



EBA/CP/2014/14

7 July 2014

Consultation Paper

Draft Guidelines for common procedures and methodologies for the supervisory review and evaluation process under Article 107 (3) of Directive 2013/36/EU

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1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions in Section 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 7 October 2014. Please note that comments submitted after this deadline, or submitted via other means, may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

These guidelines, developed pursuant to Article 107(3) of Directive 2013/36/EU, are addressed to competent authorities and aim at promoting common procedures and methodologies for the supervisory review and evaluation process (SREP) referred to in Article 97 of Directive 2013/36/EU and for the assessment of the organisation and treatment of risks referred to in Articles 76 to 87 of Directive 2013/36/EU. The guidelines comprehensively cover all aspects of SREP: an ongoing supervisory process bringing together findings from all supervisory activities performed on an institution into a comprehensive supervisory view.

The common SREP framework introduced in these guidelines is built around:

- a. business model analysis;
- b. assessment of internal governance and institution-wide control arrangements;
- c. assessment of risks to capital and adequacy of capital to cover these risks; and,
- d. assessment of risks to liquidity and adequacy of liquidity resources to cover these risks.

Quarterly monitoring of key indicators is used as a basis for identifying material deteriorations in the risk profile and supporting the SREP framework. The elements of the SREP framework are assessed and scored on a 1-4 scale. The outcome of the assessments, both individually and considered in a holistic manner, form the basis for the Overall SREP assessment, which represents the up-to-date supervisory view of the institution's risks and viability. The summary of the Overall SREP assessment should capture this view, and should also reflect any supervisory findings made over the course of the previous 12 months and any other developments that have led the competent authority to change its view of the institution's risks and viability. It should form the basis for supervisory measures and communication with the institution.

These guidelines make a link between ongoing supervision, addressed in Directive 2013/36/EU, with the determination of whether the institution is 'failing or likely to fail', as addressed in Directive 2014/59/EU. This is through the assessment in the SREP of the institution's viability, as measured by the Overall SREP assessment and Overall SREP score. The Overall SREP score has four positive grades to be applied to viable institutions (1-4) and one negative grade ('F') - indicating that the competent authority has determined that the institution is 'failing or likely to fail' in the meaning of Article 32 of Directive 2014/59/EU.

These guidelines recognise the principle of proportionality by:

- a. introducing a categorisation of institutions (with four distinct categories) according to their systemic importance and the span of any cross-border activities; and,
- b. building a minimum supervisory engagement model, where the frequency, depth and intensity of the assessments vary depending on the category of the institution.

These guidelines introduce consistent methodologies for the assessment of risks to capital and risks to liquidity, and for the assessment of capital and liquidity adequacy. This is essential both for achieving more consistent prudential outcomes across the Union, and for the purposes of reaching joint decisions on the capital and liquidity adequacy of cross-border EU banking groups.

These Guidelines are issued for public consultation and are expected to be applied by 01 January 2016, taking into account the results of the public consultation. These guidelines recognise longer transitional arrangements for the application of certain quantitative liquidity and capital provisions.

3. Background and rationale

The EBA has a mandate to foster sound and effective supervision and to drive supervisory convergence across the EU emerging from requirements set out in Directive 2013/36/EU and more generally from its obligations under its founding Regulation.

Article 107 of Directive 2013/36/EU addresses the consistency of supervisory reviews, evaluation and supervisory measures, mandating the EBA to:

- Assess the information provided by national competent authorities on the functioning of their review and evaluation process referred to in Article 97 of Directive 2013/36/EU and the methodologies used to base decisions on referred to in Articles 98, 100, 101, 102, 104, and 105 for the purpose of developing consistency in the supervisory review and evaluation process. Findings from such assessments must be annually reported to the EU institutions.
- Develop guidelines addressed to the competent authorities to further specify, in a manner that is appropriate to the size, the structure and internal organisation of institutions and the nature, scope and complexity of their activities, the common procedures and methodologies for the supervisory review and evaluation process and for the assessment of the organisation and treatment of the risks referred to in Articles 76-78.

These guidelines address the latter mandate. This mandate covers common procedures and methodologies for SREP as defined in Article 97 of Directive 2013/36/EU, building on the technical criteria listed in Article 98, including the assessment of organisation and treatment of risks. In particular, it is expected that the guidelines should cover overall risk management and governance arrangements (Article 76), use of internal approaches for risk calculation (Articles 77, 78), credit and counterparty risk (Article 79), residual risk (Article 80), concentration risk (Article 81), securitisation risk (Article 82), market risk (Article 83), interest rate risk from non-trading activities (Article 84), operational risk (Article 85) and liquidity risk (Article 86).

The EBA has two relevant statutory objectives set out in its founding Regulation (Article 1 and 8(1)(h)) in relation to the development of the guidelines, requiring it to contribute among other things to:

- improving the functioning of the internal market, including, in particular, a sound, effective and consistent level of regulation and supervision;
- ensuring the integrity, transparency, efficiency and orderly functioning of financial markets;
- preventing regulatory arbitrage and promoting equal conditions of competition; and,

- to foster depositor and investor protection.

It has a more specific obligation to play an active role in building a ‘common supervisory culture’ and consistent supervisory practices, as set out in its founding Regulation. This requires it to carry out activities including:

- contributing to developing high-quality and uniform supervisory standards; and,
- developing new practical instruments and convergence tools to promote common supervisory approaches and practices.

The supervisory review and evaluation process, and the wider Pillar 2 components of the Basel framework, vary to a fairly large degree globally and throughout the EEA. The transposition of the Basel framework into EU legislation in relatively general terms left room for various approaches to supervision, reflecting the wide variation in banking systems, national laws and supervisory models, resources and traditions across jurisdictions.

In interpreting the Article 107(3) of Directive 2013/36/EU mandate to ‘further specify’ common procedures and methodologies for the SREP the EBA – with reference to its statutory obligations – defines its primary objective as the development of guidelines that increase the quality and consistency of supervisory SREP practices, and hence of their outcomes.

This means the observable effect of adoption of the guidelines should be that institutions with similar risk profiles, business models, and geographic exposures are reviewed and assessed by EU competent authorities in a consistent way and subject to broadly consistent supervisory expectations, actions and measures, where applicable, including institution-specific prudential requirements.

To achieve this objective, in addition to specifying SREP procedures and methodologies as required by Directive 2013/36/EU, these guidelines also provide guidance around consequent supervisory measures a competent authority should consider, including prudential measures as specified in Directive 2013/36/EU.

The guidelines do not look to establish to a granular level of detail harmonised procedures and methodologies. Such an objective would be challenging on account of the wide variety of national approaches around the application of Pillar 2. It would also seem to counter the legislative preference for mandating the development of guidelines rather than Regulatory Technical Standards.

Although these guidelines grant flexibility, competent authorities should not apply these guidelines in such a manner that the result will be less convergence the set out in the guidelines, or lower supervisory standards. Rather the guidelines may be overlaid with supplementary processes and methodologies if believed necessary to facilitate supervisory practices at a national level.

These guidelines set the scope of application of the common SREP framework introduced in these guidelines, following the criteria set out in Regulation (EU) 575/2013 and Directive 2013/36/EU. Competent authorities may apply these guidelines to other types of financial institutions not covered by Regulation (EU) 575/2013 at their own discretion.

The common SREP framework introduced in these guidelines is built around the following major components:

1. categorisation of the institution and its periodic review;
2. monitoring of key indicators;
3. business model analysis;
4. assessment of internal governance and institution-wide controls;
5. assessment of risks to capital;
6. assessment of risks to liquidity and funding;
7. assessment of the adequacy of the institution's own funds
8. assessment of the adequacy of the institution's liquidity resources;
9. the Overall SREP assessment; and,
10. supervisory measures (and early intervention measures where necessary) and communication of the outcome of the SREP to the institution.

The categorisation of institutions into four categories is based on their size, structure, internal organisation, scope, nature and complexity of their activities. It should reflect the level of systemic risk posed by an institution. It is essential for the proportionate application of these guidelines: the frequency, intensity and granularity of SREP assessments, and the level of engagement, will depend on the institution's category.

Regular monitoring of key financial and non-financial indicators supports the SREP. It allows competent authorities to monitor changes in the financial condition and risk profile of institutions. It should prompt updates of the assessment of SREP elements where it brings to light new material information outside of planned supervisory activities.

The focus of the business model analysis is on the assessment of the viability of the institution's current business model and sustainability of its strategic plans. This can reveal key vulnerabilities facing the institution that may not be revealed by other elements of the SREP. Competent authorities should score the risk to the viability of an institution stemming from its business model and strategy.

The focus of the assessment of internal governance and institutions-wide controls is on (i) ensuring that these are adequate to its risk profile, business model, size and complexity of the institution, and (ii) assessing the degree to which the institution adheres to the requirements and standards of good internal governance and risk controls arrangements. Competent authorities should score the risk to the viability of an institutions stemming from deficiencies identified in governance and controls arrangements.

The focus of the assessment of risks to capital and risks to liquidity and funding is on the assessment of the material risks the institution is or might be exposed to. This is both in terms of risk exposure itself, and the quality of management and controls to mitigate the impact of the risk. Competent authorities should score the scale of the potential prudential impact on the institution posed by the risk.

Institution may face risks that are not covered or not fully covered by Regulation (EU) 575/2013 or the capital buffers set out in Directive 2013/36/EU. Through the assessment of the adequacy of the institution's own funds competent authorities should determine the quantity and composition of additional own funds required to cover risks the institution is or might be exposed to in addition to those covered by the minimum own funds requirements, and whether own funds requirements can be met over the economic cycle. In addition to the determination of such additional own funds requirements, competent authorities should score the viability of the institution given the quantity and composition of own funds held. The guidelines establish minimum composition requirements for own funds requirements covering certain risk types, however competent authorities are not prohibited from applying stricter requirements to cover such risks if they believe that appropriate. By contrast they should not apply less strict requirements.

Through the assessment of the adequacy of the institution's liquidity resources competent authorities should determine whether the liquidity held by the institution ensures an appropriate coverage of risks to liquidity and funding. Competent authorities should determine whether the imposition of specific liquidity requirements is necessary to capture risks to liquidity and funding to which an institution is or may be exposed. Competent authorities should score the viability of the institution stemming from its liquidity position and funding profile.

Having conducted the assessment of the above SREP elements, competent authorities should form a comprehensive, holistic view on the risk profile and viability of the institution – the Overall SREP assessment - and summarise this view in the summary of the Overall SREP assessment. This summary should reflect any supervisory findings made over the course of the previous 12 months and any other developments that have led the competent authority to change its view of the institution's risks and viability. The outcome of the Overall SREP assessment should be the taking of any necessary supervisory measures necessary to address concerns.

In the assessment of SREP elements competent authorities should use a range of '1' (no discernible risk) to '4' (high risk), reflecting the 'supervisory view' of the risk based on the relevant scoring tables in each element-specific titles. This guidance on scoring is not mechanical: scores are assigned on the basis of supervisory judgement. Competent authorities should use the

accompanying ‘considerations’ provided for guidance to support supervisory judgement. Competent authorities are not prohibited from applying more granular scoring on top of the base requirements laid out in the guidelines if they believe it is valuable for supervisory planning purposes.

The guidelines also provide practical guidance on the application of supervisory measures listed in Articles 104 and 105 of Directive 2013/36/EU, including the application of additional own funds requirements and quantitative institution-specific liquidity requirements, which is an important step in further converging supervisory practices for the purposes of reaching a joint decision on institution-specific prudential requirements under Article 113 of Directive 2013/36/EU.

The assessment through the SREP of the viability of an institution and its compliance with the requirements of Regulation (EU) 575/2013 and Directive 2013/36/EU allows for the use of the outcomes of the assessment in setting triggers for early intervention measures, as provided in Article 27 of Directive 2014/59/EU. It also allows for the determination of whether an institution can be considered as ‘failing or likely to fail’ pursuant to Article 32 of Directive 2014/59/EU (when such a determination is made by a competent authority).

These guidelines also accommodate the interaction between institution-specific supervisory measures based on the outcomes of SREP, and macro-prudential measures. This is necessary as Directive 2013/36/EU allows Pillar 2 to be used for macro-prudential purposes. It requires competent authorities to take systemic risks into account when carrying out the SREP, including the risks that an institution poses to the financial system. The ESRB has provided guidance on the use of Pillar 2 for macro-prudential purposes, including the role of the SREP, in its ‘Handbook on Operationalising Macro-prudential Policy in the Banking Sector’. It advises, among other things, that competent authorities coordinate with the national macro-prudential (designated) authority when evaluating systemic risks under the SREP and when addressing systemic risks by using Pillar 2 measures.

When applying additional own funds requirements to institutions subject to Article 113 of Directive 2013/36/EU using the provisions set out in Article 103 of Directive 2013/36/EU, the setting of the additional own funds requirements are subject to the joint decision process set out under Article 113.

These guidelines cover the application of supervisory measures to cover institution-specific risk exposures. Where competent authorities take additional measures based on institutions having similar risk profiles, business models or geographic locations of exposures, these measures should be taken through the provisions set out in Article 103 of Directive 2013/36/EU.

4. Draft Guidelines for common procedures and methodologies for supervisory review and evaluation process under Article 107 (3) of Directive 2013/36/EU

Title 1. Subject matter, definitions and scope of application

1.1 Subject matter

1. These guidelines set out the common procedures and methodologies for the functioning of the Supervisory Review and Evaluation Process (SREP) referred to in Article 97 of Directive 2013/36/EU, including for the assessment of the organisation and treatment of risks referred to Articles 76 to 87 of that Directive and processes and actions taken with reference to Articles 98, 100, 101, 102, 104, and 105 of that Directive.
2. These guidelines are addressed to competent authorities referred to in Article 4 (2) of the EBA Regulation and to institutions under their remit for the purposes of application of Article 110 of Directive 2013/36/EU.

1.2 Definitions

3. The following definitions cover terms specifically introduced for the purposes of these guidelines:

‘Capital buffer requirements’ means the own funds requirements set out in Chapter 4 of Title VII of Directive 2013/16/EU.

‘Conduct risk’ means the current or prospective risk to the institution’s earnings and own funds arising from inappropriate supply or wilful misconduct in providing financial services.

‘Counterbalancing capacity’ means the institution’s ability to hold, or have access to, excess liquidity over the short-term, medium-term and long-term time horizons in response to stress scenarios.

‘Credit spread risk’ means the risk arising from changes in the market value of debt financial instruments due to fluctuations in their credit spread.

‘Funding risk’ means the risk that the institution does not have stable sources of funding in the medium and long term, resulting in the current or prospective risk that an institution cannot meet its financial obligations, such as payments and collateral needs, as they fall due in the medium to long term, either at all or without increasing funding costs unacceptably.

‘FX lending’ means lending to borrowers independent of the legal form of the credit facility (e.g. including deferred payments or similar financial accommodations) in currencies other than the legal tender of the country in which the borrower is domiciled.

‘FX lending risk’ means the current or prospective risk to the institution’s earnings and own funds arising from FX lending to unhedged borrowers.

‘Internal capital adequacy assessment process (ICAAP)’ means the process for the identification, measurement, management and monitoring of internal capital implemented by the institution according to Article 73 of Directive 2013/36/EU.

‘Internal liquidity adequacy assessment process (ILAAP)’ means the process for the identification, measurement, management and monitoring of liquidity implemented by the institution according to Article 86 of Directive 2013/36/EU.

‘Institution’s category’ means the indicator of the institution’s systemic importance assigned according to the institution’s size, complexity and scope of its activities.

‘Interest rate risk’ (IRR) means the current or prospective risk to the institution’s earnings and own funds arising from adverse movements in interest rates.

‘Intraday liquidity’ means the funds which can be accessed during the business day to enable the institution to make payments in real time.

‘Intraday liquidity risk’ means the current or prospective risk that the institution will fail to manage its intraday liquidity effectively.

‘IT risk’ means the current or prospective risk to the institution’s earnings and own funds arising from inadequate or poorly managed information technology and processing.

‘Macro-prudential requirements’ means measures taken to address macro-prudential or systemic risk.

‘Material currency’ means a currency in which the institution has material balance-sheet or off-balance-sheet positions.

‘Model deficiencies’ means the risk that internal approaches as defined in Article 3 of Directive 2013/36/EU under-estimate own funds requirements.

‘Overall Capital Requirement (OCR)’ means the sum of the TSCR, capital buffer requirements, and macro-prudential requirements.

‘Overall SREP assessment’ means the up-to-date assessment of the overall viability of an institution based on assessment of the SREP elements.

‘Overall SREP score’ means the numerical indicator of the overall risk to the viability of the institution based on the Overall SREP assessment.

‘Reputational risk’ means the current or prospective risk to the institution’s earnings, own funds or liquidity arising from damages to the institution’s reputation.

‘Risk appetite’ means the aggregate level and types of risk the institution is willing to assume within its risk capacity, in line with its business model, to achieve its strategic objectives.

‘Risks to capital’ means distinct risks that should they crystallise will have a significant prudential impact on the institution’s own funds over the next 12 months. These include but are not limited to those risks covered by Articles 79 to 87 of Directive 2013/36/EU.

‘Risks to liquidity and funding’ mean distinct risks that should they crystallise will have a significant prudential impact on the institution’s liquidity over different time horizons.

‘SREP element’ means one of the following: business model analysis, assessment of internal governance and institution-wide risk controls, assessment of risks to capital, SREP capital assessment, assessment of risks to liquidity and funding, and SREP liquidity assessment.

‘Structural FX risk’ means the risk arising from equity held that has been deployed in offshore branches and subsidiaries in a currency other than the parent undertaking’s reporting currency.

‘Supervisory benchmarks’ means risk-specific quantitative tools developed by the competent authority to provide an estimation of the own funds to cover risks or elements of risks not covered by Regulation 2013/575/EU.

‘Survival period’ mean the period during which the institution can continue operating under stressed conditions and still meet its payments obligation.

‘Total risk exposure amount (TREA)’ means total risk exposure amount as defined in Article 92 of Regulation 2013/575/EU.

‘Total SREP Capital Requirement (TSCR)’ means the sum of own funds requirements as set out in Article 92 of Regulation (EU) 575/2013 and additional own funds requirements determined according to the criteria laid out in these guidelines.

‘Unhedged borrowers’ means retail and SME borrowers without a natural or financial hedge which are exposed to a currency mismatch between the loan currency and the hedge currency; natural hedges include in particular cases where borrowers receive income in foreign currency (e.g. remittances/export receipts), while financial hedges normally presume there is a contract with a financial institution.

