAP and then work with the supervisors to approve and implement that system taking into account the complexity of the institution	exchange of information at the EU level should be agreed, on an ongoing basis. ICAAPs should not be forced to converge as they should be designed by each institution to fit its own needs. This issue is specifically addressed on the new Consultation Paper on CP03	
Para 16: It is the responsibility of the institution to define and develop its ICAAP. The onus is on the institution to demonstrate to the supervisor in its dialogue (through the interaction of the ICAAP and SREP) that its internal capital assessment is comprehensive and adequate to the nature of risks posed by its business activities and its operating environment.	The SRP must be an institution-driven process, with the responsibility on the institution to explain its processes, analysis and actions to its supervisor and satisfy the supervisor that its ICAAP is appropriate for its business. CEBS should make it clear that P2 does not require additional stress testing above defined in P1. It should be an agreement between home/host supervisors on the acceptance of an institution's definition of economic cycle and stress test scenarios. Needs to be clearer how smaller institutions should approach stress testing. This could be very burdensome and beyond their professional resources.	It is considered that stress testing procedure needs clarification. Work on this issue is being undertaken by CEBS. Small credit institutions must be able to carry out simple stress-tests.	
Para 17. The supervisor's role, within the SRP, includes the review and evaluation of the institution's ICAAP, and the performance of an independent	Text should be introduced to give greater clarity to wider scope of SREP since it is so different from that for the ICAAP section which precedes it in the CP. It should be explicit that the SREP either replaces	General explanation in the introduction to this paper".	The supervisor's role, within the SRP, includes the review and evaluation of the institution's ICAAP , and the performance of an independent assessment of the institution's risk

assessment of the institution's risk profile, and if necessary taking prudential measures and other supervisory actions, including setting additional regulatory capital, to reflect the individual circumstances of the institution, with a view to ensuring consistency of capital treatment across institutions. Supervisors should have arrangements in place for the collection and verification of any relevant information, and procedures to maintain the quality and consistency of risk assessments.	the existing risk review processes or that the SREP can be satisfied by those existing processes. There needs to be a greater recognition of the differences between organisations and suggest that you add the following clause to the end of the first sentence, '… but recognizing that differences exist in risk profile, strategy and management between different organisations'. While the CP considers upward adjustment, there is no mention of the possibility of a downward adjustment of capital as a result of the SRP. This is especially appropriate where there is high degree of portfolio diversification. The explicit reference to setting additional capital in paragraph 17 should be deleted. P2 is about the strength of banks and is delivered not just through additional capital but through the quality of thinking, management and reputation.	Proposed change: "…but keeping in mind that differences exist….	profile, and if necessary taking prudential measures and other supervisory actions , including setting additional regulatory capital, to reflect the individual circumstances of the institution, with a view to ensuring consistency of capital treatment across institutions, but keeping in mind that differences exist in risk profile, strategy and management between different institutions . Supervisors should have arrangements in place for the collection and verification of any relevant information, and procedures to maintain the quality and consistency of risk assessments.
Para 19: The scope of application for the SRP should allow the supervisory authority to fulfil its legal responsibility for supervision at the individual institution level while minimising the burden on institutions.	The supervisory authorities should adopt standardized reporting formats to reduce costs. Standardised reporting formats will bring cost disadvantages to smaller banks that operate at the national level.	This issue of standardised reporting formats has already been addressed in the Common Reporting framework for the solvency ratio, currently under public consultation. No change is needed in this paper	
	Proportionality		
Para 15: The concept of proportionality is key to both the ICAAP and SREP. As such, the ICAAP should be commensurate and proportionate to the nature, scale and complexity of the activities of an institution. Similarly, the depth, frequency and intensity of the SREP will be	Whilst this principle is clearly stated in ICAAP HLP III it is not explicitly mentioned in any of the SREP HLPs where perhaps it is even more relevant. A number of respondents highlighted the need to ensure that the proportionality principle is applied throughout the paper as guideline. CEBS should bring clarification on:	The SREP HLP XI states that the depth of the SREP can be varied according to the systemic importance and either the nature and scale (size, risk profile and complexity) of the institution, or the overall assessment of the quality of governance, management and	