1.3 Scope of application

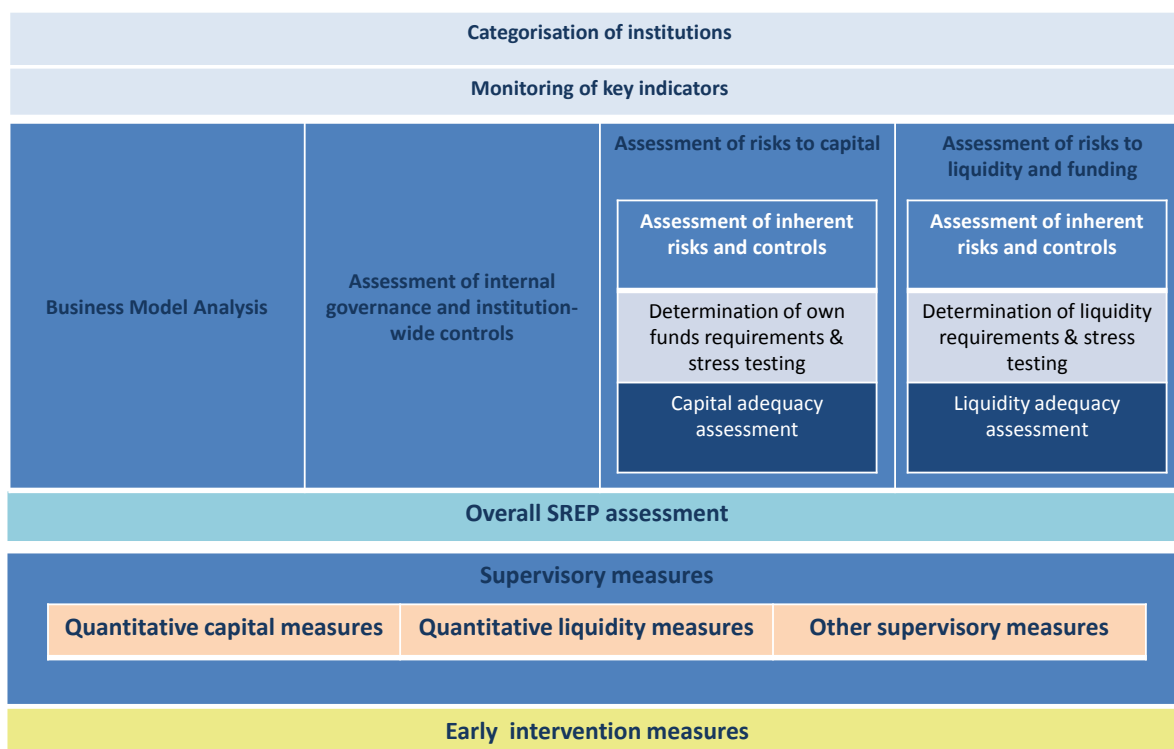
4. Competent authorities should apply these guidelines in accordance with the level of application determined in Article 110 of Directive 2013/36/EU following the requirements and waivers used in accordance with Articles 108 and 109 of Directive 2013/36/EU.
5. For parent undertakings and subsidiaries included in the consolidation, competent authorities should adjust the depth and the level of granularity of their assessment to correspond to the level of application of the requirements of Regulation (EU) 575/2013 set out in Part One, Title II of that Regulation.
6. Where an institution has a subsidiary in the same Member State, but no waivers set out in Part One of Regulation (EU) 575/2013 were granted, the application of proportionate approach for the assessment of capital and liquidity adequacy may be applied by focusing on the assessment of allocation of capital and liquidity across the entities and potential impediments to the transferability of capital or liquidity within the group.
7. For cross-border groups procedural requirements should be applied in the coordinated fashion within the framework of colleges of supervisors established according to Article 116 of Directive 2013/36/EU.
8. Where following Article 8 of Regulation (EU) 575/2013 an institution and all or some of its subsidiaries in the Union have been waived from the application of the Part 6 (Liquidity) of the Regulation (EU) 575/2013, and they are supervised as a single liquidity sub-group, competent authorities should conduct their assessment of risks to liquidity and funding, and apply supervisory measures, at the level of the liquidity sub-group.
9. The SREP process and methodologies set out in these guidelines should not be seen as exhaustive or as in any way depriving the competent authorities of their supervisory discretion to the extent this is in line with legislation applicable and these guidelines. Aspects of the guidance may not be applicable to every institution in every situation.

Title 2. The common SREP

2.1 Overview of the common SREP framework

10. Competent authorities should ensure that the SREP of an institution covers the following components, which is also summarised in Figure 1:
- a. categorisation of the institution and its periodic review;
 - b. monitoring of key indicators;
 - c. business model analysis (BMA);
 - d. assessment of internal governance and institution-wide controls;
 - e. assessment of risks to capital;
 - f. assessment of risks to liquidity;
 - g. assessment of the adequacy of the institution's own funds;
 - h. assessment of the adequacy of the institution's liquidity resources;
 - i. overall SREP assessment; and,
 - j. supervisory measures (and early intervention measures where necessary) and communication of the outcome of the SREP to the institution.

Figure 1. Overview of the common SREP framework



2.1.1 Categorisation of institutions

11. Competent authorities should categorise all institutions under their supervisory remit into one of the following categories, based on the institution's size, structure and internal organisation, nature, scope and complexity of its activities:

- ▶ Category 1 – Institutions referred to in Article 131 of Directive 2013/36/EU (G-SIIs and O-SIIs) and other institutions considered by competent authorities as large or systemically important.
- ▶ Category 2 – Institutions, other than those included in the Category 1, that are large- to medium-size operating domestically or with sizable cross-border activities, operating in several business lines, including non-banking activities, and offering credit and financial products to retail and corporate customers. Non-systemically important specialised institutions with significant market share in the respective line of business or payment system, or financial exchange.
- ▶ Category 3 – Institutions which do not qualify as Category 1 or 2 that are medium- to small-size operating domestically or with non-significant cross-border operations, operating in a limited number of business lines, offering predominantly credit products to retail and corporate customers with a limited offering of financial products. Specialised institution with less-significant market share in the respective line of business or payment system, or financial exchange.

- ▶ Category 4 – All other small non-complex domestic institutions which do not fall under Categories 1 to 3 (e.g. with limited scope of activities and non-significant market shares in their respective lines of business).
12. The categorisation should reflect the assessment of systemic risk posed by institutions to the financial system. It should be used by competent authorities as a basis for applying the principle of proportionality, as set out in Section 2.4.
 13. Competent authorities should base the initial categorisation on supervisory reporting data and on information derived from the preliminary business model analysis (see Section 4.1). The initial categorisation should be reviewed periodically, or in the event of a significant corporate event such as a large divestment, acquisition, important strategic action etc.

2.1.2 Continuous assessment of risks

14. Competent authorities should continuously assess the risks to which the institution is or might be exposed through the following activities:
 - a. monitoring of key indicators as laid out in Title 3;
 - b. business model analysis as laid out in Title 4;
 - c. assessment of internal governance and institution-wide controls as laid out in Title 5;
 - d. assessment of risks to capital as laid out in Title 6; and,
 - e. assessment of risks to liquidity and funding as laid out in Title 8.
15. The assessments should occur according to the proportionality criteria set out in Section 2.4. The assessments should be continuously reviewed in light of new information.
16. Competent authorities should ensure that the findings of the assessments outlined above:
 - a. are clearly documented in a summary of findings;
 - b. are reflected in a score assigned according to the specific guidance provided in the element-specific title of these guidelines;
 - c. support the assessments of other elements or prompt in-depth investigation of inconsistencies between the assessments of these elements;
 - d. contribute to the Overall SREP assessment and score; and,
 - e. result in supervisory measures, where appropriate.

2.1.3 Periodic assessment of capital and liquidity adequacy

17. Competent authorities should periodically review the adequacy of the institution's own funds and liquidity to provide a sound coverage of the risks to which the institution is or might be exposed through the following assessments:
 - a. SREP capital assessment as laid out in Title 7; and,
 - b. SREP liquidity assessment as laid out in Title 9.
18. The periodic assessments should occur on a 12 month to three-year basis taking into the proportionality criteria set out in Section 2.4. The assessments may occur more frequently at the discretion of the competent authority, and should be reviewed in light of material new findings from the SREP risk assessment where competent authorities determine that the findings may have a material impact on the institutions own funds and/or liquidity resources.
19. Competent authorities should ensure that the findings of the assessments:
 - a. are clearly documented in a summary;
 - b. are reflected in the score assigned to the institution's capital adequacy and liquidity adequacy, according to the guidance provided in the element-specific title;
 - c. contribute to the Overall SREP assessment and score; and,
 - d. form the basis for the supervisory requirement for the institution to hold own funds and/or liquidity resources in excess of the requirements set out in the Regulation (EU) 575/2013, or for the taking of other supervisory measures, as appropriate.

2.1.4 Overall SREP assessment

20. Competent authorities should continuously assess the risk profile of the institution and its viability through the Overall SREP assessment as laid out in Title 10. Through the Overall SREP assessment competent authorities should determine the potential for risks to cause the failure of the institution given the adequacy of its own funds and liquidity resources, governance, controls and/or business model or strategy, and from this, the need to take early intervention measures and/or determine if the institution can be considered failing or likely to fail.
21. The assessment should be continuously reviewed in light of findings from the risk assessments or the outcome of the SREP capital and SREP liquidity assessments.
22. Competent authorities should ensure that the findings of the assessment:

- a. are reflected in the score assigned to the institution's overall viability, according to the guidance provided in the Title 10;
- b. are clearly documented in a summary of the Overall SREP assessment, including the SREP scores assigned (Overall and for individual elements) and any supervisory findings made over the course of the previous 12 months; and,
- c. form the basis for the supervisory determination whether institution can be considered 'failing or likely to fail' according to Article 32 of Directive 2014/59/EU.

2.1.5 Taking supervisory measures and communicating findings

23. Competent authorities should take supervisory measures connected to the findings of the assessments of the SREP as laid out in Title 10. Supervisory measures in these guidelines are grouped into the following:
 - a. capital measures;
 - b. liquidity measures; and,
 - c. other supervisory measures (including early intervention measures).
24. The decision on the need and application of the supervisory measures should be taken by competent authorities based on the Overall SREP assessment, building on the findings of the assessments of the individual SREP elements. However, where findings from the monitoring of key indicators, assessment of SREP elements, or any other supervisory activity, necessitate the taking of supervisory measures to address immediate concerns, competent authorities should not wait for the completion of the assessment of all SREP elements and update of the Overall SREP assessment, but apply measures, as necessary, and subsequently update the Overall SREP assessment.
25. Competent authorities should inform the institution of the outcome of the Overall SREP assessment alongside associated supervisory measures as outlined in Section 2.4.

2.2 Scoring in the SREP

26. Following the criteria laid out in the element-specific titles competent authorities should score the institution's:
 - ▶ business model and strategy;
 - ▶ internal governance and institution-wide controls;
 - ▶ individual risks to capital;

- ▶ capital adequacy;
 - ▶ individual risks to liquidity and funding;
 - ▶ liquidity adequacy; and,
 - ▶ overall SREP assessment.
27. Competent authorities should ensure that all these scores are regularly reviewed, at least with the frequency defined in Section 2.4 of this title, and without undue delay on the basis of material new findings or developments.
28. In the assessment of SREP elements competent authorities should use a range of '1' (no discernible risk) to '4' (high risk), reflecting the 'supervisory view' of the risk based on the relevant scoring tables in each element-specific title. Competent authorities should use the accompanying 'considerations' provided in these tables for guidance to support supervisory judgement (i.e. it is not necessary for the institution to fulfil all the 'considerations' linked to a score of '1' to achieve a score of '1'), and/or they may further elaborate them or add additional considerations. For the SREP elements a score of '4' is the worst possible score that can be assigned (i.e. even where the institution's position is worse than that envisaged under the 'considerations' of a score of '4', a score of '4' should still be assigned).
29. Competent authorities should ensure that through the scoring of individual risks they provide an indication of the potential prudential impact of the risk to the institution after considering the quality of risk controls to mitigate this impact.
30. Competent authorities should ensure that the scoring of the business model, internal governance and institution-wide controls, capital adequacy and liquidity adequacy achieve the following objectives:
- ▶ to provide an indication of the threat posed to the institution's viability by the SREP elements assessed, given the individual risk assessments;
 - ▶ to indicating the likelihood that supervisory measures should be taken to address concerns; and,
 - ▶ to indicate the likelihood that early intervention measures should be taken, and to act as a trigger for them.
31. Competent authorities should ensure that the scoring of the Overall SREP assessment achieves the following objectives:
- ▶ to provide an indication of the institution's overall viability;
 - ▶ to indicate the likelihood that early intervention measures should be taken, and to act as a trigger for them; and,

- ▶ to determine, through the assessment of the overall viability of the institution, whether that institution is failing or is likely to fail.

32. Competent authorities should base the Overall SREP score on a '1' to '4' scale reflecting the overall viability of the institution. When the outcome indicates that Article 32 of Directive 2014/59/EU applies, competent authorities should apply a score of 'F'.

2.3 Organisational arrangements

33. Competent authorities should ensure that for the purpose of conducting the SREP their organisational arrangements include at least the following:

- a. a description of the roles and responsibilities of their supervisory staff with respect to performing the SREP as well as the relevant reporting lines, both in normal and in emergency situations;
- b. procedures for documenting and recording findings and supervisory judgements;
- c. arrangements for the approval of the findings and scores, as well as escalation procedures in case of dissenting views within the competent authority, both in normal and in emergency situations; and,
- d. arrangements for communicating the results of the SREP to the institution, reflecting also the interaction within colleges of supervisors in the case of groups and their entities.

2.4 Proportionality and supervisory engagement

34. Competent authorities should apply the principle of proportionality reflected in the scope, frequency and intensity of supervisory engagement with an institution, and supervisory expectations of the standards the institution should meet – according to the category of the institution. Competent authorities should apply the components of Titles 4, 5, 6 and 8 to the extent appropriate for the size, nature, business model and complexity of the institution.

35. Specifically, when planning SREP activities competent authorities should adhere to a minimum level of supervisory engagement (e.g. in the form of a dialogue and challenge session with representatives of the institution and/or onsite inspections as appropriate depending on the element being assessed) by category, as follows (and as outlined in Table 1):

Category 1 institutions

- ▶ Competent authorities should perform monitoring of key indicators on a quarterly basis.

- ▶ Competent authorities should at least annually produce a documented summary of the Overall SREP assessment.
- ▶ Competent authorities should at least annually update the assessments of all individual SREP elements. For risks to capital and risks to liquidity and funding, this should include the assessment of at least the most material individual risks.
- ▶ Competent authorities should at least annually inform the institution of the outcome of the Overall SREP assessment. This should be accompanied by:
 - a statement on the quantity and composition of the own funds the institution is required to hold in excess of the requirements set out in Chapter 4 of Title VII of Directive 2013/36/EU and in Regulation (EU) No 575/2013 relating to elements of risks and risks not covered by Article 1 of that Regulation;
 - a statement on the liquidity held and any specific liquidity requirements set by the competent authority; and,
 - a statement on other supervisory measures, including any early intervention measures, that the competent authority intends to take.
- ▶ Competent authorities should have ongoing engagement with the institution's management body and senior management for the assessment of each SREP element.

Category 2 institutions

- ▶ Competent authorities should perform monitoring of key indicators on a quarterly basis.
- ▶ Competent authorities should at least annually produce a documented summary of the Overall SREP assessment.
- ▶ Competent authorities should at least every two years update the assessments of all individual SREP elements. For risks to capital and risks to liquidity and funding, this should include the assessment of at least the most material individual risks.
- ▶ Competent authorities should at least every two years inform the institution of the outcome of the Overall SREP assessment. This should be accompanied by:
 - a statement on the quantity and composition of the own funds the institution is required to hold in excess of the requirements set out in Chapter 4 of Title VII of Directive 2013/36/EU and in Regulation (EU) No 575/2013 relating to elements of risks and risks not covered by Article 1 of that Regulation;

- a statement on the liquidity held and any specific liquidity requirements set by the competent authority; and,
 - a statement on other supervisory measures, including any early intervention measures, that the competent authority intends to take.
- ▶ Competent authorities should have ongoing engagement with the institution's management body and senior management for the assessment of each SREP element.

Category 3 institutions

- ▶ Competent authorities should perform monitoring of key indicators on a quarterly basis.
- ▶ Competent authorities should at least annually produce a documented summary of the Overall SREP assessment.
- ▶ Competent authorities should at least every three years update the assessments of all individual SREP elements, or sooner in light of material new information emerging on the risk posed. For risks to capital and risks to liquidity and funding, this should include the assessment of at least the most material individual risks.
- ▶ Competent authorities should at least every three years inform the institution of the outcome of the Overall SREP assessment. This should be accompanied by:
- a statement on the quantity and composition of the own funds the institution is required to hold in excess of the requirements set out in Chapter 4 of Title VII of Directive 2013/36/EU and in Regulation (EU) No 575/2013 relating to elements of risks and risks not covered by Article 1 of that Regulation;
 - a statement on the liquidity held and any specific liquidity requirements set by the competent authority; and,
 - a statement on other supervisory measures, including any early intervention measures, that the competent authority intends to take.
- ▶ Competent authorities should have risk-based engagement with the institution's management body and senior management (i.e. where necessary) for the assessment of the material risk element(s).

Category 4 institutions

- ▶ Competent authorities should perform monitoring of key indicators on a quarterly basis.

- ▶ Competent authorities should at least annually produce a documented summary of the Overall SREP assessment.
- ▶ Competent authorities should at least every three years update the assessments of all individual SREP elements, or sooner in light of material new information emerging on the risk posed. For risks to capital and risks to liquidity and funding, this should include the assessment of at least the most material individual risks.
- ▶ Competent authorities should at least every three years inform the institution of the outcome of the Overall SREP assessment. This should be accompanied by:
 - a statement on the quantity and composition of the own the institution is required to hold in excess of the requirements set out in Chapter 4 of Title VII of Directive 2013/36/EU and in Regulation (EU) No 575/2013 relating to elements of risks and risks not covered by Article 1 of that Regulation;
 - a statement on the liquidity held and any specific liquidity requirements set by the competent authority; and,
 - a statement on other supervisory measures, including any early intervention measures, that the competent authority intends to take.
- ▶ Competent authorities should have engagement with the institution's management body and senior management at least every three years.

Table 1. Application of SREP to different categories of institutions

Category	Monitoring of key indicators	Assessment of all SREP elements (at least)	Summary of the Overall SREP assessment	Minimum level of engagement
1	Quarterly	Annual	Annual	Ongoing engagement with institution's management body and senior management; engagement with institution for assessment of each element.
2	Quarterly	Every 2 years	Annual	Ongoing engagement with institution's management body and senior management; engagement with institution for assessment of each element.
3	Quarterly	Every 3 years	Annual	Risk-based engagement with institution's management body and senior management; engagement with institution for assessment of material risk

				element(s).
4	Quarterly	Every 3 years	Annual	Engagement with institution's management body and senior management at least every three years.

36. Where competent authorities determine that institutions have similar risk profiles they may conduct thematic SREP assessments on multiple institutions as a single assessment (e.g. a BMA may be conducted on all small mortgage lenders given it is likely to identify the same business viability issues for all these institutions).
37. Competent authorities should determine an additional level of engagement based on the findings from previous assessment of SREP elements, whereby greater supervisory resources and intensity should be required, regardless of the category of the institution, for institutions with a poor Overall SREP score (at least on a temporary basis).
38. For institutions covered by the supervisory examination programme required by Article 99 of Directive 2013/36/EU competent authorities should ensure that the level of engagement and application of SREP will be determined by the programme, superseding the above requirements.
39. When planning SREP activities competent authorities should pay special attention to coordinating activities with other parties directly or indirectly involved in the assessment, in particular when input is required from the institution and/or other competent authorities involved in the supervision of groups as covered in Title 11.
40. When conducting the SREP by applying these guidelines competent authorities should recognise that different elements do not have the same relevance for all institutions, and that it may be appropriate to apply different degrees of granularity depending on the category the institution is assigned to.

Title 3. Monitoring of key indicators

42. Competent authorities should engage in quarterly monitoring of key financial and non-financial indicators in order to monitor changes in the financial condition and risk profile of institutions. Competent authorities should use this monitoring aims to update the assessment of SREP elements in light of new material information outside of planned supervisory activities. Where monitoring reveals a material deterioration in the risk profile of the institution, or other anomalies, competent authorities should investigate the causes, and, where relevant, review the assessment of the relevant SREP element in light of the new information.
43. Competent authorities should establish monitoring systems and patterns allowing for the identification of material deteriorations and anomalies in the behaviour of indicators, and should set thresholds, where relevant. Competent authorities should also establish escalation procedures for all relevant indicators (or combination of indicators) covered by the monitoring to ensure that the investigation of anomalies and material deteriorations occurs.
44. Competent authorities should tailor the set of indicators and their thresholds to the specificities of individual institutions or groups of institutions with similar characteristics (peer groups). The framework of indicators, monitoring patterns and thresholds should reflect the institution's size, complexity, business model and risk profile.
45. Competent authorities should identify the indicators to be tracked through the quarterly monitoring using definitions from common reporting standards. Where relevant, EBA dashboards or indicators being monitored by the EBA may be used as a source of information against which individual institutions can be monitored.
46. The framework of indicators established and outcomes of the monitoring of key indicators should also be used as one of the inputs into the assessment of risks to capital and risks to liquidity and funding under the respective SREP elements.
47. Indicators used for quarterly monitoring should include at least the following institution-specific indicators:
 - a. financial and risk indicators addressing all risk categories covered by these guidelines;
 - b. all ratios directly derived from Regulation (EU) No 575/2013 and by Directive 2013/36/EU and used for the calculation of minimum prudential requirements (e.g. CT1, LCR, NSFR etc.);

- c. the minimum requirements for own funds and eligible liabilities (MREL) as set for an institution pursuant to provisions of Directive 2014/59/EU;
 - d. relevant market-based indicators (e.g. equity price, CDS spread etc.); and,
 - e. where available, recovery indicators used in the institution's own recovery plans.
- 48. Competent authorities should accompany institution-specific indicators with relevant macro-economic indicators, where available, in the geographies, sectors and markets where the institution operates.
- 49. Identification of material deteriorations or anomalies in indicators should be considered as a prompt for further investigation. Specifically, the competent authorities should:
 - a. determine the cause and make an assessment of materiality of the potential prudential impact on the institution;
 - b. document the cause and outcome of the assessment; and,
 - c. review the risk assessment and SREP score, where relevant, in light of any new findings.

Title 4. Business model analysis

4.1. General considerations

50. This title sets out criteria for the assessment of the business model and strategy of the institution. This assessment may be conducted on a group-wide basis or on business lines or product lines, and on an institution-specific or a thematic basis.
51. Competent authorities should use the outcome of the BMA to support all other elements of the SREP. Specific elements of the BMA, particularly related to the quantitative assessment of the business model, may be conducted if appropriate as part of the assessment of other SREP elements (e.g. understanding the funding structure can occur as part of the risks to liquidity assessment).
52. Competent authorities should conduct regular business model analyses (BMA) on institutions they supervise to assess business and strategic risks and determine the:
- ▶ viability of the institution's current business model on the basis of its ability to generate acceptable returns over the following 12 months; and,
 - ▶ sustainability of the institution's strategy on the basis of its ability to generate acceptable returns over a forward-looking period of at least three years, based on its strategic plans and financial forecasts.
53. Competent authorities should also use the BMA to support the identification of the institution's key vulnerabilities, which are most likely to materially impact the institution / lead to its failure on a forward-looking basis.
54. Competent authorities should undertake the following steps as part of the BMA:
- a. preliminary assessment;
 - b. identifying the areas of focus;
 - c. assessment of the business environment;
 - d. quantitative analysis of the current business model;
 - e. qualitative analysis of the current business model;
 - f. analysis of the forward-looking strategy and financial plans (including changes planned to the business model);
 - g. assessment of business model viability;

- h. assessment of sustainability of the strategy;
 - i. identification of key vulnerabilities that the institution's business model and strategy expose it to or may expose it to; and,
 - j. summarising the findings and scoring.
55. In order to conduct the BMA competent authorities should use at least the following sources of quantitative and qualitative information:
- a. institution's strategic plan(s) with current year and forward looking forecasts, and underlying economic assumptions;
 - b. financial reporting (e.g. P&L, balance sheet disclosures);
 - c. regulatory reporting (COREP, FINREP, credit register, where available);
 - d. internal reporting (management information, capital planning, liquidity reporting, internal risk reports);
 - e. recovery and resolutions plans;
 - f. third party reports (e.g. audit reports, equity/credit analyst); and,
 - g. other relevant studies/surveys (e.g. from IMF, macro stability institutions, European institutions).

4.2. Preliminary assessment

56. Competent authorities should analyse the institution's main activities, geographies and market position to identify, at the highest level of consolidation in the jurisdiction, the institution's:
- a. major geographies;
 - b. major subsidiaries/branches;
 - c. major business lines; and,
 - d. major product lines.
57. For this purpose, competent authorities should consider a range of relevant metrics, such as:
- a. contribution to overall revenues/costs;
 - b. share of assets;

- c. share of TREA; and,
- d. market position.

58. Competent authorities should use this preliminary assessment to:

- a. determine materiality of business areas: Competent authorities should determine which geographies, subsidiaries/branches, business lines and product lines are the most material based on profit generation (e.g. based on P&L) and/or risk (e.g. based on TREA or other measures of risk). Competent authorities should use this information as a basis for identifying the focus on the BMA (further covered in Section 4.3).
- b. identify the peer group: Competent authorities should determine the relevant peer group for the institution. For the purposes of conducting a BMA the competent authority should determine the peer group on the basis of the rival product / business lines targeting the same source of profits / customers (e.g. the credit card businesses of different institutions targeting credit card users in country X).
- c. support the application of the principle of proportionality: Competent authorities may use the outcomes of the preliminary assessment to help the allocation of institutions into proportionality categories on the basis of the identified complexity of the institution.

4.3. Identifying the areas of focus of the BMA

59. Competent authorities should determine the focus of the BMA. They should focus on business lines that are most important in terms of current business model viability or future sustainability, and/or most likely to increase the institution's exposure to existing or new vulnerabilities. Competent authorities should take into account (in order of relative importance):

- a. materiality of business lines – whether certain business lines are more important in terms of generating profits (or losses);
- b. previous supervisory findings – whether the findings for other elements of the SREP can provide indicators on business lines requiring further investigation;
- c. importance to strategic plans – whether there are business lines that the institution wishes to substantially grow;
- d. outcome of thematic reviews – whether a sector-wide analysis (e.g. the subprime mortgage market) has revealed common underlying issues that prompt additional institution-specific analysis;

- e. observed changes in the business model – whether there are observed de facto changes in the business model that have occurred without the institution declaring any planned changes or releasing new strategic plans; and,
- f. peer comparisons – whether there is atypical performance of a business line compared to peers (being an outlier).

4.4. Assessment of the business environment

60. For the purpose of forming a view on the plausibility of an institution’s strategic assumptions competent authorities should undertake an analysis of the business environment. This takes into consideration the current and forward-looking business conditions in which an institution operates or is likely to operate based on its main or material geographic and business exposures. As part of this assessment competent authorities should develop an understanding of the direction of macro-economic and market trends and the strategic intentions of the peer group.
61. Competent authorities should use this analysis to develop an understanding of the:
- a. key macro-economic variables in which the relevant entity, product or segment being assessed operates or will operate based on its main geographies. Examples of key variables include GDP, unemployment rates, interest rates and house price indices.
 - b. the competitive landscape and how it is likely to evolve, considering the activities of the peer group. Examples of areas for review include expected target market growth (e.g. residential mortgage market) and the activities and plans of key competitors in the target market.
 - c. overall trends in the market which may impact on the institution’s performance and profitability. This should include at least regulatory (e.g. changes to retail banking product distribution legislation), technological (e.g. moves to electronic platforms for types of trading) and societal/demographic (e.g. greater demand for Islamic banking facilities).

4.5. Analysis of current business model

62. In order to understand the means and methods used by an institution to operate and generate profits, competent authorities should undertake quantitative and qualitative analyses.

4.5.1 Quantitative analysis

63. Competent authorities should undertake an analysis of quantitative features of the institution’s current business model for the purpose of understanding its financial

performance and the degree to which this is driven by its risk appetite being higher or lower than peers.

64. Areas for analysis by competent authorities should include:

- a. profit and loss, including trends: competent authorities should assess the underlying profitability of the institution (e.g. after exception items and one-offs), the breakdown of income streams, the breakdown of costs, impairments provisions and key ratios (e.g. net interest margin, cost / income, loan impairment). Competent authorities should consider how the above items have evolved in recent years and identify underlying trends;
- b. balance sheet, including trends: competent authorities should assess the asset and liability mix, the funding structure, the evolution of TREA and own funds, and key ratios (e.g. return on equity, Core Tier 1, funding gap). Competent authorities should consider how the above items have evolved in recent years and identify underlying trends;
- c. concentrations, including trends: competent authorities should assess concentrations in the P&L and balance sheet, related to customers, sectors and geographies. Competent authorities should consider how the above items have evolved in recent years and identify underlying trends; and,
- d. risk appetite: competent authorities should assess the formal limits put in place by the institution by risk type (credit risk, funding risk etc.) and its adherence to them in order to understand the risks that the institution is willing to take in order to drive its financial performance.

4.5.2 Qualitative analysis

65. Competent authorities should undertake an analysis of qualitative features of the institution's current business model for the purpose of understanding its success drivers and key dependencies.

66. Areas for analysis by competent authorities should include:

- a. key external dependencies: Competent authorities should determine the main exogenous factors that influence the success of the business model. This may include third-party providers, intermediaries, and specific regulatory drivers;
- b. key internal dependencies: Competent authorities should determine the main endogenous factors that influence the success of the business model. This may include the quality of IT platforms and operational and resource capacity;
- c. franchise: Competent authorities should determine the strength of the relationship with customers, suppliers and partners. This may include the

institution's reliance upon its reputation, the effectiveness of branches, the loyalty of customers, and effectiveness of partnerships; and,

- d. areas of competitive advantage: Competent authorities should determine the areas in which the institution has a competitive advantage over peers. This may include any of the above, for example the quality of the institution's IT platforms, or other factors such as the institution's global network, scale of business, or product proposition.

4.6. Analysis of the strategy and financial plans

67. Competent authorities should undertake a quantitative and qualitative forward-looking analysis of the institution's financial projections and strategic plan for the purpose of understanding the assumptions, plausibility and riskiness of its business strategy.
68. Areas for analysis by competent authorities should include:
 - a. overall strategy: Competent authorities should consider the main quantitative and qualitative management objectives;
 - b. projected financial performance: Competent authorities should consider projected financial performance, covering the same or similar metrics as covered in the quantitative analysis of the current business model;
 - c. success drivers of the strategy and financial plan: Competent authorities should determine the key changes to the current business model proposed in order to meet the objectives;
 - d. assumptions: Competent authorities should determine the plausibility and consistency of the assumptions made by the institution that drive its strategy and forecasts. This may include assumptions in areas such as macro-economic metrics, market dynamics, volume and margin growth in key products, segments and geographies etc.; and,
 - e. executing capabilities: Competent authorities should determine the institution's execution capabilities based on the management's track record in meeting previous strategy and forecasts and the complexity and ambition of the strategy set against the current business model.
69. Competent authorities may conduct parts of this analysis concurrently with the quantitative and qualitative analysis of the current business model, particularly the analysis of the projected financial performance and of the success drivers of the strategy, respectively.

4.7. Assessment of business model viability

70. Having conducted the analyses covered in Sections 4.4 and 4.5 competent authorities should form, or update, their view on the viability of the institution's current business model on the basis of its ability to generate acceptable returns, over the following 12 months, given its quantitative performance and key success drivers and dependencies.
71. Competent authorities should assess the acceptability of returns against the following criteria:
- a. return on equity (ROE) against the cost of equity (COE) – competent authorities should consider whether the business model generates a return above cost (excluding one-offs) on the basis of ROE against COE. Other metrics such as return on assets or risk-adjusted return on capital may also support this assessment;
 - b. funding structure – competent authorities should consider whether the funding mix is appropriate to the business model and to the strategy. Volatility or mismatches in the funding mix may mean that a business model or strategy, even where generating returns above costs, may not be viable or sustainable given the current or future business environment;
 - c. risk appetite – competent authorities should consider whether the institution's business model or strategy relies on a risk appetite, for individual risks (e.g. credit, market) or more generally, in order to generate sufficient returns that is considered high or is an outlier among the peer group.

4.8. Assessment of sustainability of the institution's strategy

72. Having conducted the analyses covered in Sections 4.4 - 4.6 competent authorities should form, or update, their view on the sustainability of the institution's strategy on the basis of its ability to generate acceptable returns, as defined above, over a forward-looking period of at least three years based on its strategic plans and financial forecasts.
73. Competent authorities should assess the sustainability of the institution's strategy based on:
- a. the plausibility of the institution's assumptions and projected financial performance against the supervisory view of the current and forward-looking business environment;
 - b. the impact on the projected financial performance of the supervisory view of the business environment (where this differs from the institution's assumptions); and,
 - c. the riskiness of the strategy (i.e. complexity and ambition of the strategy set against the current business model) and consequent likelihood of success based

on the institution's likely execution capabilities (measured by the institution's success in execution of previous strategies of similar scale or the performance against the strategic plan to date).

4.9. Identification of key vulnerabilities

74. Having conducted the BMA competent authorities should assess the key vulnerabilities that the institution's business model and strategy expose it to or may expose it to. This may include considering:
- a. poor expected financial performance;
 - b. reliance on an unrealistic strategy;
 - c. excessive concentrations or volatility (e.g. of earnings);
 - d. excessive risk-taking;
 - e. funding structure concerns; and/or,
 - f. significant external issues (e.g. regulatory threats, such as mandating 'ring-fencing' of business units).
75. Following the above assessment, competent authorities should form a view on the viability of the institution's business model and the sustainability of its strategy, and any necessary measures to address problems and concerns.

4.10. Summary of findings and scoring

76. Based on the assessment of viability and sustainability of business model, competent authorities should form an overall view on the business model and strategy. This view should be reflected in a summary of findings, accompanied by a score using the considerations set out in Table 2.

Table 2. Supervisory considerations for assigning a business model and strategy score

Score	Supervisory view	Considerations
1	The business model and strategy pose no discernible risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution generates strong and stable returns with an acceptable risk appetite and funding structure. • There are no material asset concentrations or concentrated sources of income. • The institution has a strong competitive position in chosen markets and a strategy

		<p>likely to reinforce this.</p> <ul style="list-style-type: none"> • The institution has financial forecasts developed on the basis of plausible forward-looking business environment assumptions. • Strategic plans are appropriate given the current business model and management execution capabilities.
2	The business model and strategy pose a low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution generates average returns compared to peers and/or historic performance, or relies on a risk appetite or funding structure to generate appropriate returns that, while acceptable, implies a low level of business model risk. • There are some asset concentrations or concentrated sources of income. • The institution faces competitive pressure for its products/services in one or more key markets. Some doubts around its strategy to address the situation. • The institution has financial forecasts developed on the basis of optimistic forward-looking business environment assumptions. • Strategic plans are reasonable given the current business model and management execution capabilities but not without risk.
3	The business model and strategy pose a medium level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution generates returns which are often weak or not stable, or relies on a risk appetite or funding structure to generate appropriate returns that raise supervisory concerns. • There are significant asset concentrations or concentrated sources of income. • The institution has a weak competitive position for its products/services in its chosen markets, and may have few business lines with good prospects.

		<p>Institution's market share may be declining significantly. Doubts around its strategy to address the situation.</p> <ul style="list-style-type: none"> • The institution has financial forecasts developed on the basis of overly optimistic forward-looking business environment assumptions. • Strategic plans may not be plausible given the current business model and management execution capabilities.
4	The business model and strategy pose a high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution generates very weak and highly unstable returns, or relies on an unacceptable risk appetite or funding structure to generate appropriate returns. • The institution has extreme asset concentrations or concentrated sources of income. • The institution has a very poor competitive position for its products/services in its chosen markets and participates in business lines with very weak prospects. Strategic plans very unlikely to address the situation. • The institution has financial forecasts developed on the basis of very unrealistic forward-looking business environment assumptions. • Strategic plans are not plausible given the current business model and management execution capabilities.

Title 5. Internal governance and institution-wide controls assessment

5.1 General considerations

77. The assessment of internal governance and institution-wide controls should focus on verifying whether the institution's governance and controls arrangements are adequate to its risk profile, business model, size and complexity, and to what degree the institution adheres to the requirements and standards of good internal governance and risk controls arrangements. In the assessment competent authorities should evaluate the risk of significant prudential impact posed by poor governance and controls arrangements, and their effect on the viability of the institution.
78. For the purposes of SREP the assessment of internal governance and institution-wide controls should encompass the assessment of the following areas:
- a. overall internal governance framework;
 - b. corporate and risk culture;
 - c. organisation and functioning of the management body;
 - d. remuneration policies and practices;
 - e. risk management framework, including ICAAP and ILAAP;
 - f. internal control framework;
 - g. information systems and business continuity; and
 - h. recovery planning arrangements.
79. The title does not address governance and risk management/controls aspects that are specific to individual risk types, i.e. which are not institution-wide, as the criteria for their assessment are addressed in Titles 6 and 8.
80. The assessment of internal governance and institution-wide controls should inform the assessment of risk management and controls in Titles 6 and 8, as well as the assessment of ICAAP and ILAAP in the SREP capital assessment (Title 7) and SREP liquidity assessment (Title 9). Likewise, risk-by-risk analysis of ICAAP calculations/capital estimates reviewed under Title 7 and, any deficiencies identified there, should inform the assessment of the overall ICAAP framework assessed under this title.

5.2 Overall internal governance framework

81. Competent authorities should assess whether the institution has an appropriate and transparent corporate structure, which is 'fit for purpose' and has implemented appropriate governance arrangements. Following the EBA Guidelines on internal governance this assessment should include an assessment of whether the institution demonstrates at least:
- a. a robust and transparent organisational structure with clear responsibilities, including the management body and its committees;
 - b. that the management body knows and understands the operational structure of the institution (e.g. entities and the links and relationships among them; special purpose or related structures) and the associated risks ('Know-your-structure' principle);
 - c. risk policies and policies to identify and avoid conflicts of interest;
 - d. an outsourcing policy that considers the impact of the outsourcing on the institution's business and the risks it faces; and,
 - e. that the internal governance framework is transparent to stakeholders.

5.3 Corporate and risk culture

82. Competent authorities should assess whether the institution has a sound corporate and risk culture, which is adequate to the scale, complexity, and nature of its business, and is based on sound, articulated values which take into account the institution's risk tolerance/risk appetite.
83. Following the EBA Guidelines on internal governance competent authorities should assess whether:
- a. the management body bears the overarching responsibility for the institution and sets its strategy;
 - b. the management body sets governance principles, corporate values and appropriate standards, including independent whistle-blower processes and procedures;
 - c. the institution's ethical corporate and risk culture creates an environment of effective challenge in which decision-making processes promote a range of views (e.g. by including independent members in its management body committees); and,

- d. there is evidence of the clear and strong communication of strategies and policies to all relevant staff and that the risk culture is applied across all levels of the institution.

5.4 Organisation and functioning of the management body

84. Following the EBA Guidelines on internal governance competent authorities should assess:
 - a. the setting, overseeing and regular assessment of the internal governance framework with its main components by the management body; and,
 - b. whether an effective interaction between the management and the supervisory functions of the management body exists.
85. Following the EBA Guidelines on internal governance and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders, competent authorities should review the composition and the functioning of the management body by assessing whether there is:
 - a. an adequate number of members of the body, and of an appropriate composition;
 - b. a sufficient level of commitment and independence of members;
 - c. a fit and proper assessment of members upon appointment, and on an on-going basis;
 - d. a review of the effectiveness of the management body;
 - e. appropriate internal governance practices and procedures for the management body and its committees, where relevant; and,
 - f. sufficient time allowed for members of the management body to consider risk issues and appropriate access granted to information on the risk situation of the institution.

5.5 Remuneration policies and practices

86. Competent authorities should assess whether the institution has in place a remuneration policy as specified in Articles 92-96 of Directive 2013/36/EU and appropriate remuneration policies for all staff members. Following the EBA Guidelines on internal governance and EBA Guidelines on remuneration policies and practices, competent authorities should assess whether:
 - a. the remuneration policy is in line with the institution's risk profile and is maintained, approved and overseen by the management body;

- b. the implemented compensation schemes support the institution's corporate values and are aligned with its risk appetite, its business strategy and its long-term interests;
- c. staff who have a material impact on the institution's risk profile are appropriately identified and Regulation (EU) No 604/2014 is correctly applied, in particular with regard to:
 - i. the application of the qualitative and quantitative criteria for the identification of staff; and,
 - ii. the provisions on exclusions of staff who were identified only under the quantitative criteria within Article 4 of Regulation (EU) No 604/2014;
- d. the remuneration policy does not incentivise excessive risk-taking; and,
- e. there is the correct allocation between variable and fixed remuneration and the provisions on the limitation of the variable remuneration component – to 100% of the fixed remuneration component (200% with shareholders' approval) – are complied with and variable remuneration is not paid through vehicles or methods that facilitate the non-compliance with the Directive 2013/36/EU or Regulation (EU) No 575/2013.

5.6 Risk management framework

87. Competent authorities should assess whether the management body of the institution has established an appropriate risk management framework and risk management processes. This assessment should include at least the review of:
- a. the risk appetite framework and strategy;
 - b. the ICAAP and ILAAP frameworks; and,
 - c. stress testing capabilities.

5.6.1 Risk appetite framework and strategy

88. To review the risk appetite framework and strategy of an institution, competent authorities should assess:
- a. whether the risk appetite framework considers all material risks that the institution is exposed to and contains risk limits, tolerances and thresholds;
 - b. whether the risk appetite and risk strategy are consistent, and both are implemented accordingly;

- c. whether the risk appetite framework is forward looking and is in line with the strategic planning horizon, and regularly reviewed;
 - d. whether the responsibility of the management body, in respect of the risk appetite framework, is clearly defined;
 - e. whether the risk strategy appropriately considers the financial resources of the institution (i.e. Risk appetite should be consistent with supervisory own funds and liquidity requirements and other supervisory measures); and,
 - f. whether the risk appetite statement is documented in writing and there is evidence that is communicated to the staff of the institution.
89. In assessing the risk management framework, competent authorities should consider the extent to which it is embedded in, and how it influences, the overall strategy of the institution. Competent authorities should in particular assess the link between the strategic plan, risk and capital and liquidity management frameworks.

5.6.2 ICAAP and ILAAP frameworks

90. Competent authorities should periodically review the institution's ICAAP and ILAAP and determine their (1) soundness, (2) effectiveness and (3) comprehensiveness according to the criteria set out in this section. Competent authorities should also assess how ICAAP and ILAAP are integrated into overall risk management and strategic management practices, including capital and liquidity planning.
91. These assessments should contribute to the calculation of additional own funds requirements and the assessment of capital adequacy as outlined in Title 7, as well as to the evaluation of the liquidity adequacy as outlined in Title 9.