determined by the risks posed to the supervisor's objectives.	- on how proportionality should be exercised in the credit institutions within a group, -on the criteria which should be used to apply the proportionality principle. Size, risk profile and complexity should be used throughout the paper instead of 'large and complex institutions'. The simplifications for less complex institutions should also be highlighted throughout the principles.	systems and controls or both. It is difficult to develop into more details what proportionality means as it is a case-by-case issue. The ICAAP guidelines pay due consideration to the less sophisticated institutions. As SREP is closely intertwined with ICAAP, the SREP would a result pay due attention to the situation. CEBS considers that this concept is already clear. (See the introduction to this paper)	
	Supervisory disclosure		
	Disclosure should be restricted between the supervisors and the bank directly concerned. Overly prescriptive approach - with too many detailed rules and guidelines - may not be appropriate as it might impede the necessary flexibility that both supervisors and credit institutions need. Increased supervisory disclosure would help the banks understand better the approach of their supervisors, without overburdening them. In that respect, CEBS should be more prescriptive regarding certain specific obligations of the supervisors, by for instance adding paragraph 779 of the Basel Accord. CEBS should clarify that disclosure is limited only to the methodology underpinning the SRP (not the details of a single institution).	SREP principle IX explains to whom the results can /should be unveiled, including an explanation on to what extent these results will be communicated to the auditors. SREP Principle IX appears in line with paragraph 779 of the Basel Accord. It clearly states that the results of the SREP will be communicated to the institution. In doing so, the institution will have to explain in sufficient detail the factors which have led to the risk assessment conclusions, indicate areas of weakness and the timeframe for remedial action, explain the reasons for any adjustment to the capital requirements, provide pointers as to what improvements could be made	

		to systems and controls … Under article 144 of the draft directive, competent authorities shall disclose the general criteria and methodologies they use in the review and evaluation in Pillar 2. Supervisors do not intend to disclose any individual decision that could come out their Pillar 2 process.	
	Risk-based regime (material risks)		
"comprehensive assessment of risks" (all material risks to be included, with consideration at least of credit risk, operational risk, market risk, interest rate risk in the banking book, liquidity risk and other risks, such as reputation and strategic risk).	A number of respondents highlighted that the principle of material risks should be applied consistently across the entire document. Material risk should cover both the question of whether a risk has to be considered as material per se and to the question of whether the potential consequences from the manifestation of this risk would be material in relation to scope and type of a bank's transaction Objective should be to minimize the burden on institutions.	Under ICAAP HLP VIII, materiality is assessed by the credit institution. In order to evaluate how material the risk is, the institution may need to consider all its risks. The objective is not to minimize the burden but to adopt a risk-based approach.	
18. The Pillar 1 capital requirement will continue to be seen as a ***minimum*** for regulatory capital requirements based on uniform rules.	This should state: Generally sufficient minimum standards…	CEBS considers that no drafting change needed	
	ICAAP I		
I. Every institution must have a process for assessing its capital adequacy in relation to its risk profile (an ICAAP).	There is no definition of adequate. Capital standard under Pillar 2 is same as under Pillar 1, but the form of the test is different. Pillar 2 should not be used to restore or exceed historical capital levels.	As stated in indent 18, for institutions and supervisors alike, judgments on risks and capital adequacy are based on the overall risk profile and are therefore more than an assessment of compliance	

		with Pillar 1 minimum capital requirements.	
	ICAAP II		
II b. Therefore the ICAAP should be the responsibility of each institution itself to fit its circumstances and needs, and using its own inputs and definitions.	Guidance could be provided. This potentially places a heavy burden on the institution.	It is up to the credit institutions to carry out their ICAAP within the guidance elaborated in paragraphs 16 and 21	
	ICAAP III		
III a. Deciding on how to categorise institutions in order to apply the principle of proportionality cannot be defined in a principles paper; it is more of a case-by-case issue, which will probably take account of factors such as size, significance to financial stability or to other ***objectives of the supervisory authority,*** risk profile, complexity, sophistication, history of compliance, legal form of the institution etc.	A respondent suggests to remove one of the criteria listed for determining whether the ICAAP is proportionate: the significance to other objectives of the supervisory authority'	This criterion can be removed : "financial stability" is already an including concept .	
III c. For less sophisticated institutions, and without prejudice to Principe V, the outsourcing of parts of the ICAAP and/or its review is also an issue. ***Conditions for accepting such outsourcing could be established nationally or at European level.*** It must be clear that each institution is considered according to its specific situation	The principles should be explicit on which part(s) of the ICAAP may be outsourced: small institutions are unlikely to be able to comply with the demands to manage all the risks in HLPs II and VIII. A small institution, which cannot measure credit risk and has opted for the SA, will hardly be able to measure other risks. The suggestion that these conditions are determined nationally seems to contradict the 'consistency' objective and does not seem	This issue addressed in the general principles on outsourcing issued by CEBS in April 2004 (See the introduction to this paper*).* CEBS proposes to change the indent making an explicit reference to theses standards	III c. Without prejudice to Principle V, the outsourcing of parts of the ICAAP must meet the CEBS' standards on outsourcing (CP02 *The high level principles on Outsourcing* , published 30 April 2004). However, it is important to emphasise that institution remains responsible for the ICAAP regardless of the degree of outsourcing . It must be clear that each institution is considered

and individual risk profile.	reasonable when there is no conceptual reason why the nature of outsourcing risks and the way they are assessed should vary in different jurisdictions. Provisions on outsourcing should be deleted.		according to its specific situation and individual risk profile See new version
	ICAAP IV		
IV. The ICAAP should be formal, the capital policy fully documented and the management body's responsibility.	Clarification for the term management body - Executive, Administrative, Supervisory board? Principle IV overemphasizes the ICAAP as a risk management strategy.	The definition of the directive should apply. The ICAAP is a comprehensive process that institutions must have to identify and measure their risks for capital purposes.	
IV d. even though outsourcing of parts of the ICAAP –bearing in mind CEBS' HLP on outsourcing- could be permissible for less sophisticated institutions, it must be clear that ICAAP remains at all times the responsibility of the institution's management body.	CEBS should be careful to avoid restricting institutions from outsourcing on the basis of prescriptive principles. Decision to outsource parts of the ICAAP should be reviewed on a case-by-case basis. HLP on outsourcing should serve as a basis.	CEBS HLP on outsourcing will definitively serve as a basis.	
	ICAAP V		
V a. For the more sophisticated institutions , a complete integration of the ICAAP into the day–to-day management is expected	Clarification on what exactly means the day-to-day integration. The interpretation shouldn't be too literal. Risk measurement through capital requirement must be part of a bank's management but capital is only one dimension in the bank's management and should not be placed too high in the list of mitigating factors.	This requirement should not be interpreted literally as a daily checking but as something to be integrated in the corporate culture of the institution concerned .Anyway, the expression "day to day" can be deleted	V a. For the more sophisticated institutions, a complete integration of the ICAAP into the management is expected.
	ICAAP VI		
VI a. The ICAAP should be	The ICAAP should be continuously adjusted to	The ICAAP review period and how	V a The ICAAP should be reviewed

reviewed ***at least annually***, to ensure that the risks are covered correctly and reflect the actual risk profile of the institution.	reflect significant changes in an institution's business, its environment and therefore in its risk profile. Since management, internal audit and the regulator will all have a role in reviewing the ICAAP it would be helpful to define their different roles. In particular, internal audit's focus will be on reviewing the process rather than the content. It should be made clear that an annual review - under an annual account audit – may be deemed to meet the requirements concerning a regular review by banks. ICAAP review on an annual basis should not be a mandatory requirement. The ICAAP review period should be determined by the supervisor in line with the institutions risk profile	this review should be carried out should be determined by the institution. The review period should be in any case at least annual. Proposed change: The ICCAP should be reviewed by the institutions when deemed necessary to ensure that the risk …This review should be made at least on an annual basis	by the institution as often as is deemed necessary to ensure that risks are covered adequately and that capital coverage reflects the actual risk profile of the institution. This review should take place at least annually
	ICAAP VII		
VII a. The ICAAP should be risk–based VII e. Those less sophisticated institutions that take the Pillar 1 "model" as the starting point of their ICAAP (see below), should also start to meet this principle, in so far as the Capital Requirements Directive is promoting a risk-based model (even in the Standardised Approach for credit risk), and because general management and control frameworks will increasingly be based on risks considerations. Together with Principle VIII indicate that qualitative aspects	The rationality of the bank's management should be presumed. Such a request could imply quantifying what is mainly qualitative We do not see any reason why this approach should be excluded for more sophisticated institutions and do not believe that local regulators intend to exclude this approach for any institution or Group. To include a statement such as 'An institution's assessment of capital under the ICAAP will be both quantitative and qualitative in nature. As a result, there is no formulaic quantitative link between the totality of an institution's risk profile and strategic goals and the amount of capital it determines it should hold in total. However the total amount of capital should be assessed in light of Pillar 1 minimum requirements and additional quantitative information (where it exists) combined	The second comment seems to be a misunderstanding of what VII e) actually means as clearly this was stated to highlight that the risk-based approach should be applicable to every kind of institution.	