Soundness of the ICAAP and ILAAP

92. In order to evaluate the soundness of ICAAP and ILAAP, competent authorities should consider if the policies, processes, inputs and models constituting the ICAAP and ILAAP are proportionate to the nature, scale and complexity of the activities of the institution. To do so competent authorities should assess the appropriateness of the ICAAP and ILAAP to assess and maintain an adequate level of own funds and of liquidity to cover risks to which the institution is or might be exposed and to make business decisions (e.g. for allocating capital under the business plan), including under stressed conditions following the EBA Guidelines on stress testing.
93. In the assessment of the soundness of the ICAAP and ILAAP the competent authorities should consider:
- a. whether methodologies and assumptions applied by institutions are appropriate and consistent across risks, grounded in solid empirical input data, with

parameters calibrated in a prudent way and whether they are equally applied for risk measurement and capital and liquidity management;

- b. whether the definition and composition of available internal capital or liquidity resources considered by the institution for the ICAAP and ILAAP are consistent with the risks measured by the institution; and,
- c. whether the distribution/allocation of available capital and liquidity resources among business lines or legal entities properly reflects the risk each of them is or may be exposed, and properly takes into account any legal or operational constraints to transferability of these resources.

Effectiveness of the ICAAP and ILAAP

94. When assessing the effectiveness of the ICAAP and the ILAAP, competent authorities should examine their use in the decision making and management process at all levels in the institution (e.g. limit setting). Competent authorities should determine the role of the ICAAP and ILAAP in risk, capital and liquidity management, including if they are used for business purposes or if they have been developed only for regulatory purposes. The assessment should consider the interconnections and interrelated functioning of the ICAAP/ILAAP with the risk appetite framework, risk management, liquidity and capital management, including forward-looking funding strategies and if this is appropriate to the business model and complexity of the institution.
95. To this end, competent authorities should assess whether the institution has policies, procedures and tools to facilitate:
- a. the clear identification of the functions and/or management committees responsible for the different elements of the ICAAP and ILAAP (e.g. modelling and quantification, internal auditing and validation, monitoring and reporting, issue escalation, etc.);
 - b. capital and liquidity planning - the calculation of capital and liquidity resources on a forward-looking basis (including under the assumed stress scenarios) connected to the overall strategy or to significant transactions;
 - c. the allocation and monitoring of capital and liquidity resources among business lines and risk types (e.g. risk limits defined for business lines, entities or individual risks are consistent with the objective of ensuring the overall adequacy of internal capital and liquidity resources of the institution);
 - d. the regular and prompt reporting of capital and liquidity adequacy to the senior management and to the management body. In particular, the frequency of reporting should be adequate with respect to risks and business volumes development, to existing internal buffers and to the internal decision-making

process in order to allow the institution's management to put in place remedial actions before capital or liquidity adequacy is jeopardised; and,

- e. senior management or management body awareness and actions where business strategy and/or significant individual transactions may be inconsistent with the ICAAP and available internal capital (e.g. senior management approval of a significant transaction, where the transaction is likely to have a material impact on available internal capital) and ILAAP.
96. Competent authorities should assess whether there is appropriate commitment on and knowledge of the ICAAP and ILAAP and their outcomes by the management body. In particular, whether the management body approves the ICAAP and ILAAP frameworks and outcomes, considers the outcomes of ICAAP and ILAAP reviews conducted by internal audit, and, where relevant, outcomes of internal validation of ICAAP and ILAAP.
97. Competent authorities should assess to what extent the ICAAP and ILAAP are forward-looking in nature. Competent authorities should do this through assessing the consistency of the ICAAP and ILAAP with capital and liquidity plans and strategic plans.

Comprehensiveness of the ICAAP and ILAAP

98. Competent authorities should assess the coverage of ICAAP and ILAAP of business lines, legal entities, and risks to which the institution is or might be exposed, and the ICAAP and ILAAP's compliance with legal requirements (note that assessment of the reliability of the ICAAP and ILAAP calculations of own funds and liquidity resources to cover risks is set out in Title 7 and Title 9 of these guidelines).
99. As part of this assessment competent authorities should consider if:
- a. the ICAAP and ILAAP are implemented homogeneously for all the relevant institution's business units and/or legal entities with respect to risk identification and assessment;
 - b. the ICAAP and ILAAP cover all material risks regardless of whether the risk arises from entities not subject to consolidation (SPVs, SPEs); and,
 - c. where any subsidiary has in place different internal governance arrangements or processes, these deviations are justified (e.g. adoption of advanced models only to part of the group may be justified by a lack of sufficient data to estimate parameters for some business lines or legal entities, provided the latter do not convey a high risk contribution to the rest of the portfolio).

5.6.3 Stress testing

100. Following the EBA Guidelines on stress testing, competent authorities should assess the institution's stress testing programmes, covering the appropriateness of scenario selection,

and the underlying assumptions, methodologies, infrastructure and use of stress tests. This should assess at least the:

- a. extent to which stress testing is embedded in an institution's risk management framework;
- b. institution's ability and infrastructure, including data, to implement the stress testing programme in individual business lines and entities and across the group, where relevant;
- c. involvement of senior management and management body in stress testing programmes; and,
- d. integration of stress testing into decision-making throughout the institution.

5.7 Internal control framework

101. Following the EBA Guidelines on internal governance, competent authorities should assess whether the institution has an appropriate internal control framework. This assessment should include at least:

- a. the extent to which an institution has an internal control framework with established independent control functions operating under a clear decision making process with a clear allocation of responsibilities for implementation of the framework and its components;
- b. whether the internal control framework is implemented in in all areas of the institution, with business and support units being responsible in the first place for establishing and maintaining adequate internal control policies and procedures;
- c. whether the institution has put in place policies and procedures to identify, measure, monitor, mitigate and report risk and associated risk concentrations and whether these are approved by the management body;
- d. whether the institution has established an independent risk control function that is actively involved in elaborating the institution's risk strategy and all material risk management decisions, and provides the management body and senior management with all relevant risk related information;
- e. whether the independent risk control function ensures that the institution's risk measurement, assessment and monitoring processes are appropriate;
- f. whether the institution has a chief risk officer with a sufficient mandate and independence from risk-taking, and exclusive responsibility for the risk control function and the monitoring of the risk management framework;

- g. whether the institution has a compliance policy and a permanent and effective compliance function that reports to the management body;
- h. whether an institution has in place a new product approval policy and process with a clearly specified role for the independent risk control function, approved by the management body;
- i. whether the institution has a capacity to produce risk reports and uses them for management purposes and whether such risk reports are (i) accurate, comprehensive, clear and useful, and (ii) produced and communicated to the relevant parties with an appropriate frequency; and,
- j. whether the institution has an independent internal audit function that:
 - assesses the effectiveness and efficiency of the internal control framework;
 - is not directly involved in the design or selection of models or other risk management tools;
 - works on the basis of a risk based audit plan; and,
 - reports directly to the management body or its audit committee.

5.8 Information systems and business continuity

102. Following the EBA Guidelines on internal governance, competent authorities should assess whether the institution has effective and reliable information and communication systems and whether these systems fully support risk data aggregation capabilities in normal times as well as during times of stress. In particular, the competent authorities should assess whether the institution is at least able to:

- a. generate accurate and reliable risk data ;
- b. capture and aggregate all material risk data across the institution;
- c. generate aggregate and up-to-date risk data in a timely manner; and,
- d. generate aggregate risk data to meet a broad range of on-demand requests from the management body or competent authorities.

103. Competent authorities should also assess whether the institution has established effective business continuity management with tested contingency and business continuity plans as well as recovery plans for critical resources.

5.9 Recovery planning

104. Following the requirements of Articles 6 and 8 of Directive 2014/59/EU competent authorities should assess whether the institution has appropriate recovery plans in place. Findings from this assessment should feed into the assessment of internal governance and institution-wide controls, and any deficiencies identified be reflected in the score. Similarly, findings from the assessment of SREP elements, including internal governance and institution-wide control arrangements, should inform the assessment of recovery plans.

5.10 Application at the consolidated level and implications for entities of the group

105. When applied at the consolidated level, in addition to the elements covered in the sections above, competent authorities should assess whether:

- a. the management body of the institution's parent undertaking understands both the organisation of the group and also the role of its different entities and the links and relationships among them;
- b. the organisational and legal structure of the group – where relevant – is clear and transparent and suitable for the size and the complexity of the business and operations;
- c. the institution has established effective group-wide management information and reporting system applicable to all material business lines and legal entities, and whether this is available to the management body of an institution's parent undertaking on a timely basis;
- d. the management body of the institution's parent undertaking has established consistent group-wide strategies including a risk appetite framework;
- e. group risk management covers all material risks regardless of whether the risk arises from entities not subject to consolidation (SPVs, SPEs);
- f. the institution carries out regular stress testing covering all material risks and entities; and,
- g. the group-wide internal audit function is segregated from all other functions, has a group-wide risk-based auditing plan, is appropriately staffed and has direct reporting line to the management body of the parent undertaking.

106. When conducting the assessment of internal-governance and institution-wide controls at the entity level of the groups competent authorities should assess – in addition to the assessment of the elements listed in this title – how the group-wide arrangements, policies and procedures are implemented at the subsidiary level.

5.11 Summary of findings and scorings

107. Following the above assessment, competent authorities should form a view on the adequacy of the institution's internal governance arrangements and institution-wide controls. This view should be reflected in a summary of findings, accompanied by a score using the considerations set out in Table 3.

Table 3. Supervisory considerations for assigning an internal governance and institution-wide controls score

Score	Supervisory view	Considerations
1	Deficiencies in internal governance and institution-wide control arrangements pose no discernible risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution has a robust and transparent organisational structure with clear responsibilities and separation of risk taking and risk management and control functions. • There is a sound corporate culture. • The composition and the functioning of the management body are appropriate. • The remuneration policy in line with risk strategy and long-term interests. • The risk management framework and the risk management processes, including ICAAP, ILAAP, stress testing framework, capital and liquidity planning are appropriate. • The internal control framework and internal controls are appropriate. • Information systems and business continuity arrangements are appropriate. • The recovery plan is complete and credible.
2	Deficiencies in internal governance and institution-wide control arrangements pose a low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution has a largely robust and transparent organisational structure with clear responsibilities and separation of risk taking and risk management and control functions. • There is a largely sound corporate culture • The composition and the functioning of the management body are largely

		<p>appropriate.</p> <ul style="list-style-type: none"> • The remuneration policy is largely in line with risk strategy and long-term interests. • The risk management framework and the risk management processes, including ICAAP, ILAAP, stress testing framework, capital and liquidity planning are largely appropriate. • The internal control framework and internal controls are largely appropriate. • Information systems and business continuity arrangements are largely appropriate. • The recovery plan is largely complete and largely credible.
3	<p>Deficiencies in internal governance and institution-wide control arrangements pose a medium level of risk to the viability of the institution.</p>	<ul style="list-style-type: none"> • The institution's organisational structure and responsibilities are not fully transparent and risk taking and risk management and control functions not fully separated. • There are doubts around the appropriateness of the corporate culture. • There are doubts around appropriateness of the composition and functioning of the management body. • There are concerns that the remuneration policy may conflict with risk strategy and long-term interests. • There are doubts around the appropriateness of the risk management framework and the risk management process, including ICAAP, ILAAP, stress testing framework, capital and liquidity planning. • There are doubts around the appropriateness of the internal control framework and internal controls. • There are doubts around the appropriateness of information systems

		<p>and business continuity arrangements.</p> <ul style="list-style-type: none"> • The recovery plan is incomplete and there are some doubts around its credibility.
4	<p>Deficiencies in internal governance and institution-wide control arrangements pose a high level of risk to the viability of the institution.</p>	<ul style="list-style-type: none"> • The institution's organisation structure and responsibilities are not transparent and risk taking and risk management and control functions not separated. • The corporate culture is inappropriate. • The composition and the functioning of the management body are inappropriate. • The remuneration policy conflicts with risk strategy and long-term interests. • The risk management framework and the risk management processes, including ICAAP, ILAAP, stress testing framework, capital and liquidity planning are inappropriate. • The internal control framework and internal controls are inappropriate. • The information systems and business continuity arrangements are inappropriate. • The recovery plan is incomplete and unreliable.

Title 6. Methodology for the assessment of risks to capital

6.1 General considerations

108. Competent authorities should assess the risks to capital that have been identified as material for the institution. The purpose of this title is to provide common methodologies to be considered when assessing individual risks and risk management and controls. It does not intend to be exhaustive and gives leeway to competent authorities to take into account other additional criteria that may be deemed relevant according to their experience and the specificities of the institution.

109. This title provides competent authorities with guidelines for the assessment of the following risks to capital:

- a. credit and counterparty risk;
- b. market risk;
- c. operational risk;
- d. interest rate risk from non-trading activities (IRRBB).

110. For credit, market and operational risk competent authorities should verify the institution's compliance with minimum requirements set out in Regulation (EU) No 575/2013. However, these guidelines extend the scope of the assessment beyond those minimum requirements to allow competent authorities to form a comprehensive view on risks to capital.

111. For the purpose of the guidelines, when defining the sub-categories of a risk, competent authorities should consider the nature of the risk exposure rather than if they are defined as elements of credit, market or operational risk in Regulation (EU) No 575/2013 (e.g. equity exposures in the banking book may be considered under a market risk assessment despite being considered as an element of credit risk in Regulation (EU) No 575/2013).

112. Equally, competent authorities may decide upon different break-downs than the one presented in these guidelines, provided that all material risks are assessed and that this is agreed within the college of supervisors, where relevant.

113. When evaluating risks to capital, competent authorities should also consider the potential impact of funding cost risk following the methodology included in the Title 8 and may decide on the necessity of measures to mitigate it.

114. Competent authorities may assess other risks identified as material to a specific institution but which are not listed above.

115. Competent authorities should identify all material risks to capital. The following may assist the identification process:

- drivers of TREA;
- risks identified in the institution's ICAAP;
- risks arising from the institution's business model (including those identified by other institutions operating a similar business model); and,
- information stemming from the monitoring of key indicators.

116. The above elements should also be taken into account by competent authorities when planning the intensity of their supervisory activity related to the assessment of a specific risk.

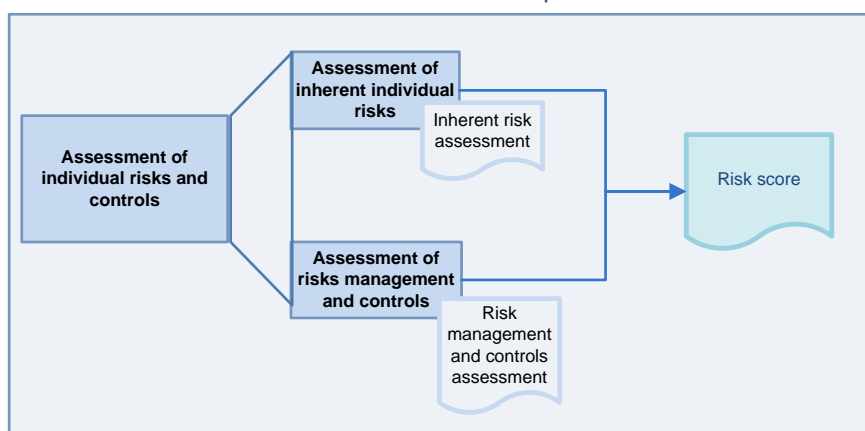
117. In their implementation of the methodologies set out in this title, competent authorities should identify relevant quantitative indicators and other metrics, which could be also used for the purposes of monitoring of key indicators, as specified in Title 3.

118. Under each of the risk categories competent authorities should assess:

- a. inherent risk (risk exposures); and,
- b. risk management and controls.

119. This assessment is represented in Figure 2 below.

Figure 2. Interaction within the assessment of risks to capital



120. When performing the risk assessment, competent authorities should rely on all available information sources including regulatory reporting, ad-hoc reporting agreed with the

institution, the institution's internal metrics and reports (e.g. internal audit report, risk management reports, ICAAP), on-site inspection reports, and external reports (e.g. the institution's communication to investors, rating agencies).

121. The outcome of the assessment of each individual risk should be reflected in a summary of findings, which provides an explanation of the main risks drivers, and a score.
122. In deriving the score for each risk to capital, competent authorities should take into account the assessment of both the inherent risk and the quality and effectiveness of the institution's management and controls.
123. Competent authorities should determine the score predominately through the assessment of the inherent risk, but they should also reflect considerations about risk management and controls, such that the adequacy of management and controls may increase or – in exceptional cases – reduce the risk of significant prudential impact (i.e. considerations for inherent risk may under- or over-estimate the level of risk depending on the adequacy of management and controls). The assessment of the adequacy of management and controls should be made with reference to the considerations set out in Tables 4 to 7.
124. Under the national implementation of these guidelines, different methods may be used by competent authorities to derive individual risks scores. In some cases, inherent risk levels and the quality of risk management and control may be scored separately, resulting in an intermediate and final score; while in others, the assessment process may not use intermediate scores.

6.3 Assessment of credit and counterparty risk

6.3.1 General considerations

125. Competent authorities should assess credit risk arising from all banking book exposures (i.e. on and off balance sheet). They should also assess counterparty credit risk and settlement risk.
126. In assessing credit risk competent authorities should consider all the components which determine potential credit losses, in particular: the probability of a credit event (i.e. default), or correlated credit events, which mainly concerns the borrowers and their ability to repay relevant obligations; the size of exposures subject to credit risk, and the possibility this can change (increase) over time; and, the credit risk mitigation (CRM) techniques adopted by the institution.

6.3.2 Assessment of inherent credit risk

127. Through the assessment of inherent credit risk competent authorities should determine the main drivers of the institution's credit risk exposure and evaluate the significance of the prudential impact of this risk for the institution. The assessment of inherent credit risk should therefore be structured under the following main steps:
- a. preliminary assessment;
 - b. assessment of the nature and composition of the credit portfolio;
 - c. assessment of portfolio credit quality;
 - d. assessment of the level and quality of credit risk mitigation; and,
 - e. assessment of the level of provisions and of credit valuation adjustments.
128. Competent authorities should assess credit risk both in current and prospective terms. Competent authorities should combine the analysis of current portfolio credit risk with the assessment of the institution's credit risk strategy (potentially as part of the wider assessment of strategy carried out as part of the BMA) and consider how the expected, as well as stressed, macro-economic developments could affect those elements and ultimately the institution's earnings and own funds.
129. Competent authorities should primarily conduct the assessment on the portfolio and asset class level. Where relevant, competent authorities should also analyse single borrowers or transactions. Competent authorities may also use sampling techniques when assessing portfolio risk.

130. The assessment may be performed vertically (i.e. by considering all the dimensions for relevant sub-portfolios) or horizontally (i.e. by considering one dimension, for example credit quality, for the overall portfolio).

Preliminary assessment

131. In order to determine the scope of the assessment of credit risk, competent authorities should preliminary identify the sources of credit risk to which the institution is or might be exposed. To do so competent authorities should leverage the knowledge gained from the assessment of other SREP elements, from the comparison of the institution's position to peers, and from any other supervisory activities.

132. Competent authorities should consider at least the:

- a. the credit risk strategy and appetite;
- b. the own funds requirement for credit risk compared to the total own funds requirement, and – where relevant – the internal capital allocated for credit risk compared to the total internal capital; its historical evolution and forecast, if available;
- c. the nature, size and composition of the institution's on and off-balance sheet credit-related items;
- d. the level and evolution over time of impairments and write-offs and of the default rates of the credit portfolio; and,
- e. the profitability of the credit portfolio compared to the contribution of credit risk to TREA.

133. Competent authorities should perform the preliminary analysis considering the evolution of the above over time in order to achieve an informed view of main drivers of the institution's credit risk.

134. Competent authorities should focus their assessment on those drivers and portfolios deemed as the most material.

Nature and composition of the credit portfolio

135. Competent authorities should assess the nature of the credit exposure (i.e. type of borrowers and of exposures) to identify the underlying risk factors, and their composition to assess the significance of such factors for the institution's credit portfolio risk.

136. In performing this assessment, competent authorities should consider how the nature of credit risk exposure can affect the size of exposure (i.e. credit lines/undrawn commitments

drawn down by the borrowers), given the nature of the facilities and the institution's legal capacity to unilaterally cancel undrawn amounts of committed credit facilities.

137. For assessing the nature of credit risk, competent authorities should consider at least the following elements of credit risk, where identified as material:

- credit risk concentration;
- counterparty credit risk and settlement risk;
- country risk;
- credit risk from securitisations;
- FX lending risk; and,
- specialised lending.