should also be integrated in the ICAAP process	with a qualitative evaluation of the numerous other relevant factors.' A listing of the most important aspects would enhance the certainty for credit institutions.		
	Diversification of risks and netting		
	The positive impact of diversification should be recognised. Pillar 2 should not simply sum the areas of capital deficiency and disregard the areas of capital surplus A need to explicitly recognise that diversification may exist and should warrant capital reductions.	This issue could be related to that of correlation.(See *analysis paper*)	
	ICAAP VIII (all risks)		
VIII a. The ICAAP should consider all risks: i. Pillar 1 risks; ii. risks covered but not fully captured under Pillar 1; iii. non-Pillar 1 risks, and iv. risk factors external to the institution.	Should refer to all *material* risks. Delete ii and iv. Risks in (ii) should already be covered in (i).	Already commented. Here, all risks should be understood as every type of risk, once the materiality criterion has been applied. This is specified in VII b)	
VIII b. The ICAAP should capture all of the material risks to which the institution is exposed, with the concept of materiality defined and explained by the institution, including non-banking risks (e.g. insurance).	Some risks are best dealt with through appropriate systems and controls and that where those systems and controls are in place and effective then there should be no additional capital requirement. Principle of material risks should be applied consistently across the entire document	See the previous comment	
VIII c. There is no standard categorisation of risk types, although supervisors will usually expect that the institution has	This implies that institution's internal risk categories should be mapped to the regulatory ones. If so, this list is not complete.	Annex B raises many concerns as it is seen as something imposed without enough regulatory basis.	

considered all material risks - see annex B.	The taxonomy of risks in annex B causes concern that supervisors may reduce the RAS to a tick-box exercise. Small institutions will not be able to assess the effect on capital of some risks (e.g. macro economic factors, procyclicality etc.) *This is a very repetitive comment among respondents	CEBS wish to emphasize that the Annex B is just a guide. (See the introduction to this paper)	
VIII d. External factors to be taken into account may include, e.g. new accounting rules, EU and wider legislation, macro-economic factors, procyclicality.	Institution itself should decide what external factors to take into account. Any lists should be guidelines not requirements.	This was not intended to constitute a list. Even if some of these risks are related to very concrete pieces of legislation, significant legislative changes should be taken into consideration, if possible.	
VIII e. There may be other (risks) which are more qualitative in nature	Recommend not elaborating on risks that are not "generally accepted". If a risk is not quantifiable how can supervisors determine its materiality		
VIII f. Specifically regarding credit risk, the following should be taken into account: stress-testing in IRB, residual risk in CRM, concentration risk, securitisation etc.	Could be deleted. These risks are already reflected through corresponding hair cuts and a fairly conservative recognition of securities under Pillar 1 CRM techniques. Does stress testing refer to stress or scenario testing? Residual risk in CRM should not be addressed in P2. Residual risk should be treated as operational risk. Other techniques should be positively.	As said before, the issues of stress testing warrants some clarification, as the term stress testing is currently being issued in different context with different meanings. CEBS will undertake work on stress testing in this domain.	
VIII g. In the aggregating all risks in a comprehensive manner the institution may take into account risk correlations.	This statement is warmly welcomed. CEBS should explicitly recognize that diversification may exist and should warrant capital reductions Majority of banks are not in a position to carry out		