Credit risk concentration

138. Competent authorities should form a view on the degree of credit concentration risk to which the institution is exposed. Specifically competent authorities should assess the risk the institution will incur significant losses stemming from a concentration of exposures to a small group of borrowers, to a set of borrowers with similar default behaviour, or to highly-correlated financial assets (see article 81 of Directive 2013/36/EU).

139. Competent authorities should conduct this assessment considering different categories of credit concentration risk. This may include:

- a. single name concentrations (including client or group of connected clients as defined for large exposures);
- b. sectoral concentrations;
- c. geographical concentrations;
- d. product concentration; and,
- e. collateral and guarantees concentration.

140. To identify credit concentrations, competent authorities should consider the common drivers of credit risk across exposures and focus on those exposures which tend to exhibit similar behaviour (i.e. high correlation).

141. Competent authorities should pay particular attention to hidden sources of credit concentration risk which can crystallise under stressed conditions, where the level of credit risk correlation can increase compared to normal conditions.

142. For groups, competent authorities should consider the credit concentration risk which can result from consolidation, and which may be not evident at solo level.

143. When assessing credit concentrations, competent authorities should consider the possibility of overlaps (e.g. a high concentration toward a specific government will probably lead to a country concentration and single name concentration), and therefore should avoid applying a simple aggregation of the different types of credit concentration, and rather should consider underlying drivers.

144. In order to assess the level of concentration competent authorities can use different measures and indicators, the most common being the Herfindahl Hirschmann Index (HHI) and Gini coefficients.

Counterparty credit and settlement risks

145. Competent authorities should assess the counterparty credit and settlement risks faced by institutions arising from derivatives exposures and financial instruments transactions.

146. For this assessment, the following aspects should be considered:

- a. the quality of counterparties and relevant credit valuation adjustments (CVA)
- b. the complexity of financial instruments underlying relevant transactions;
- c. the exposure to counterparty credit and settlement risks in terms of both current market values and nominal amount, compared to overall credit exposure and to own funds;
- d. the proportion of transactions processed through financial market infrastructures (FMI) which provide payment versus delivery settlement;
- e. the proportion of relevant transactions to central counterparties (CCPs) and the effectiveness of loss protection mechanisms thereof; and,
- f. the existence, significance, effectiveness and enforceability of netting agreements.

Country risk

147. Competent authorities should assess:

- a. the degree of concentration within all types of exposures to country risk, including sovereign exposures, in proportion to the whole institution's credit portfolio (per obligor and amount);

- b. the economic strength and stability of the borrower's country and its track record in terms of punctual payment and occurrence of serious default events;
- c. risk of other forms of sovereign intervention that can materially impair the creditworthiness of borrowers (e.g. deposit freezes, expropriation, or punitive taxation); and,
- d. the risk arising from the potential that an event (e.g. natural events, or social/political events) impacting the whole country leads to default by a large group of debtors (collective debtor risk).

Competent authorities should also assess the transfer risk linked to cross-border foreign currency lending for material cross-border lending and exposures in foreign currencies.

Credit risk from securitisation

148. Competent authorities should assess the credit risk related to securitisations where institutions act as originator, investor, sponsor or credit enhancement provider.

149. In order to appreciate the nature of relevant exposures and their potential development, competent authorities should:

- a. understand the strategy, risk appetite and business motivations of institutions towards securitisations; and,
- b. analyse securitisation exposures taking into consideration both the role played and the seniority of tranches held by institutions as well as the type of securitisation (e.g. traditional vs. synthetic, securitisation vs. re-securitisation).

150. In assessing the credit risk arising from securitisation exposures competent authorities should assess at least:

- a. the appropriateness of allocation of securitisation exposures to the banking book and trading book and the consistency with the institution's securitisation strategy;
- b. if the appropriate regulatory treatment is applied to securitisations;
- c. the rating and the performance of the securitisation tranches held by the institution as well as the nature, composition and the quality of the underlying assets;
- d. the consistency of capital relief with the actual risk transfer for originated securitisations. Competent authorities should also verify whether the institution provides any form of implicit (non-contractual support) to the transactions and the potential impact on own funds for credit risk;

- e. whether there is a clear distinction between drawn and undrawn amounts for liquidity facilities provided to the securitisation vehicle; and,
- f. the existence of contingency plans for Asset Backed Commercial Paper conduits managed by the institution in the event that an issuance of commercial paper is not possible due to liquidity conditions, and the impact on the total credit risk exposure of the institution.

FX lending risk

151. Competent authorities should assess the existence and the materiality of the additional credit risk arising from FX lending exposures towards unhedged borrowers. However, where relevant, competent authorities should extend the scope of this assessment to other type of customers (i.e. other than retail or SME borrowers) which are unhedged. In particular, competent authorities should assess the higher credit risk arising from:

- a. an increase in both the outstanding value of debt and the flow of payments to service such debt; and,
- b. an increase in the outstanding value of debt compared to the value of collateral assets denominated in the domestic currency.

152. In evaluating FX lending risk, competent authorities should consider:

- a. the type of exchange rate regime and how this could impact on the evolution of the FX rate between domestic and foreign currencies;
- b. the sensitivity impact of exchange rate movements on borrowers' credit rating/scoring and debt servicing capacity; and,
- c. possible concentrations of lending activity in a single foreign currency or in a limited number of highly correlated foreign currencies.

Specialised lending

153. Competent authorities should assess the specialised lending separately from other lending activities since the risk of such exposures lies in the profitability of the object or of the project financed (e.g. commercial real estate, energy plant, shipping, commodities, etc.) rather than on the borrower (which generally is a special purpose vehicle).

154. Generally these exposures tend to be of significant size relative to the portfolio, so representing a source of credit concentration, and of long maturity, which makes it difficult to perform reliable projections on profitability.

155. In assessing the relevant risk, competent authorities should consider:

- a. the profitability of the projects and the conservativeness of the assumptions underlying the business plans (including the credit risk of the main customers);
- b. the impact of changes in the regulation, especially in case of subsidised sectors, on future cash flows;
- c. the impact of changing market demand, where relevant, and the existence of a market for the potential future sale of the object financed;
- d. the existence of a syndicate or of other lenders sharing the credit risk; and,
- e. any form of guarantee pledged by the sponsors.

Assessment of the portfolio credit quality

156. In assessing inherent credit risk, competent authorities should consider the quality of the credit portfolio, distinguishing by performing, non-performing and forborne exposures categories.

157. Competent authorities should assess the overall credit quality on portfolio level and the different quality grades within each of above categories in order to determine the institution's overall credit risk. Competent authorities should also consider whether the actual credit quality is consistent with the stated risk appetite, and establish causes for deviation from it.

158. When assessing portfolio credit quality, competent authorities should pay particular attention to the adequacy of the classification of credit exposures and assess the impact of potential misclassification, with the subsequent delay in the provisioning and recognition of losses by the institution. In conducting this assessment, competent authorities may use peer analysis and benchmark portfolios, where available. Competent authorities may also use sampling of loans when assessing portfolio credit quality.

Performing exposures

159. In evaluating the credit quality of performing exposures, competent authorities should consider the evolution of the portfolio in terms of composition, size and credit worthiness, its profitability and the risk of future deterioration, at least by analysing the following elements, where available:

- a. borrowers' credit grade distribution (e.g. by internal and/or external ratings or other information suitable to measure creditworthiness, e.g., leverage ratio, ratio of revenues devoted to the payment of instalments, etc.);
- b. growth rates by type of borrowers, sectors and products and the consistency with credit risk strategies;

- c. sensitivity of borrowers' credit grade, or more in general of borrowers' repayment capacity, to the economic cycle;
- d. historical migration rates across credit grades, delinquency and default rates for different time horizons; and,
- e. profitability (e.g. credit spread vs. credit losses).

160. In performing these analyses, competent authorities should consider both the number of obligors and the relevant amounts and take into account the level of portfolio concentration.

Forborne exposures

161. Competent authorities should assess the extent of forborne loans, and the potential losses that may stem from them. This should include at least the:

- a. forbearance rates per portfolio and their evolution over time, also compared to peers;
- b. level of collateralisation of forborne exposures; and,
- c. migration rates of forborne exposures to performing and non-performing exposures, also compared with peers.

Non-performing exposures

162. Competent authorities should assess the materiality of non-performing loans per portfolio and the potential losses that may stem from them. This should include at least the:

- a. non-performing rates per portfolio, industry, geography and evolution over time;
- b. distribution of the exposures across classes of non-performing assets (i.e. past-due, doubtful, etc.);
- c. types and level of residual collateral;
- d. migration rates from non-performing classes to performing, forborne exposures, and across non-performing classes;
- e. foreclosed assets and evolution over time;
- f. historical recovery rates by portfolio, industry, geography or type of collateral and duration of recovery process; and,
- g. vintage of non-performing loan portfolio.

163. In conducting the analysis competent authorities should employ peer analysis and use benchmark portfolios (i.e. portfolios of borrowers common to groups of institutions) where appropriate and possible.

Assessment of the level and quality of credit risk mitigation

164. In order to assess the potential impact of credit risk on the institution, competent authorities should also consider the level and the quality of guarantees (including credit derivatives) and collateral which would mitigate credit losses in the case of credit events.

165. Specifically, competent authorities should consider the:

- a. coverage provided by collateral and guarantees by portfolios, borrowers' type, rating, industry and other relevant aspects;
- b. historical recovery ratios by type and amount of collateral and guarantees; and,
- c. materiality of dilution risk (see Article 4 of Regulation (EU) 575/2013) for purchased receivables.

166. Competent authorities should also assess the materiality of residual risk (see Article 80 of Directive 2013/36/EU) and in particular the:

- a. adequacy and enforceability of collateral agreements and of guarantees;
- b. timing and ability to realise collateral and to execute guarantees under the national legal framework;
- c. liquidity and volatility in asset values for collateral;
- d. recoverable value of collateral under any credit enforcement actions (e.g. foreclosure procedures); and,
- e. guarantors' creditworthiness.

167. Competent authorities should also assess the concentration of guarantors and collateral, as well as the correlation with borrowers' creditworthiness (i.e. wrong way risk) and the potential impact in terms of the effectiveness of protection.

Assessment of the level of provisions and credit valuation adjustments

168. Competent authorities should assess whether the level of provisions and credit valuation adjustments are appropriate for the quality of the exposures and, where relevant, for the level of collateral. Competent authorities should assess:

- a. whether the level of provisions is consistent with the level of risk in different portfolios, across time and compared with the institution's relevant peers;

- b. whether the credit valuation adjustments to derivatives' market values reflects the creditworthiness of relevant counterparties;
 - c. whether accounting provisions are in line with applicable accounting principles and are assessed as sufficient to cover expected losses;
 - d. whether non-performing, forborne and foreclosed assets are sufficiently provisioned, taking into account the level of existing collateral and the vintage of such exposures; and,
 - e. whether provisions are consistent with historical losses, expected macro-economic developments and reflect any changes to relevant regulation (e.g. foreclosure, repossession, creditor protection, etc.).
169. Where deemed necessary, competent authorities should use on-site inspections or other appropriate supervisory actions to assess whether or not the level of provisioning and risk coverage is adequate, by, e.g., assessing a sample of loans.
170. Competent authorities should also take into consideration any findings raised by internal and external auditors, where available.

Stress testing

171. When evaluating the inherent credit risk of an institution, competent authorities should take into account the results of stress tests performed by the institution to identify any previously unidentified sources of credit risk, such as those emerging from changes in credit quality, credit concentrations, collateral value and credit exposure during a stress.

6.3.3 Assessment of credit risk management and controls

172. In order to reach a comprehensive understanding of the institution's credit risk profile, competent authorities should also review the governance and risk management framework underlying its credit activities. To this end, competent authorities should assess the:
- a. credit risk strategy and appetite;
 - b. organisational framework;
 - c. policies and procedures;
 - d. risk identification, measurement, management, monitoring and reporting; and,
 - e. internal control framework.

Credit risk strategy and appetite

173. Competent authorities should assess whether the institution has a sound, clearly formulated and documented credit risk strategy, approved by the management body. For this assessment competent authorities should take into account:

- a. whether the management body clearly articulates the credit risk strategy and appetite as well as the process for their review;
- b. whether senior management properly implements and monitors the credit risk strategy approved by the management body, ensuring that institutions activities are consistent with the established strategy, that written procedures are developed and implemented, and that responsibilities are clearly and properly assigned;
- c. whether the institution's credit and counterparty risk strategy reflects the institution's appetite levels for credit risk and whether it is consistent with the overall risk appetite;
- d. whether the institution's credit risk strategy is appropriate for the institution given its:
 - business model;
 - overall risk tolerance;
 - market environment and role in the financial system; and,
 - financial condition, funding capacity and own funds adequacy;
- e. whether the institution's credit risk strategy covers its credit-granting activities, collateral management, as well as the management of NPLs, and whether this strategy supports risk-based decision making, reflecting aspects that may include, for example, exposure type (commercial, consumer, real estate, sovereign), economic sector, geographical location, currency, and maturity, including concentration tolerances;
- f. whether the institution's credit risk strategy broadly covers all the activities of the institution where credit risk can be significant;
- g. whether the institution's credit risk strategy takes into account cyclical aspects of the economy, including under stress conditions, and the resulting shifts in the composition of the credit risk portfolio; and,
- h. whether the institution has an appropriate framework in place to ensure that the credit risk strategy is effectively communicated to all relevant staff.

Organisational framework

174. Competent authorities should assess whether the institution has an appropriate organisational framework to enable effective credit risk management, measurement and control, with sufficient (both qualitative and quantitative) human and technical resources to carry out the required tasks. They should take into account whether:

- a. there are clear lines of responsibility for the taking on, measuring, monitoring, managing and reporting of credit risk;
- b. the credit risk control and monitoring systems are subject to independent review and there is a clear separation between risk takers and risk managers;
- c. the risk management, measurement and control functions cover credit risk institution-wide; and,
- d. the staff involved in credit granting activities (both in business and management and control areas) have appropriate skills and experience.

Policies and procedures

175. Competent authorities should assess whether the institution has appropriate policies for the identification, management, measurement and control of credit risk. For this assessment competent authorities should take into account whether:

- a. the management body approves the policies for managing, measuring and controlling credit risk and discusses and reviews them regularly, in line with risk strategies;
- b. senior management is responsible for developing and implementing the policies and procedures for managing, measuring and controlling credit risk, defined by the management body;
- c. the policies and procedures are sound, consistent with the credit risk strategy and cover all the main businesses and processes relevant for managing, measuring and controlling credit risk, in particular:
 - credit granting and pricing: for example, borrowers, guarantors and collateral eligibility; credit limits; selection of FMIs, CCPs and correspondent banks; types of credit facilities available; terms and conditions (including collateral and netting agreements requirement) to be applied;
 - credit risk measurement and monitoring: for example, criteria to identify group of connected counterparties; criteria for assessing borrowers' creditworthiness and collateral evaluation and frequency for their review; criteria to quantify impairments, credit valuation

adjustments and provisions; and,

- credit management: for example, criteria to review products, terms and conditions; criteria to apply forbearance practice or restructuring; criteria for loans classification and management of NPLs;
- d. such policies are compliant with relevant regulation, and adequate for the nature and complexity of the institution's activities, and enable a clear understanding of the credit risk inherent to the different products and activities under the scope of the institution;
- e. whether such policies are clearly formalised, communicated and applied consistently across the institution; and,
- f. whether these policies are applied consistently across banking groups and allow a proper management of shared borrowers and counterparties.

Risk identification, measurement, monitoring and reporting

176. Competent authorities should assess whether the institution has an appropriate framework for identifying, understanding, measuring, monitoring and reporting credit risk, in line with the institution's size and complexity, and that this framework is compliant with relevant minimum requirements under Regulation (EU) No 575/2013.

177. In this regard, competent authorities should consider whether the data, information systems and analytical techniques are appropriate to enable the institution to fulfil supervisory reporting requirements, and to detect, measure and regularly monitor the credit risk inherent in all on- and off-balance sheet activities (where relevant at group level), in particular with regard to:

- borrower/counterparty/transaction's credit risk and eligibility;
- credit exposures (irrespective of the nature) of borrowers and, where relevant, of groups of connected borrowers;
- collateral coverage (including netting agreements) and eligibility thereof;
- ongoing compliance with the contractual terms and agreements (covenants);
- unauthorised overdrafts and conditions for reclassification of credit exposures; and,
- relevant sources of credit risk concentration.

178. Competent authorities should assess whether the institution has a clear understanding of the credit risk related to the different type of borrowers, transactions and credit granted. They should also assess whether the institution has appropriate skills, systems and methodologies

to measure the risk thereof on borrower/transaction and portfolio level, consistent with the size, nature, composition and complexity of the institution's activities involving credit risk. In particular, competent authorities should ensure that such systems and methodologies:

- a. enable the institution to discriminate among different levels of borrower and transaction risk;
- b. provide a sound and prudent estimation of the level of credit risk and of collateral value;
- c. identify and measure credit risk concentrations (single name, sectoral, geographical, etc.);
- d. enable the institution to project credit risk estimates for planning purposes and for stress testing;
- e. enable the institution to determine the level of provision and credit valuation adjustments to cover expected and incurred losses; and,
- f. at least comply with the requirements to determine relevant minimum own funds as set out in Regulation (EU) No 575/2013, in particular with the requirements regarding approaches that require permission by competent authorities before being used for the calculation of own funds requirements, and, where material, should aim to capture those risk elements not covered or not fully covered by the requirements of Regulation (EU) No 575/2013.

179. Competent authorities should assess whether the institution's management body and senior management understand the assumptions underlying the credit measurement system and if they are aware of the degree of relevant model risk.

180. Competent authorities should assess whether the institution has undertaken stress testing to understand the impact of adverse events on its credit risk exposures and on the adequacy of its credit risk provisioning. They should take into account:

- a. stress test frequency;
- b. relevant risk factors identified;
- c. assumptions underlying the stress scenario; and,
- d. the internal use of stress testing outcomes for capital planning and credit risk strategies.

181. Competent authorities should assess whether the institution has defined and implemented a continuous and effective monitoring of credit risk exposures (including credit concentration)

throughout the institution, also by means of specific indicators and relevant triggers to provide effective early warning alerts.

182. Competent authorities should assess whether the institution has implemented a regular reporting of credit risk exposures, including the outcome of stress testing, which is addressed to the management body, the senior management and to the relevant credit risk managers.

Internal control framework

183. Competent authorities should assess whether the institution has in place a strong and comprehensive control framework and sound safeguards to mitigate its credit and risk in line with its credit risk strategy and appetite. For this purpose competent authorities should take into account whether:

- a. the scope covered by the institution's control functions includes all consolidated entities, all geographical locations and all credit activities;
- b. there are internal controls, operating limits and other practices aimed at keeping credit risk exposures within levels acceptable to the institution, in accordance with the parameters set by the management body and senior management and the institution's risk appetite; and,
- c. the institution has in place appropriate internal controls and practices that ensure that breaches and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

184. Competent authorities should assess the limit system, including whether:

- a. the limit system is adequate to the complexity of the institution's organisation and credit activities, as well as to their capability to measure and manage credit risk;
- b. the limits established are absolute or whether breaches of limits are possible. In the latter case the institution's policies should clearly describe the period of time and the specific circumstances under which those breaches of limits are possible;
- c. the institution has in place procedures to keep credit managers up to date with regards to their applicable limits and their degree of utilisation; and,
- d. the institution has in place adequate procedures to regularly update their limits (e.g. consistently with changes in strategies).

185. Competent authorities should also assess the functionality of the internal control framework in ensuring overall compliance. To this end they should assess whether:

- a. the institution conducts internal audits of the credit risk management framework on a periodic basis;
- b. the internal audit covers the main elements of credit risk management, measurement and controls across the institution; and,
- c. the internal audit function is effective in determining the adherence to internal policies and relevant external regulation and to address any deviations from either.

186. For institutions adopting an internal approaches to determine minimum own funds requirements for credit risk, competent authorities should also assess if the internal validation process is sound and effective in challenging model assumptions and identifying any potential shortcomings with respect to the credit risk modelling, quantification, system and to other relevant minimum requirements as set out in the regulation (EU) 275/2013.

6.3.3 Summary of findings and scoring

187. Following the above assessment, competent authorities should form a view on the institution's credit and counterparty risk. This view should be reflected in a summary of findings, accompanied by a score using the considerations set out in Table 4.