	meaningful aggregation of risks. .		
Risk taxonomy in annex B (see also below)	The list neither reflects the diversity in supervisory practice nor the diversity in institutions' own risk practices. P2 should not become a box-ticking exercise. The risks in annex B must not gain any regulatory status and CEBS must recognise that there is no standard categorisation of risk types. If ICCAP must be comprehensive then CEBS should not set a list of risk types which does not reflect diversity of all risk nor the diversity of institutions' won risk practices. Annex B suggests that Pillar 2 RAS will overlap with Pillar 1 risks and risks becoming box-ticking exercise. Pillar 2 must be qualitative. List of risk factors: should not be presented as exhaustive, risks are difficult to assess independently, likely to conflict with the institutions categorization + contradiction with VIII b) Would rather stick to the material risks used in the Basel Accord	Same comment as in VIII c)	
	ICAAP IX (impact analysis)		
IX b. The plan should also set out how the institution will comply with capital requirements in the future, any relevant limits related to capital, and a general contingency plan for dealing with divergences and unexpected events (e.g. raising additional capital, restricting business, or use of risk mitigation techniques).	Some of these requirements may be too onerous on smaller institutions. How forward looking should (how far into the future) should the planning be?	The principle of proportionality should be applied here.	

IX c. Larger and more complex institutions should conduct stress tests which take into account the risks specific to the jurisdiction(s) in which they are operating and the particular stage of the business cycle. *Institution should analyse what impact new legislation, the actions of competitors etc. may have on its performance, in order to see what changes in the environment it could sustain.*	Institutions and regulators should have regard to the cost/ benefit analysis of investing considerable effort in such work in an environment with so much uncertainty. Provisions regarding impact analysis of new legislation, as well as of competitors' actions, is too far-reaching and should be deleted. Stress tests defined by Basel should meet the requirements	Again, this should be proportional to size and involvement of an institution in a certain type of business, etc. Relevant legislative changes with a clear impact in lines of business/accounting requirements should always be analyzed. Since the paragraph only concerns "Larger and more complex institutions" the proportionality question is already taken into account	
	ICAAP X (economic capital models)		
X. The ICAAP should be based on adequate measurement and assessment processes	Not clear how a small institution - that is unable to measure credit risk - can demonstrate that that the SA provides adequate cover for its risks.		
X b. Institutions will not be required to use formal economic capital (or other) models, although it is expected that more sophisticated institutions will elect to do so.	More sophisticated institutions may choose to design new ICAAPs using Pillar 1 with enhancements. There are many disadvantages of Economic Capital models, including their tendency to cover only parts of the overall business activities. Proposal to include diversification as a risk mitigating factor in ICAAP Risk mitigation through diversification should lead to capital reductions.		
X c iii. as a more sophisticated and complex system, possibly using "bottom-up" transaction-based approaches with integrated correlations.	CEBS should produce a detailed clarification of the method proposed here.	An explanation could be advisable.	
	ICAAP XI		

XI a. The ICAAP should produce a reasonable overall capital number and assessment. *The institution should be able to explain the similarities and differences between its ICAAP (which should cover all the risks) and the regulatory requirements to the supervisor's satisfaction.*	There should not be need for explanation if the ICAAP meets prudential supervision requirements. SREP only calls for mandatory explanation whenever there are differences. Concern that ICAAP number may be misrepresented without full access to all its details. Second sentence could be deleted without replacement.	An explanation should be always necessary ,as the supervisor should know the institution process behind the assessment and the reasonability of its procedures and methods CEBS considers that no change required	The ICAAP should produce a reasonable overall capital number and assessment. The institution should be able to explain to the supervisor's satisfaction the similarities and differences between its ICAAP (which should cover all risks) and its regulatory requirements.
XI b. Institutions might be encouraged to make greater disclosures, in order to allow them (and others) to make a comparison, for their internal purposes, of their ICAAP within their peer group, and in order to have a basis for comparison and a reasonableness check.	The need for benchmarking will be better served by an active bilateral dialogue between supervisors and institutions, rather than through public disclosure. Widespread opinions against this type of disclosure, skepticism about its usefulness as a tool for comparison of ICAAPs, as methodologies and principles are different Disclosure of Economic Capita/RAPM-figures should not be mandatory. Too sensitive information to be disclosed. Competition concerns Too much uniformity in peer groups could reduce diversity in risk measures and management techniques and exacerbate systemic problems.. If peer analysis is intended then it must be based on deeper examination and not on the comparison of a single ICAAP output. Dangers in supervisors encouraging too great a degree of uniformity of practice. P2 should have a systemic value in allowing institutions to exercise a diverse range of measures and management techniques. The SRP should be in its entirety a confidential process between banks and supervisors.	The issue on disclosure on ICAAP could deserve more in-depth attention. Comments suggesting a kind of herding behaviour promoted by too much disclosure could also be taken into consideration OK: the purpose of greater disclosure could be made less ambitiously and respecting confidentiality concerns:	Institutions might be encouraged to make greater disclosures of information which is not proprietary or confidential. This may provide them a means for comparing their ICAAP with their peer group, for internal purposes
	SREP details		