Table 4. Supervisory considerations for assigning a credit and counterparty risk score

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is no discernible risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies non-material risk. Exposure to complex products and transactions is not material. • The level of credit risk concentration is not material. • The level of forborne and non-performing exposures is not material. Credit risk of performing exposures is not material. • The coverage of provisions and of credit valuation adjustments is very high. • Coverage and quality of guarantees and collateral is very high. 	<ul style="list-style-type: none"> • There is consistency between the institution's credit risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for credit risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. • Credit risk measurement monitoring and reporting systems are appropriate. • Internal limits and the control framework for credit risk are sound.
2	There is a low risk of significant prudential impact on the institution having	<ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies low risk. Exposure to complex products and transactions is low. 	<ul style="list-style-type: none"> • Limits allowing mitigating or limiting the credit risk are in line with the

	considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The level of credit risk concentration is low. • The level of forborne and non-performing exposures is low. The credit risk from performing exposures is low. • The coverage of provisions and of credit valuation adjustments is high. • Coverage and quality of guarantees and collateral is high. 	institution's credit risk management strategy and risk appetite.
3	There is a medium risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies medium risk. Exposure to complex products and transactions is medium. • The level of credit risk concentration is medium. • The level of forborne and non-performing exposures is medium. The credit risk from performing exposures is medium and subject to further deterioration under stress conditions. • The coverage of provisions and of credit valuation adjustments is medium. • Coverage and quality of guarantees and collateral is medium. 	
4	There is a high risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The nature and composition of credit risk exposure implies high risk. Exposure to complex products and transactions is high. • The level of credit risk concentration is high. • The level of forborne and non-performing exposures is high. The credit risk from performing exposures is high. • The coverage of provisions and of credit valuation adjustments is low. • Coverage and quality of guarantees and collateral is low. 	

6.4 Assessment of market risk

6.4.1 General considerations

188. The assessment of market risk concerns those on and off-balance-sheet positions subject to losses arising from movements in market prices. Competent authorities should at least consider the following subcategories when assessing market risk:

- position risk, further distinguished as general and specific risk;
- foreign exchange risk;
- commodities risk; and,
- CVA risk

189. The assessment should cover, at least, risks arising from interest rate-related instruments, equity and equity related instruments, foreign exchange positions and commodities risk positions, assigned to both in the trading and banking book.

190. The assessment should also consider the following sub-categories of market risk in relation to the banking book:

- credit spread risk arising from positions measured at fair value;
- risk arising from equity exposures; and,
- structural foreign exchange rate risk.

191. Interest rate risk from non-trading activities (IRRBB) is excluded from the scope of the market risk assessment as it is covered in Section 6.6.

6.4.2 Assessment of inherent market risk

192. Through the assessment of inherent market risk competent authorities should determine the main drivers of institution's market risk exposure and evaluate the risk of significant prudential impact on the institution. The assessment of inherent market risk should be structured under the following main steps:

- a. preliminary assessment;
- b. assessment of the nature and composition of the institution's market risk portfolio;
- c. assessment of the profitability;
- d. assessment of market concentration risk; and

- e. outcome of stress testing.

Preliminary assessment

193. In order to determine the scope of the assessment of market risk, competent authorities should preliminary identify the sources of market risk to which the institution is or might be exposed. To do so competent authorities should leverage the knowledge gained from the assessment of other SREP elements, from the comparison of the institution's position to peers, and from any other supervisory activities.

194. Competent authorities should consider at least the:

- a. institution's market activities, business lines, and products;
- b. overarching strategy of the market risk related portfolio and of the risk appetite in market activities;
- c. relative weight of market positions in terms of total assets, their evolution over time, and the institution's growth forecasts, if available;
- d. relative weight of net gains on market positions in total operating income; and,
- e. the own funds requirement for market risk compared to the total own funds requirement, and – where relevant – the internal capital allocated for market risk compared to the total internal capital; its historical evolution and forecast, if available.

195. In their initial assessment, competent authorities should also consider significant changes in the institution's market activities with the focus on potential changes of the total market risk exposure. They should at least assess:

- a. significant changes in market risk strategy, policies and size of limits;
- b. the potential impact on the institution's risk profile of those changes; and,
- c. major market trends.

Nature and composition of the institution's market risk portfolio

196. Competent authorities should analyse the nature of the institution's market risk exposures (trading and banking book) with the aim of identifying particular risk exposures and related market risk factors/drivers (e.g. exchange rates, interest rates or credit spreads) for further in depth assessment.

197. Competent authorities should analyse market risk exposures by relevant asset classes and/or financial instruments according to their size, complexity and level of risk. For the most relevant exposures supervisors should assess their related risk factors and drivers.

198. While analysing market risk activities, competent authorities should also consider the complexity of financial products and of specific market operations (e.g. derivatives, high frequency trading, OTC products or products valued using mark to model techniques). The following points should be considered:

- a. if the institution holds derivatives positions competent authorities should assess both the market value and the notional amount; and,
- b. when the institution is engaged in OTC derivatives competent authorities should evaluate the weight of these transactions in the market risk portfolio, and the type of financial instruments (the counterparty credit risk associated to these products is covered under the credit risk methodology).

199. When appropriate, competent authorities should assess distressed and/or illiquid positions (e.g. 'legacy portfolios', i.e. portfolios of illiquid assets related to the discontinued banking practices/activities that are managed on a run-off model) and evaluate their impact on the institution's profitability.

200. For those institutions using internal approaches for calculating their regulatory own funds requirements, competent authorities should also consider the following indicators to identify particular risk areas and related risk drivers:

- a. the split of market risk own funds requirements between the VaR, stressed VaR (SVaR), incremental risk charge (IRC) and comprehensive risk measure (CRM);
- b. the evolution of the VaR and SVaR (possible indicators could be the day-to-day/week to week evolution, the quarterly average and back-testing results); and,
- c. the multiplication factors applied to VaR and SVaR.

201. When appropriate, competent authorities should also consider the internal risk measures of institutions. For example, sensitivities of the market risk to different risk factors and potential losses.

202. When analysing inherent market risk competent authorities should consider 'point-in-time' figures and trends, both on an aggregate basis and by portfolio. When possible this analysis should be completed with the comparison of the institution's figures to peers and to relevant macro-economic indicators.

Profitability analysis

203. Competent authorities should analyse the historic profitability, including volatility of profits, of market activities to better understand the institution's market risk profile. This analysis could be performed on a portfolio level as well as being broken down by business lines or asset classes (potentially as part of the wider assessment carried out as part of the BMA).

204. While assessing the profitability, competent authorities should pay specific attention to the main risk areas identified during the assessment of the composition of the market risk related activities. Supervisors should distinguish between trading revenues and non-trading revenues (like commissions, clients fees etc.) and between realised and unrealised profits/losses.
205. For those asset classes and/or exposures generating abnormal profits or losses, competent authorities should assess their profitability in comparison to the level of risk assumed by the institution (e.g. VaR / Net gains on financial assets and liabilities held for trading) to identify and analyse possible inconsistencies. When possible, competent authorities should compare the institution's figures to its historical performance and peers.

Market concentration risk

206. Competent authorities should form a view on the degree of market concentration risk to which the institution is exposed, either arising from exposures to a single risk factor or from exposures to multiple risk factors that are correlated.
207. When evaluating possible concentrations, competent authorities should pay special attention to concentrations in complex products (e.g. structured products), illiquid products (e.g. government bonds from an emerging country) or products valued using mark to model techniques.

Stress testing

208. When evaluating the inherent market risk of an institution, competent authorities should take into account the results of stress tests performed by the institution to identify any previously unidentified sources of market risk. This is especially important in the case of tail risk events which may be underrepresented or entirely absent from historical data due to their low frequency of occurrence. Another source of potential hidden vulnerabilities competent authorities should consider is the potential for jumps in pricing parameters, such as a sudden increase in certain prices or price bubbles in commodities.

6.4.3 Assessment of market risk management and controls

209. In order to reach a comprehensive understanding of the institution's market risk profile, competent authorities should review the governance and risk management framework underlying its market activities. To this end competent authorities should assess the following elements:
- a. market risk strategy and risk appetite;
 - b. organisational framework;
 - c. policies and procedures;

- d. risk identification, measurement, monitoring and reporting; and
- e. internal control framework.

Market risk strategy and appetite

210. Competent authorities should assess whether institutions have a sound, clearly formulated and documented market risk strategy, approved by the management body. For this assessment competent authorities should take into account whether:

- a. the management body clearly articulates the market risk strategy and appetite and the process for their review (e.g. in case of overall risk strategy review, profitability and/or capital adequacy concerns);
- b. senior management properly implements the market risk strategy approved by the management body, ensuring that the institution's activities are consistent with the established strategy, written procedures are developed and implemented, and responsibilities are clearly and properly assigned;
- c. the institution's market risk strategy properly reflects the institution's appetite for market risk and is consistent with the overall risk appetite;
- d. the institution's market risk strategy and appetite are appropriate for the institution, given its:
 - business model;
 - overall risk strategy and appetite;
 - market environment and its role in the financial system; and,
 - financial condition, funding capacity and own funds adequacy;
- e. the institution's market risk strategy establishes guidance for the management of the different instruments and/or portfolios subject to market risk, and supports adoption of risk-balanced business decisions;
- f. the institution's market risk strategy broadly cover all the activities of the institution where market risk is significant;
- g. the institution's market risk strategy takes into account the cyclical aspects of the economy and the resulting shifts in the composition of the market risk portfolio; and,
- h. the institution has an appropriate framework in place to ensure that market risk strategy is effectively communicated to all relevant staff.

Organisational framework

211. Competent authorities should assess whether the institution has an appropriate organisational framework for market risk management, measurement, monitoring and control functions, with sufficient (both qualitative and quantitative) human and technical resources. They should take into account whether:

- a. there are clear lines of responsibility for taking, monitoring, controlling and reporting, market risk;
- b. there is a clear separation, in the business area, between the front-office (position takers) and the back-office (responsible for allocating, recording and settling transactions);
- c. the market risk control and monitoring system is subject to independent review and is clearly identified in the organisation, and functionally and hierarchically independent of the business area;
- d. the risk management, measurement, monitoring and control functions cover market risk in the entire institution (including subsidiaries and branches), and in particular all areas where market risk can be taken, mitigated or monitored; and,
- e. the staff involved in market activities (both in business and management and control areas) have appropriate skills and experience.

Policies and procedures

212. Competent authorities should assess whether the institution has clearly defined policies and procedures for the identification, management, measurement and control of market risk. They should take into account:

- a. whether the management body approves the policies for managing, measuring and controlling market risk and discusses and reviews them regularly, in line with risk strategies;
- b. whether senior management is responsible for developing them, ensuring an adequate implementation of the management body's decisions;
- c. whether market policies are compliant with relevant regulation and adequate for the nature and complexity of the institution's activities, enabling a clear understanding of the market risk inherent to the different products and activities under the scope of the institution. Whether such policies are clearly formalised, communicated and applied consistently across the institution; and,
- d. in case of groups, whether these policies are applied consistently across the group and allow a proper management of the risk.

213. Competent authorities should assess that the institution's market policies and procedures are sound, consistent with the market risk strategy and cover all the main businesses and processes relevant for managing, measuring and controlling market risk. In particular, the assessment should cover the:

- a. nature of operations, financial instruments and markets in which the institution can operate, including internal hedges;
- b. positions to include in, and to exclude from, the trading book for regulatory purposes;
- c. definition, structure and responsibilities of the institution's trading desks, where appropriate;
- d. requirements relating to trading and settlement processes;
- e. procedures for limiting and controlling market risk;
- f. framework to ensure that all positions measured at fair value are subject to prudent valuation adjustments. This framework should include requirements for complex positions, illiquid products and products valued using models;
- g. criteria applied by the institution to avoid association with individuals/groups involved in fraudulent activities and other crimes; and,
- h. procedures for new market activities and/or products. Major hedging or risk management initiatives should be approved by the management body or its appropriate delegated committee. Competent authorities should ensure that:
 - new market activities and/or products are subject to adequate procedures and controls before being introduced or undertaken; and
 - the institution has undertaken an analysis of their possible impact in its overall risk profile.

Risk identification, measurement, monitoring and reporting

214. Competent authorities should assess whether the institution has an appropriate framework for identifying, understanding and measuring market risk, in line with the institution's size and complexity, and that this framework is compliant with relevant minimum requirements under Regulation (EU) No 575/2013. They should consider whether:

- a. the data, information systems and measurement techniques enable management to measure the market risk inherent in all material on and off balance sheet activities (where relevant at group level), including both trading and banking portfolios as well as complying with supervisory reporting requirements;

- b. institutions have adequate staff and methodologies to measure the market risk in their trading and banking portfolios, taking into account the institution's size, complexity and the risk profile of its activities;
- c. the institution's risk measurement system takes into account all material risk factors related to its market risk exposures (e.g. basis risk, credit spreads in corporate bonds or credit derivatives, vega and gamma risks in options, etc.). Where some instruments and/or factors are excluded from the risk measurement systems, competent authorities should assess materiality of the exclusions and determine if such exclusions are justified;
- d. internal models are able to approximate actual trading results (i.e. 'profit attribution');
- e. the institutions risk measurement systems are able to identify possible market risk concentrations arising either from exposures to a single risk factor or exposures to multiple risk factors that are correlated;
- f. risk managers and the institution's senior management understand the assumptions underlying the measurement systems, in particular in the case of more sophisticated risk management techniques; and,
- g. risk managers and the institution's senior management are aware of the degree of model risk which prevails in the institution's pricing models and risk measurement techniques and whether they periodically check the validity and quality of the different models used in market risk related activities.

215. Competent authorities should assess whether an institution has implemented adequate stress tests that complement its risk measurement system. To this purpose, they should take into account the adequacy of the following elements:

- a. stress test frequency;
- b. whether relevant risk drivers are identified (e.g. illiquidity/gapping of prices, concentrated positions, on-way markets etc.);
- c. assumptions underlying the stress scenario; and,
- d. internal use of stress testing outcomes for capital planning and market risk strategies.

216. Competent authorities should assess whether institutions have in place adequate monitoring and reporting framework for market risk that ensure prompt action at the appropriate level of the institution's senior management or management body, where necessary. The monitoring system should include specific indicators and relevant triggers to provide effective early warning alerts. They should take into account whether:

- a. the institution has effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk activities; and,
- b. the management and control area reports regularly to the management body and the senior management at least the following information:
 - current market exposures, P&L results and risk measures (e.g. VaR) compared to policy limits; and,
 - significant breaches of limits.

Internal control framework

217. Competent authorities should assess whether the institution has in place a strong and comprehensive control framework and sound safeguards to mitigate its market risk in line with its market risk management strategy and risk appetite. They should take into account whether:

- a. the scope covered by the institution's control function includes all consolidated entities, all geographical locations and all financial activities;
- b. there are internal controls, operating limits and other practices aimed at ensuring market risk exposures do not exceed levels acceptable to the institution, in accordance with the parameters set by the management body and senior management and the institution's risk appetite; and,
- c. whether the institution has in place appropriate internal control and practices that ensure that breaches and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action. They should take into account whether the institution's:
 - internal control and practices are able to identify breaches of individual limits set at a desk or business unit level, as well as breaches of the overall limit for the market activities; and
 - internal control and practices allow a daily identification and monitoring of limits breaches and/or exceptions.

218. Competent authorities should assess the limit system, including whether:

- a. the limits established are absolute or whether breaches of limits are possible. In the latter case, the institution's policies should clearly describe the period of time and the specific circumstances under which those breaches of limits are possible;

- b. the limit system sets an overall limit for market activities and specific limits for the main risk subcategories. It should allow, when appropriate, allocation of limits by portfolios, desks, business units or type of instruments. The level of detail should reflect the characteristics of the institution's market activities;
- c. the set of limits (risk metrics based limits, notional limits, loss control limits, etc.) established by the institution suits the size and complexity of its market activities;
- d. the institution has in place procedures to keep traders up to date with regards to their applicable limits and their degree of utilisation; and,
- e. the institution has in place adequate procedures to regularly update their limits.

219. Competent authorities should assess the functionality of the internal control framework in ensuring overall compliance. To this end they should assess whether the:

- a. institution conducts internal audits of market risk management framework on a regular basis;
- b. internal audit function covers the main elements of market risk management, measurement and control across the institution; and,
- c. internal audit function is effective in determining the adherence to internal policies and any relevant external regulation, and to address any deviation from either.

220. For institutions using internal models to determine own funds requirements for market risk, competent authorities should assess if the internal validation process is sound and effective in challenging model assumptions and identifying any potential shortcomings with respect to the market risk modelling, quantification, system and other relevant minimum requirements as set out in Regulation (EU) 575/2013.

6.4.4 Summary of findings and scoring

221. Following the above assessment, competent authorities should form a view on the institution's market risk. This view should be reflected in a summary of findings, accompanied by a score using the considerations set out in Table 5.

222. Since factors such as complexity, level of concentration or the volatility of market exposures' returns can be imperfect indicators of the market risk level, in assessing and scoring inherent market risk, competent authorities should consider all these factors in parallel and not in isolation and understand the drivers under the volatility trends.

Table 5. Supervisory considerations for assigning a market risk score

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is no discernible risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature and composition of exposures imply that market risk is not material. The institution's exposures to market risk are non-complex. The level of market risk concentration is not material. The institution's market risk exposures generate non-volatile returns. 	<ul style="list-style-type: none"> There is consistency between the institution's market risk policy and strategy and its overall strategy and risk appetite. The organisational framework for market risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. Market risk measurement monitoring and reporting systems are appropriate. Internal limits and the control framework for market risk are sound. Limits allowing mitigating or limiting the market risk are in line with the institution's market risk management strategy and risk appetite.
2	There is a low risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature and composition of market risk exposures imply low risk. The complexity of the institution's market risk exposures is low. The level of market risk concentration is low. The institution's market risk exposures generate low volatility of returns. 	
3	There is a medium risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature and composition of market risk exposures imply medium risk. The complexity of the institution's market risk exposures is medium. The level of market risk concentration is medium. The institution's exposures to market risk generate medium volatility of returns. 	
4	There is a high risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature and composition of market risk exposures imply non-material risk. The complexity of the institution's market risk exposures is high. The level of market risk concentration is high. The institution's exposures to market risk generate high volatility of returns. 	

6.5 Assessment of operational risk

6.5.1 General considerations

223. Competent authorities should assess operational risk throughout all the business lines and operations of the institution. In conducting this assessment, they should determine how operational risk may materialise (economic loss, near miss, loss of future earnings, gain) and should also consider potential impacts in terms of other related risks (e.g. credit-operational risk, market-operational risk ‘boundary cases’).

224. Competent authorities should assess the materiality of operational risk arising from outsourced services and activities, and whether these can affect the institution’s ability to process transactions and/or provide services, or cause legal liabilities for damages to third parties (e.g. customers and other stakeholders).

225. When assessing operational risk competent authorities should also consider:

- a. Reputational risk: reputational risk is included under operational risk due to the strong links with this risk (e.g. most of operational risk events have a strong impact in terms of reputation) and because most of the risk management instruments are common to both of them. However, the outcome of reputational risk assessment should not be reflected in the scoring of operational risk but, where relevant, it should be considered as part of the BMA and/or the liquidity risk assessment, since it may materialise in terms of reduction in earnings and loss of confidence or disaffection in the institution by investors, depositors or interbank-market participants.
- b. Model risk: model risk comprises two distinct forms of risk:
 - i. risk relating to the under-estimation of own funds requirements by regulatory approved models (e.g. IRB models for credit risk); and,
 - ii. risk relating to the improper use of any other models by the institutions for decision-making (e.g. product pricing, financial instruments evaluation, value at risk limits monitoring etc.).

In the case of (i) competent authorities should consider the model risk as part of the specific risk to capital assessment (e.g. IRB model deficiency is considered as part of the credit risk assessment). In the case of (ii) competent authorities should consider the risk as part of the operational risk assessment.

226. In assessing operational risk competent authorities may use the event-type classification provided by Regulation (EU) No 575/2013 for the advanced measurement approaches (Article 324) in order to have a clearer view on the spectrum of operational risks and to have

a level of consistency in analysing this risk across institutions, irrespective of the approach adopted to determine own fund requirements for operational risk.

6.5.2 Assessment of inherent operational risk

227. Competent authorities should conduct an assessment of the nature and the extent of the operational risk to which the institution is or might be exposed. To this end, competent authorities should develop a thorough understanding of the institution's business model, its operations, risk culture and the environment in which it operates since all these factors determine the institution's operational risk exposure.

228. The assessment of inherent operational risk comprises two steps, which are further elaborated in this section:

- a. preliminary assessment; and,
- b. assessment of the nature and significance of the operational risk exposures facing the institution.

Preliminary assessment

229. In order to determine the scope of the assessment of operational risk, competent authorities should preliminary identify the sources of operational risk to which the institution is exposed. To do so competent authorities should leverage the knowledge gained from the assessment of other SREP elements, from the comparison of the institution's position to peers (including relevant external data, where available), and from any other supervisory activities.

230. Competent authorities should consider at least:

- a. the overarching strategy for operational risk and operational risk tolerance;
- b. the business and external environments (including geographical location) in which the institution operates;
- c. the own funds requirement for operational risk (distinguished by BIA, TSA and AMA) compared to the total own funds requirement, and – where relevant – the internal capital for operational risk compared to the total internal capital; its historical evolution and forecast, if available;
- d. the level and evolution of gross income, assets and operational risk losses over the past few years;
- e. recent significant corporate events (such as mergers, acquisitions, disposals, restructuring), which might determine a change in the institution's operational risk profile in the short or medium to long term (e.g. because systems, processes

and procedures would not be fully aligned with the risk management policies of the parent undertaking in the short term);

- f. changes to significant elements of the IT systems and/or of processes which might determine a change in the operational risk profile (e.g. because a new or changed IT system has not been properly tested; insufficient training for the new systems/processes and procedures which might lead to errors);
- g. compliance failures with the applicable legislation as well as with internal regulation as reported by external auditors and the internal audit function or brought to attention by public information (bearing in mind both the current situation and the evolution of regulatory compliance behaviour over time);
- h. the ambitiousness of business plans and aggressive incentives and compensation schemes (e.g. in terms of sale targets, headcount reduction, etc.), which might increase the risk of non-compliance, human errors and employee malpractice;
- i. the complexity of processes and procedures, of products (sold to customers or dealt in) and of IT systems (including use of new technologies), to the extent they might lead to errors, delays, mis-specification, security breach, etc.; and,
- j. the institution's outsourcing strategy in terms of the type of business operations that are outsourced, monitoring practices of the quality of services received by the institution, level of awareness of operational risk related to outsourced activities and of the overall service providers' risk exposure pursuant to the requirements of the EBA Guidelines on outsourcing.

231. Where relevant, the competent authority should analyse the aspects above by business lines/legal entities and geographies as well as by event type categories, provided that data are available, and compare the institution's position to its peers.

Nature of operational risk exposures

232. Competent authorities should determine the nature of operational risk exposures and distinguish those which are more inclined to lead to 'high frequency/low impact' events from those causing 'low frequency/high severity' losses (which are the most dangerous from a prudential point of view).

233. For this purpose, competent authorities should analyse risk exposures at a granular level, by breaking down the main relevant event type categories into smaller sub-categories which should be further split by business lines, products, processes and geographies, where relevant.

234. Due to the specificity of operational risk and in order to form a forward looking view on operational risk exposures and potential losses, competent authorities should also aim at investigate the key drivers, which are behind the events.
235. Competent authorities should therefore link operational risk exposures and event type categories to the primary risk drivers (processes, people, systems, and external factors) and assess their materiality for institutions.
236. In performing this analysis, competent authorities should consider the interactions of such risk drivers in determining the institution's operational risk exposures (e.g. exposure to more risk drivers might increase the likelihood of an operational event and consequent loss).

Significance of operational risk exposure

237. Once the major sources and drivers of operational risk have been identified, the competent authority should focus on those which might have the most material impact on the institution. The competent authority should assess the institution's 'potential exposure' to the operational risk drivers by using both expert judgment and quantitative indicators relating to either the institution or its peers.
238. In assessing the significance of operational risk exposures, competent authorities should consider both the frequency and severity of the events to which the institution is exposed.
239. A primary source of information competent authorities should consider is the institution's operational losses and event database which, where available and reliable (i.e. accurate and complete), provides the historical operational risk profile of the institution.
240. For institutions adopting the Advanced Measurement Approach (AMA) for the purpose of minimum own funds requirements calculation, the competent authority should initially consider the output of the internal approach, provided this is deemed 'fit for purpose' and is capable of measuring the operational risk exposure to the desired level of detail (e.g. product, process, etc.) and assuming the model is sufficiently forward looking.
241. In addition, competent authorities should perform a more qualitative analysis and leverage the institution's risk assessment, peer analysis data and public and/or consortium databases, if available and relevant. Competent authorities may also consider other factors, specific to the relevant business units, etc. affected by the potential deficiencies, which can provide a measure of the risk exposure.
242. In performing the assessment of an institution's risk exposure, competent authorities should employ a forward looking approach, leveraging scenario analyses performed by the institution, where available.

Assessment of operational risk sub-categories

243. Competent authorities should assess operational risk across operational risk sub-categories (defined by the event types and further break-downs thereof) and the risk drivers associated with each.

244. In conducting the assessment, competent authorities should pay particular attention to some sub-categories of operational risk because of their pervasive nature, and their relevance to the majority of institutions and also because of their potential prudential impact. Such sub-categories include, *inter alia*:

- a. conduct risk;
- b. systems – IT risk; and
- c. model risk.

Conduct risk

245. Competent authorities should assess the relevance and significance of the institution's exposures to conduct risk and in particular to:

- a. mis-selling of products, in both retail and wholesale markets;
- b. pushed cross-selling of products to retail customers, like packaged bank accounts or add-on products the customers do not need;
- c. conflict of interest in conducting business;
- d. manipulation of benchmark interest rates, foreign exchange rates or any other financial instruments or indices in order to enhance the institution's profits;
- e. barriers to switching financial products during their lifetime and/or to switch financial service providers;
- f. poorly designed distribution channels that may enable conflict of interest with false incentives;
- g. automatic renewals of products or exit penalties; and/or,
- h. unfair processing of customer complaints.

246. Since conduct risk covers a wide range of issues and may arise from many business processes and products competent authorities should leverage the outcome of the BMA and scrutinise incentive policies in order to gain a high level insight as to sources of conduct risk.

247. Where relevant, the competent authority should consider the level of competition in the markets in which the institution operates and determine if any dominant position alone or within a small group presents material risk of misconduct (e.g. as a result of cartel-like behaviour).

248. Possible indicators to flag the existence of conduct risk are represented by:

- a. past sanctions assigned by relevant authorities to the institution for misconduct practices;
- b. recent sanctions assigned to peers for misconduct practices; and,
- c. complaints records in terms of number and amount at stake.

249. The competent authority should apply a forward looking approach, considering the possible impact of regulatory developments in respect of consumer protection and the supply of financial services in general.

Systems - IT risk

250. Competent authorities may evaluate operational risk using various methodologies based on well-established industry standards (e.g. ISO 27000, COBIT, ITIL, etc.). Whichever the approach adopted, the competent authority should at least assess:

- a. the quality and effectiveness of business continuity testing and planning (e.g. ability of the IT system of the institution to keep the business fully operative);
- b. the security of internal and external accesses to systems and data (e.g. whether the IT systems provides information and access to only the right people);
- c. the accuracy and integrity of the data used, for example, for reporting, risk management, accounting, position keeping, etc. (e.g. whether the IT system ensures that the information and its reporting is accurate, timely and complete); and,
- d. the agility of change execution (e.g. whether the changes in IT systems are carried out within acceptable cost and at the required speed of implementation).

251. Competent authorities should also assess complexity of the IT architecture and whether it may affect the aspects above.

252. In assessing these elements, a competent authority should gather, where available, relevant internal incident reports and internal audit reports, as well as other indicators defined and used by the institution to measure and monitor IT risk.

253. Competent authorities should then assess the significance of the potential impact of IT risk both in terms of losses and reputational damage to the institution. In doing so it should leverage relevant sensitivity and scenario analyses or stress testing results, whenever available.

Model risk

254. Competent authorities should assess the institution's exposure to model risk arising from the use of internal models in the main business areas and operations. Competent authorities should consider:

- i. to what extent and for which purposes (i.e. asset evaluation, product pricing, trading strategies, risk management, etc.) the institution uses models to make decisions and the business significance of such decisions; and,
- ii. the level of the institution's awareness of and how it manages model risk.

255. For the purposes of point (i), competent authorities should determine for which business/activity the institution makes material use of models. In conducting this assessment, competent authorities may look at the following areas, which represent common areas where institutions make extensive use of models:

- a. financial instruments trading;
- b. risk measurement and management; and,
- c. capital allocation (including lending policies and pricing).

256. For the purpose of point (ii) competent authorities should assess whether:

- a. the institution has implemented any control mechanism (e.g. market parameters calibration, internal validation or back-testing, counter-checking with expert judgement, etc.) and the soundness thereof (i.e. in terms of methods, frequency, follow-up, etc.); and,
- b. the institution adopts a prudential use of models (e.g. by increasing or decreasing relevant parameters according to the direction of the positions; etc.) in case it is aware of model deficiencies or market and business developments.

257. In conducting model risk assessment, competent authorities should leverage the outcome of the assessment of other risks to capital and risks to liquidity and funding, in particular with respect to the adequacy of methodologies used for measuring risk, pricing and evaluating assets and/or liabilities.

258. For those business areas which make a significant recourse to models, the competent authority should then assess how significant the impact of model risk might be, also through sensitivity and scenario analyses or stress testing.

6.5.3 Assessment of reputational risk

259. Competent authorities should conduct an assessment of the reputational risk to which the institution is exposed, leveraging on their understanding of the institution's governance, its business model, products and the environment in which it operates.

260. By nature, reputational risk is more relevant for large institutions, in particular for those with listed equities or debts or which operate in interbank markets. Accordingly, in assessing reputational risk competent authorities should dedicate more attention to those which present those characteristics.

261. Competent authorities should consider both internal and external factors or events, which might give rise to reputational concerns in respect of the institution. Competent authorities should consider the following qualitative indicators in their assessment of the institution's exposure to reputational risk:

- a. the number of sanctions from official bodies in the year (not only from competent authorities, but also considering sanctions arising from tax or other settlements);
- b. media campaigns and consumer association initiatives that contribute to a deteriorating public perception and the reputation of the institution;
- c. the number and the evolution of customer complaints;
- d. negative events affecting the institution's peers when they are associated by the public with the whole financial sector or a group of institutions;
- e. funding of sectors not well perceived by the public (e.g. weapons industry, embargoed countries, etc.) or of people and countries on sanctions lists (e.g. OFAC lists); and,
- f. other 'market' indicators, if available (e.g. rating downgrades or the evolution of the stock price throughout the year).

262. Competent authorities should assess the significance of reputational risk exposure of the institution and the interconnectedness with the other risks (i.e. credit, market, operational and liquidity) by leveraging the other risks assessments in order to capture any possible second round effects in either direction (from reputation to other risks and vice versa).

6.5.4 Assessment of operational risk management, measurement and controls

263. Competent authorities should assess the framework and arrangements that the institution has in place to specifically manage and control operational risk as an individual risk category. This assessment should take into account the outcome of the analysis of the overall risk management and internal control framework addressed in Title 5 as this will influence the institution's operational risk exposures.
264. Competent authorities should approach this review having regard to the key operational risk drivers (i.e. people, processes, external factors, systems), which can also act as mitigating factors, and should consider:
- a. operational risk management strategy and tolerance;
 - b. organisational framework;
 - c. policies and procedures;
 - d. operational risk identification, measurement, monitoring and reporting;
 - e. business resilience and continuity plans; and,
 - f. internal control framework as it applies to the management of operational risk.

Operational risk management strategy and tolerance

265. Competent authorities should assess whether the institution has defined and formalised a sound operational risk management strategy and tolerance level, approved by the management body. For this assessment competent authorities should take into account whether:
- a. the management body clearly articulates the operational risk management strategy and tolerance level as well as the process for their review (e.g. in case of overall risk strategy review, loss trend and/or capital adequacy concerns, etc.);
 - b. senior management properly implements and monitors the operational risk management strategy approved by the management body, ensuring that the institution's operational risk mitigation measures are consistent with the established strategy;
 - c. these strategies are appropriate and efficient with respect to the nature and the materiality of the operational risk profile and whether the institution monitors their effectiveness over time and their consistency with the operational risk tolerance level;

- d. the institution's operational risk management strategy covers all the activities, processes and systems of the institution – including on a forward looking basis through the strategic plan – where operational risk is or may be significant; and,
- e. the institution has an appropriate framework in place to ensure that operational risk management strategy is effectively communicated to relevant staff.

266. In order to assess the credibility of such strategies, competent authorities should also assess whether the institution has allocated sufficient resources to their implementation, and whether relevant decisions taken are irrespective of minimum own funds requirements benefits which might accrue (in particular for institutions adopting BIA or TSA approaches to determine minimum own funds requirements).

Organisational framework for management and oversight of operational risk

267. Competent authorities should assess the soundness and effectiveness of the organisational framework with respect to the management of operational risk. In this regard, the competent authority should determine whether:

- a. there are clear lines of responsibility for the identification, analysis, assessment, mitigation, monitoring and reporting of operational risk;
- b. the operational risk control and monitoring systems are subject to independent review and there is a clear separation between risk takers and risk managers and the control and oversight risk functions;
- c. the risk management, measurement, and control functions cover operational risk institution-wide, across the entire institution (including branches) in an integrated manner, irrespective of the measurement approach adopted to determine minimum own funds, and they also cover outsourced business functions and other activities; and,
- d. the operational risk management framework is structured with sufficient and qualitatively appropriate human and technical resources.

Policies and procedures

268. Competent authorities should assess whether the institution has appropriate policies and procedures for the management of operational risk, including residual risk after mitigation techniques have been applied. For this assessment competent authorities should take into account whether:

- a. the management body approves the policies for managing operational risk and reviews them regularly, in line with the operational risk management strategies;

- b. senior management is responsible for developing and implementing the policies and procedures for managing operational risk;
- c. operational risk management policies and procedures are clearly formalised and communicated throughout the institution and they cover the whole organisation or at least those processes and businesses most exposed to operational risk;
- d. such policies and procedures cover all the elements of the operational risk management, measurement and control including, where relevant, loss data collection, quantification methodologies, mitigation techniques (e.g. insurance policies), causal analysis techniques in respect of operational risk events, limits and tolerances and the handling of exceptions thereof;
- e. the institution has implemented a new products, processes and systems approval process, which requires the assessment and mitigation of potential inherent operational risks;
- f. such policies are adequate for the nature and complexity of the institution's activities, and enable a clear understanding of the operational risk inherent to the different products and activities under the scope of the institution;
- g. such policies are clearly formalised, communicated and applied consistently across the institution. In the case of banking groups, whether these policies are applied consistently across the group and allow a proper management of the risk; and,
- h. the institution promotes an operational risk management culture throughout the organisation, by means of training and by setting targets in terms of operational losses reduction.

Risk identification, measurement, monitoring and reporting

269. Competent authorities should assess whether the institution has an appropriate framework for identifying, assessing, measuring and monitoring operational risk, in line with the institution's size and complexity, and that the framework is at least compliant with the relevant requirements to determine minimum own funds requirements under Regulation (EU) No 575/2013. Competent authorities should take into account whether:

- a. the institution has implemented effective processes and procedures for a comprehensive identification and assessment of operational risk exposure (e.g. Risk and Control Self Assessments, RCSA) and for the detection and accurate categorisation of relevant events (i.e. loss data collection), including boundary cases with other risks (e.g. credit loss caused or augmented by an operational risk event). In this regard, competent authorities should also determine the ability of

the institution to identify the key drivers of relevant operational losses and use this information for operational risk management purposes;

- b. the institution has appropriate information systems and methodologies to quantify or assess the inherent operational risk, which at least comply with requirements to determine relevant minimum own funds as set out in the Regulation (EU) No 575/2013 (e.g. for the TSA mapping of relevant profit & loss items to the regulatory eight business lines; for the AMA the length of time series, treatment of insurances, correlation, etc.);
- c. the institution has implemented adequate stress testing and scenario analysis, as appropriate, to understand the impact of adverse operational events on its profitability and own funds, also taking in due consideration the potential failure of internal controls and mitigation techniques. Where relevant, competent authorities should consider the consistency of these analyses with the RCSA and with the outcome of peer analysis;
- d. the institution's management body and senior management understand the assumptions underlying the measurement system and if they are aware of the degree of relevant model risk;
- e. the institution has defined and implemented a continuous and effective monitoring of operational risk exposures throughout the institution, including outsourced activities and new products and systems, also by means of specific indicators (key risk indicators and key control indicators) and relevant triggers to provide effective early warning alerts; and,
- f. the institution has implemented regular reporting on operational risk exposure, including on stress testing outcomes, which is addressed to both the management body, the senior management and to the managers of relevant businesses and processes as appropriate.

Business resilience and continuity plans

270. Competent authorities should assess whether the institution has comprehensive and tested business resiliency and continuity plans in place to ensure an ability to operate on an ongoing basis and limit losses in the event of severe business disruption.

271. Competent authorities should determine whether the institution has established business continuity plans commensurate with the nature, size, and complexity of its operations. Such plans should take into account different types of likely or plausible scenarios to which the institution may be vulnerable.

272. Competent authorities should assess the quality and effectiveness of the institution's continuity management planning process. In doing so, competent authorities should evaluate

the quality of the institution's adherence to recognised Business Continuity Management (BCM) processes. Accordingly, competent authorities should determine whether the institution's continuity management planning process entails:

- a. Business Impact Analysis;
- b. appropriate recovery strategies incorporating internal and external dependencies and clearly defined recovery priorities;
- c. the drafting of comprehensive flexible plans to meet plausible scenarios;
- d. effective testing of the plans;
- e. BCM awareness and training programmes; and,
- f. communications and crisis management documentation and training.

Internal control framework

273. Competent authorities should assess whether the institution has in place a strong control framework and sound safeguards to mitigate its operational risk, in line with its operational risk management tolerance and strategy. Competent authorities should take into account whether:

- a. the scope covered by the institution's control functions includes all consolidated entities and geographical locations;
- b. there are internal controls and other practices (e.g. conduct policies, etc.) aimed at mitigating and keeping operational risk exposures within levels acceptable to the institution, in accordance with the parameters set by the management body and senior management and the institution's risk tolerance level; and
- c. the institution has in place appropriate internal controls and practices that ensure that breaches and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action, and to competent authorities as required.

274. Competent authorities should also assess the functionality of the internal control framework in ensuring overall compliance. To this end they should determine whether:

- a. the institution conducts internal audits of the operational risk management framework on a periodic basis;
- b. the internal audit covers the main elements of operational risk management measurement and control across the institution; and,

- c. such audits are effective in determining the adherence to internal policies and any relevant external regulation and to address any deviations thereof.

275. For institutions using an advanced measurement approach (AMA) to determine minimum own funds requirements for operational risk, competent authorities should also assess if the internal approach validation process is sound and effective in challenging model assumptions and identifying any potential shortcomings with respect to operational risk modelling, quantification, systems and to other relevant minimum requirements as set out in the Regulation (EU) No 575/2013.

276. Irrespective of the approach adopted by the institution to determine regulatory minimum own funds, when models are used for decision making (e.g. credit lending, pricing, trading financial instruments, etc.), competent authorities should assess if there is a sound internal validation process and/or model review process that allow the determination and mitigation of model risk.

Management of reputational risk

277. Competent authorities should assess whether the institution has implemented adequate arrangements, strategies, processes and mechanisms with the aim of managing reputational risk. In particular, competent authorities should take into account whether:

- a. the institution has formalised policies and processes in place for the identification, management and monitoring of this risk, which are proportionate to its size and its relevance in the system;
- b. the institution addresses this risk in a precautionary manner, for example by setting limits or requiring approval for allocating capital to specific countries, sectors or persons and or whether its contingency plans address the need to deal proactively with reputational issues in the event of a crisis;
- c. the institution conducts stress testing or scenario analysis in order to assess any second round effects of reputational risk (e.g. liquidity, funding costs, etc.);
- d. the institution acts to protect its brand through prompt communication campaigns in case of particular events which might endanger its reputation; and,
- e. the institution considers the potential impact of its strategy and business plans and more generally the institution's behaviour on reputation.

6.5.5 Summary of findings and scoring

278. Following the above assessment, competent authorities should form a view on the institution's operational risk. This view should be reflected in a summary of findings, accompanied by a score using the considerations set out in Table 6.