	SREP I (convergence)		
I d. However, the European authorities agree that while flexibility of approach is important, there will need to be common minimum standards or benchmarks in order to ensure consistency of application and a level playing field across Europe.	CRD Articles 60 and 80 (Paragraph 7d) should be noted. There is a role for CEBS to play if CRD is not amended and diversity of approach is permitted. Principle I should state that Pillar 2 should not automatically require a higher capital standard than Pillar 1. The level playing field should extend beyond the EU.	This is implicit in the HLPs already in that these state that capital is one of several possible supervisory outcomes. Agree, in so far as CEBS can influence wider negotiations. Also, these principles should be applied to third country banks operating in the EU. CEBS considers that no change is needed	
	SREP II (scope of application)		
II. The SREP should apply to all authorised institutions.	Supervisors should think in terms of the group as a whole and not introduce additional burdens on individual entities.	To be decided.: No article 136 applies for "any credit institution" Agree that additional unnecessary burdens should be avoided.	
	SREP III (other risks)		
III b. Other risks to the consolidated group will also be captured, for example where services are being provided or control functions are being exercised from outside the consolidated group on an outsourced basis (even if within the wider group): for example IT, accounting, payment and settlement functions.	Principle of material risks should be applied consistently across the entire document	Agree. But it is implicit CEBS considers that no change is needed	
	SREP IV (stress tests)		

IV a. The supervisor will perform its analysis with a formal evaluation of risks factors and of control factors in place. The principles for the minimum content of the Risk Assessment System (RAS) used by supervisors are set out in Annex A.	The standardisation and transparency of the supervisory rating systems would be desirable even if the categorization of risks in Annex B can be debated. The standardisation of supervisory methodologies would be a very positive development.	Transparency is required by the Directive and should be a key feature of national methodologies, RAS and risk buckets.	
IV e. Stress tests could be used by the supervisor to help in establishing the need for early intervention.	It is unclear what supervisory stress tests are being referred to. They would by definition not be based on the profile of an individual organisation and therefore they might give inappropriate results. Not clear what sort of stress tests a supervisor might perform on the ICAAP. Basel definitions should be applied, no need for further stress tests	Agree. But supervisors should be able to stress test their industry to obtain an overall view on its robustness. CEBS considers that no change is needed	
	SREP V (assess and review ICAAP)		
V b. The supervisor may use the results of the RAS to inform its analysis.	Not clear: supervisory authorities should not misuse the information in the ICAAP and additional capital should not be based on the simple increase of confidence intervals. Supervisory authority should not recalculate an institution's ICAAP, or second guess its processes.	This could be made clearer: the RAS is the methodology whereby the supervisor takes the input from the ICAAP and analyses it. But the RAS is independent from the ICAAP. The RAS is the Supervisors input to the dialogue with the credit institution on the ICAAP.	
	ICAAP VII (estimation of risks)		
VII b. Other considerations may also be taken into account, such as external rating goals, market image, strategic goals etc., that are essential for the institution when deciding how much capital		These are not risks buckets but institutions' strategic factors	

to hold.			
VII d. At the same time, there are some types of (less readily quantifiable) risks for which the focus in the ICAAP should be more in qualitative assessment, risk management and mitigation.	The supervisor should present more details regarding the requirements of a methodology for the estimation of reputation and strategic risks	These risk buckets will be elaborated in more detail, together with the supervisory evaluation of them (quantitative, qualitative etc). Approaches to these non quantifiable risks are more qualitative in nature and difficult to "standardise".	
	SREP VIII (capital requirements)		
VIII b. The measures available to the supervisory authorities include the possibility to: (i) require a credit institution to hold own funds and/ or Tier 1 capital above the minimum level laid down, and/or impose other limitations on own funds; (ii) improve its internal control and risk management frameworks; (iii) require credit institutions to apply a specific provisioning policy or treatment of assets in terms of own fund requirements; (iv) restrict or limit the business, operations or network of credit institutions; and (v) reduce the risk inherent in activities, products and systems of credit institutions	The list of measures could interfere with a bank's business and corporate policy. This is incompatible with the rationale of the SRP. Delete (iv) and (v). The possibility of the individual, additional capital adequacy requirements should be put at the bottom of the list of possible options. Indent 759 of Basel II If supervisors require specific provisioning policy or treatment of assets then this should be aligned with relevant accounting standards to avoid inappropriate disparities between regulatory and accounting standards. Where a provisioning is imposed, it will be aligned with the relevant accounting standards Measures available to supervisors under pillar II should be kept confidential. If that were not the case, and taken into account the complex process behind the evaluation process that could lead to misinterpretation and could have irrevocable consequences to an individual institution or its banking group	The supervisory toolkit of prudential measures is not secret (only the individual application of a measure to specific institution may be confidential). Transparency and predictability mean that CEBS will elaborate the likely measures that should be applied and might aim to reach convergence on the likely circumstances when particular measures are appropriate. The supervisory toolkit is now described in art 136 of the directive. This paragraph is in line with that. Agree that convergence in desirable. TCEBS is working on this.	
VIII d. Such measures can be used singularly or in combination. A specific own funds requirement	*At least* should be replaced by *only*. Pillar 2 must not develop into systematic or	No. Capital may be an appropriate supervisory response to a wide range of problems within an	

shall, however, be imposed ***at least*** on an institution which has an imbalance between its business risks and internal control/risk frameworks which cannot be remedied by other prudential measures or supervisory actions within an appropriate timeframe	material capital charges. Capital add-ons should be the exception not the norm. Even material intervention may be appropriate for temporary or outlier situations. Additional own funds should only be used when the use of other prudential actions are considered not to be sufficient.	institution. It depends on the specific case. Some authorities may wish to use capital on a fairly frequent basis, while others may wish to use other tools.	
VIII e. A specific own funds requirement may be set to reflect the outcome of an institution's ICAAP; or, for example, where the supervisor judges the level of own funds held to be inherently inadequate for the institution's overall risk profile.	Supervisors should use the full range of tools at their disposal, not just a capital surcharge. A mitigating measure or a change to an institutions risk and controls systems could equally serve to reduce the level of risk Individual capital adequacy requirements should only be regarded as supervisory means of the last resort.	Agree. CEBS considers that no change is needed. No, it will be for the supervisor to determine the appropriate response and to decide whether capital is needed, whether that is the first or last resort.	
	SREP IX (communication)		
IX a. The authorities will convey the results of the risk assessment to the institution.	Communication of the institution's SREP in sufficient detail back to the institution is indispensable to Pillar 2.	Agree, but no change is needed.	
	SREP X (review)		
X. The supervisory evaluation should be formally reviewed at least on an annual basis, in order to ensure that it is up to date and remains accurate.	FSA performs its ARROW assessment of most large banks on two yearly cycles, which is reasonable. The annual review does not necessarily imply on-site inspections A mandatory annual review is not appropriate regardless of size of CIs, complexity and risk profile For some categories of CIs, an annual off-site revision might prove sufficient	Supervisors will follow the Directive text (*the review and evaluation shall be updated at least on an annual basis*). However the intensity of this review is subject to proportionality.	
	ANNEX RAS		

Broad disclosure of the risk assessment System (RAS) will contribute to the dialogue with institutions on their capital situation	The Supervisory Authority should disclose the major parameters for the assessment of the individual ratings for banks regarding risks and controls. Useful to see how supervisors will promote consistency of practice. But needs to do more to cover cross border issues and cross sectoral groups. To keep out this sentence or to define what is meant by "broad disclosure of the RAS". To stand clearly that disclosure refers to methodology.	CEBS is issuing for public consultation the result of its work in this domain	
	Annex B		
	Seeking to capture all risks would be too far-reaching. List should be identical to the list of the proposed Directive. Against the Annex B list of risks. Concerns that a new concept of risk taxonomy Without a statutory status should drop these definitions (ICAAP VIII c). Launch working groups on the issue. The list should not refer to earnings.	Annex is just for guidance.	In the new Consultation Paper Annex B has been replaced with a definition of the different types of risks that institutions can face