Table 6. Supervisory considerations for an operational risk score

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is no discernible risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature of the institution's operational risk exposures is limited to few high frequency/low severity impact categories. The significance of institution's exposure to operational risk is not material, as also shown from scenario analysis and compared to the losses of peers. The level of losses experienced by the institution in recent years has not been material, or has decreased from a higher level. 	<ul style="list-style-type: none"> There is consistency between the institution's operational risk policy and strategy and its overall strategy and risk appetite. The organisational framework for operational risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. Operational risk measurement, monitoring and reporting systems are appropriate. The control framework for operational risk is sound.
2	There is a low risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature of the institution's operational risk exposures is mainly towards high frequency/low severity impact categories. The significance of the institution's exposure to operational risk is low as also shown from scenario analysis and compared to the losses of peers. The level of losses experienced by the institution in recent years has been low, or is expected to increase from a lower historic level or decrease from a higher historic level. 	
3	There is a medium risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The nature of the institution's operational risk exposures extends to some low frequency/high severity impact categories. The significance of institution's exposure to operational risk is medium, as also shown from scenario analysis and compared to the losses of peers. The level of losses experienced by the institution in the course of the few past years has been medium, or is expected to 	

		increase from a lower historic level or decrease from a higher historic level.	
4	There is a high risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The nature of the institution's operational risk exposures extends to all main categories. • The significance of institution's exposure to operational risk is high and increasing, as also shown from scenario analysis and compared to the losses of peers. • The level of losses experienced by the institution in the course of the few past years has been high or risk has significantly increased. 	

6.6 Assessment of interest-rate risk from non-trading activities

6.6.1 General considerations

279. Competent authorities should assess interest rate risk arising from interest rate sensitive positions from non-trading activities (commonly referred to as interest rate risk in the banking book, or IRRBB), including hedges for these positions, irrespective of their evaluation for accounting purposes (note that credit spread risk arising from some banking book positions is covered in the section on market risk).

280. Competent authorities should consider the following subcategories when assessing IRRBB:

- a. risks related to the timing mismatch in the maturity and repricing of assets, liabilities and off balance sheet short and long term positions (repricing risk);
- b. risk arising from changes in the slope and the shape of the yield curve (yield curve risk);
- c. risks arising from hedging exposure to one interest rate with exposure to a rate which re-prices under slightly different conditions (basis risk); and,
- d. risks arising from options, including embedded options, e.g. consumers redeeming fixed rate products when market rates change (option risk).

281. Competent authorities should take into account whether the guidance established in the EBA guidelines on IRRBB are implemented by the institution prudently. This is particularly true for the calculation of the supervisory shock specified in Art 98 (5) of the Directive 2013/36/EU as well as for the institution's internal interest rate risk identification, measurement, monitoring and control procedures.

6.6.2 Assessment of inherent IRRBB

282. Through the assessment of the inherent level of IRRBB, competent authorities should determine the main drivers of institution's IRRBB exposure and evaluate the potential prudential impact of this risk on the institution. The assessment of inherent IRRBB should be structured under the following main steps:

- a. preliminary assessment;
- b. assessment of the nature and composition of the institution's interest rate risk profile; and,
- c. assessment of the outcome of the scenario analysis and stress testing.

Preliminary assessment

283. In order to determine the scope of the assessment of IRRBB, competent authorities should preliminary identify the sources of IRRBB to which the institution is or might be exposed. To do so competent authorities should leverage the knowledge gained from the assessment of other SREP elements, from the comparison of the institution's position to peers, and from any other supervisory activities.

284. Competent authorities should consider at least:

- a. the institution's governance of interest rate risk, including the overarching IRRBB strategy and institution's risk appetite in relation to interest rate risk;
- b. the impact of a standard shock, as per Article 98(5) of Directive 2013/36/EU and articulated by EBA guidelines on IRRBB, on the economic value as a proportion of the institution's regulatory own funds as well as its impact on future net interest income (NII); and,
- c. the internal capital – where relevant – allocated to IRRBB both in total and as a proportion of the institution's total internal capital according to their ICAAP; its historical evolution and forecast, if available.

285. In their preliminary assessment, competent authorities should also consider significant changes in the exposures of the institution to IRR. They should at least assess the following aspects:

- a. significant changes in the institution's overall IRRBB strategy, policy and size of limits;
- b. potential impact on the institution's risk profile of those changes; and,
- c. major market trends.

Nature and composition of the institution's interest rate risk profile

286. Competent authorities should form a clear view on how changes in interest rates can adversely impact on earnings and economic value (the present value of expected cash flows) of an institution, in order to have both a short and a longer term view on the possible threat to capital adequacy.

287. For this purpose, competent authorities should analyse and form a clear view on the structure of the institution's assets, liabilities and off balance sheet exposures. In particular:

- a. the different positions in the banking book, their maturities or re-pricing dates as well as behavioural assumptions (e.g. assumptions regarding products with uncertain maturity) for these positions;

- b. the institution's interest cash-flows, if available;
- c. the proportion of products with uncertain maturity, and products with explicit and/or embedded options, paying particular attention to products with embedded customer optionality; and,
- d. the hedging strategy of the institution. Amount and use of derivatives (hedging vs. speculation).

288. To better determine the complexity and the interest rate risk profile of the institution, competent authorities should also understand the main features of the institution's assets, liabilities and off-balance sheet exposures, in particular:

- a. loan portfolio (e.g. volume of loans with no maturity, volume of loans with prepayment options or volume of floating rate loans with caps and floors);
- b. bond portfolio (e.g. volume of investments with options, possible concentrations);
- c. deposit accounts (e.g. rate sensitivity of the institution's deposit base to changes in interest rate, possible concentrations); and,
- d. derivatives (e.g. complexity of the derivatives used either for hedging or for speculative purposes, considerations about sold or bought interest rate options).

289. When analysing the impact on the institution's earnings, competent authorities should consider the institution's different sources of income and costs and their relative weights. They should be aware of how much the institution's returns depend on interest rate sensitive positions. They should determine how different changes in interest rates affect the institution's net interest income.

290. When analysing the impact on the institution's economic value, competent authorities should first consider the results of a standard shock, as referred to in Article 98(5) of Directive 2013/36/EU, in order to have an initial benchmark to compare how interest rate changes affect the institution. Competent authorities should evaluate compliance with guidance set out by EBA Guidelines on IRRBB and, when performing this assessment, should pay particular attention to the sensitivity of the balance sheet impact to changes in the underlying key assumptions (in particular for customers' accounts without specific re-pricing dates and/or equity capital).

291. Competent authorities should seek to understand the impact of those assumptions by reviewing the 'outlier' standard test result and then isolating the economic value risks arising from the institution's behavioural adjustments so that they may, among other things, identify and understand the risks that are arising from earnings stabilisation activity as distinct from those arisen from other aspects of the business model.

292. Competent authorities may decide to set different standard shocks for different currencies.
293. In addition to using the parallel +/- 200 basis point shock as the standard shock, competent authorities should also consider using their own designated shock scenarios (e.g. larger or smaller, for all or some currencies, allowing for non-parallel shifts in rates, considering basis risk etc.). When deciding the level at which to set these additional shock scenarios, competent authorities should take into account factors such as the general level of interest rates, the shape of the yield curve and any relevant national characteristics in their financial systems. The institution's internal systems should therefore be flexible enough to compute their sensitivity to any standard shock that is prescribed.
294. In their quantitative assessment, competent authorities should also consider the results of the institution's internal methodologies for measuring interest rate risk, when appropriate. Through the analysis of these methodologies competent authorities should gain a deeper understanding of the main risk factors underlying the institution's interest rate risk profile.
295. Competent authorities should assess that those institutions operating in different currencies perform an analysis of the interest rate risk in each currency in which they have a significant position, taking into account historical correlations between the currencies.
296. When analysing the results of both the impact of the standard shock and the institution's internal methodologies, competent authorities should consider 'point in time' figures as well as historical trends. These rates should be compared to peers and to the global market situation.

Scenario analysis and stress testing

297. Competent authorities should assess and take into account the results of the scenario analysis and stress tests (other than the standard shock) performed by the institution for their ongoing internal management process. In that context, competent authorities should be aware of the main sources of IRRBB for the institution.
298. If when reviewing the outcome of the institution's stress tests, particular concentrations of IRRBB are revealed or suspected, competent authorities may require additional analysis.

6.6.3 Assessment of IRRBB management and controls

299. In order to reach a comprehensive understanding of the institution's interest rate risk profile in the banking book, competent authorities should review the governance and framework underlying its interest rate exposures.
300. Competent authorities should assess the following elements:
- a. interest rate risk strategy and appetite (as distinct elements or as part of broader market risk strategy and appetite);

- b. organisational framework;
- c. policies and procedures;
- d. risk identification, measurement monitoring and reporting; and
- e. internal control framework.

Interest rate risk strategy and appetite

301. Competent authorities should assess whether the institution has a sound, clearly formulated and documented IRRBB strategy, approved by the management body. For this assessment competent authorities should take into account:

- a. whether the management body clearly articulates the IRRBB strategy and appetite and the process for their review (e.g. in the case of overall risk strategy review, profitability or capital adequacy concerns). Whether senior management properly implements the IRRBB strategy approved by the management body, ensuring that the institution's activities are consistent with the established strategy, written procedures are developed and implemented, and responsibilities are clearly and properly assigned;
- b. whether the institution's IRRBB strategy properly reflects the institution's appetite for interest rate risk and whether it is consistent with the overall risk appetite;
- c. whether the institution's IRRBB strategy and appetite are appropriate for the institution considering:
 - its business model;
 - its overall risk strategy and appetite;
 - its market environment and role in the financial system; and,
 - its capital adequacy;
- d. whether the institution's IRRBB strategy broadly cover all the activities of the institution where IRRBB is significant;
- e. whether the institution's IRRBB strategy takes into account the cyclical aspects of the economy and the resulting shifts in the composition of the IRRBB activities; and,
- f. whether an institution has an appropriate framework in place to ensure that the IRRBB strategy is effectively communicated to relevant staff.

Organisational framework

302. Competent authorities should assess whether the institution has an appropriate organisational framework for IRRBB management, measurement, monitoring and control functions, with sufficient human (both qualitative and quantitative) and technical resources. They should take into account whether:

- a. there are clear lines of responsibility for the taking, monitoring, controlling and reporting of IRRBB;
- b. the IRRBB management and control area is subject to independent review and is clearly identified in the organisation and functionally and hierarchically independent of the business area; and,
- c. the staff dealing with interest rate risk (both in business and management and control areas) have appropriate skills and experience.

Policies and procedures

303. Competent authorities should assess whether the institution has clearly defined policies and procedures for the management of IRRBB, consistent with its IRRBB strategy and appetite. They should take into account whether:

- a. the management body approves the policies for managing, measuring and controlling IRRBB and discusses and reviews them regularly in line with risk strategies;
- b. the senior management is responsible for developing them, ensuring an adequate implementation of the board decisions;
- c. IRRBB policies are compliant with relevant regulation and adequate for the nature and complexity of the institution's activities, enabling a clear understanding of the inherent IRRBB;
- d. such policies are clearly formalised, communicated and applied consistently across the institution;
- e. these policies are applied consistently across banking groups and allow a proper management of the risk;
- f. IRRBB policies define the procedures for new products development, major hedging or risk management initiatives and whether such policies have been approved by the management body or its appropriate delegated committee. In particular, competent authorities should ensure that:

- new products, new major hedging or risk management initiatives are subject to adequate procedures and controls before being introduced or undertaken; and
- the institution has undertaken an analysis of their possible impact in its overall risk profile.

Risk identification, measurement, monitoring and reporting

304. Competent authorities should assess whether the institution has an appropriate framework for identifying, understanding and measuring IRRBB, in line with institution's size and complexity. They should consider:

- a. whether the information systems and measurement techniques enable management to measure the inherent interest risk in all its material on and off balance sheet exposures (where relevant at group level), including internal hedges, in the banking book portfolio;
- b. whether the institution has adequate staff and methodologies to measure IRRBB (according to the requirements of EBA guidelines on IRRBB on methods for measuring IRR), taking into account the size, form and complexity of their interest rate risk exposure;
- c. whether the assumptions underlying internal methodologies take into account the guidance established by EBA guidelines on IRRBB on methods for measuring IRR. In particular, competent authorities should assess whether the institution's assumptions for positions with no contractual maturity and embedded customer optionalities are prudent. Competent authorities should also assess whether institution's include equity in the calculation of economic value and, if this is the case, analyse the impact of removing equity from that calculation;
- d. whether the institution's risk measurement systems take into account all material forms of interest rate risk to which the institution is exposed (e.g. repricing risk, yield curve risk, basis risk and option risk). In the case where some instruments and/or factors are excluded from the risk measurement systems, institutions should be able to explain why to supervisors and to quantify the materiality of the exclusions;
- e. the quality, detail and timeliness of the information provided by the information systems and whether they are able to aggregate the risk figures for all the portfolios, activities and entities included in the consolidation perimeter. Information systems should comply with guidance established by EBA Guidelines on IRRBB;

- f. the integrity and timeliness of the data that feed the risk measurement process, which should also comply with the guidance established by EBA Guidelines on IRRBB;
- g. whether the institution's risk measurement systems are able to identify possible IRRBB concentrations;
- h. whether risk managers and the institution's senior management understand the assumptions underlying the measurement systems, especially with regard to positions with uncertain contractual maturity and those with implicit or explicit options as well as the institution's assumptions for equity capital; and,
- i. whether risk managers and the institution's senior management are aware of the degree of model risk which prevails in the institution's risk measurement techniques.

305. Competent authorities should assess whether the institution has implemented adequate stress tests scenarios that complement its risk measurement system. In their assessment, they should evaluate the compliance with the relevant guidance established in EBA Guidelines on IRRBB.

306. Competent authorities should assess whether the institution has in place an appropriate monitoring and internal reporting framework for IRRBB that ensures prompt action at the appropriate level of the institution's senior management or management body, where necessary. The monitoring system should include specific indicators and relevant triggers to provide effective early warning alerts. They should take into account whether the management and control area reports regularly (the frequency will depend on the scale, complexity and level of risk of IRRBB exposures) to the management body and the senior management at least the following information:

- a. an overview of the current IRRBB exposures, P&L results and risk calculation;
- b. significant breaches of IRRBB limits; and,
- c. changes in the major assumptions or parameters on which the procedures for assessing IRRBB are based.

Internal control framework

307. Competent authorities should assess whether the institution has in place a strong and comprehensive control framework and sound safeguards to mitigate its exposures to IRRBB in line with its risk management strategy and risk appetite. They should take into account:

- a. whether the scope covered by the institution's control function includes all consolidated entities, all geographical locations and all financial activities;

- b. whether there are internal controls, operating limits and other practices aimed at keeping IRRBB exposures not exceeding levels acceptable to the institution, in accordance with the parameters set by the management body and senior management and the institution's risk appetite; and,
- c. whether the institution has in place appropriate internal control and practices that ensure that breaches and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

308. Competent authorities should assess the limit system, including whether:

- a. it is adequate for the complexity of the institution's organisation and IRRBB exposures, as well as to its capability to measure and manage this risk;
- b. addresses the potential impact of changes of interest rates on earnings and institution's economic value. From an earning perspective limits should specify acceptable levels of earnings volatility under specified interest rate scenarios. The form of limits for addressing the effect of rates on an institution's economic value should be appropriate for the size and complexity of the institution's activities and underlying positions. For banks engaged in retail banking activities with few holdings of long term instruments, options, instruments with embedded options or other instrument whose value may be altered given changes in interest rates, relatively simple limits may suffice. For more complex institutions, however, more detailed limits on acceptable changes in the estimated economic value may be needed;
- c. the limits established are absolute or whether breaches of limits are possible. In the latter case, the institution's policies should clearly describe the period of time and the specific circumstances under which those breaches of limits are possible. Competent authorities should demand information about measures/actions to adhere to limits; and,
- d. the institution has in place adequate procedures to regularly update their limits.

309. Competent authorities should assess the functionality of the internal control framework in ensuring overall compliance. To this end they should assess whether:

- a. the institution conducts internal audits of IRRBB management framework on a regular basis;
- b. the internal audit covers the main elements of IRRBB management, measurement and control across the institution; and,
- c. the internal audit function is effective in determining the adherence to internal policies and the relevant external regulation and to address any deviation.

6.6.4 Summary of findings and scoring

310. Following the above assessment, competent authorities should form a view on the institution's IRRBB. This view should be reflected in a summary of findings, accompanied by a score using the considerations set out in Table 7.

Table 7. Supervisory considerations for assigning a score to IRRBB

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is no discernible risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The sensitivity of the economic value to changes in interest rates is not material. The sensitivity of earnings to changes in interest rates is not material. The sensitivity of the economic value and earnings to changes in the underlying assumptions (e.g. products with embedded customer optionality) is not material. 	<ul style="list-style-type: none"> There is consistency between the institution's interest rate risk policy and strategy and its overall strategy and risk appetite. The organisational framework for interest rate risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. Interest rate risk measurement monitoring and reporting systems are appropriate. Internal limits and the control framework for interest rate risk are sound. Limits allowing mitigating or limiting of interest rate risk are in line with the institution's interest rate risk strategy and risk appetite.
2	There is a low risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The sensitivity of economic value to changes in interest rates is low. The sensitivity of earnings to changes in interest rates is low. The sensitivity of the economic value and earnings to changes in the underlying assumptions (e.g. products with embedded customer optionality) is low. 	
3	There is a medium risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> The sensitivity of economic value to changes in interest rates is medium. The sensitivity of earnings to changes in interest rates is medium. The sensitivity of earnings and economic value to changes in the underlying assumptions (e.g. products with embedded customer optionality) is medium. 	
4	There is a high risk of significant prudential impact on the institution having considered the level	<ul style="list-style-type: none"> The sensitivity of economic value to changes in interest rates is high. The sensitivity of earnings to changes in interest rates is high. 	

	<p>of inherent risk and the management and controls.</p>	<ul style="list-style-type: none"> • The sensitivity of earnings and economic value to changes in the underlying assumptions (e.g. products with embedded customer optionality) is high. 	
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Title 7. SREP capital assessment

7.1 General considerations

311. Competent authorities should determine through the SREP Capital Assessment whether the own funds held by the institution ensure a sound coverage of risks to capital to which the institution is or might be exposed, if such risks are assessed as material to the institution.
312. Competent authorities should do so by determining and setting the quantity (amount) and composition (quality) of additional own funds the institution is required to hold to cover elements of risks and risks not covered by Article 1 of Regulation (EU) 575/2013 (“additional own funds requirements”), including where necessary own funds requirements to cover the risk posed by model, control, governance or other deficiencies.
313. Competent authorities should assess the adequacy of the institution’s own funds, and assess the impact on own funds of an economic stress, as a key determinate of the institution’s viability. These assessments should also consider the risks posed to own funds from excessive leverage.
314. This determination should be summarised and reflected in a score, according to the criteria set out at the end of this title.

The SREP capital assessment process

315. Competent authorities should undertake the following steps as part of the SREP capital assessment process:
- a. determination of the additional own funds requirements;
 - b. reconciliation of the additional own funds requirements with the CRD buffers and any macro-prudential requirements;
 - c. determination and articulation of the TSCR and OCR;
 - d. assessment of the risk of excessive leverage;
 - e. assessment of whether the OCR and TSCR can be met over the economic cycle; and,
 - f. determination of the capital score.

7.1 Determining additional own funds requirements

316. Competent authorities should determine the additional own funds requirements, covering:

- a. the risk of unexpected losses and losses arising from the institution not making sufficient provisions over a 12 month period (except where otherwise specified in Regulation (EU) 575/2013) (“unexpected losses”);
- b. the risk arising from model deficiencies leading to the underestimation of risk; and,
- c. the risk arising from control, governance and other deficiencies.

7.1.1 Determining additional own funds to cover unexpected losses

317. Competent authorities should set additional own fund requirements to cover the risk of unexpected losses, which should be met by the institution at all times. Competent authorities should determine additional own funds requirements on a risk-by-risk basis, using supervisory judgement supported by the following sources of information:

- a. the ICAAP calculations;
- b. the outcome of supervisory benchmark calculations; and,
- c. other relevant inputs.

318. The ICAAP calculations – where deemed reliable or partially reliable – should be the starting point for the determination, supplemented by the outcome of supervisory benchmarks and other relevant inputs as appropriate. Where an ICAAP calculation is not deemed reliable, the outcome of the supervisory benchmarks should be the starting point for the determination, supplemented by other relevant inputs as appropriate.

319. Competent authorities should not allow own funds held pursuant to Article 92 of Regulation (EU) 575/2013 to be used to meet or offset the additional own funds requirements. Diversification between risks, including those covered by Regulation (EU) 575/2013, should not be considered as part of the determination of additional own funds requirements.

320. Competent authorities should ensure that additional own funds requirements set for each risk ensures a sound coverage of the risk. Additional own funds requirements that differ significantly from the outcome of the ICAAP calculation, where reliable, or the benchmark calculation, should be clearly justified within the context of the requirements of Regulation (EU) 575/2013 and Directive 2013/36/EU, and applied in a consistent manner – where not based on institution-specific considerations – in order to ensure a broad consistency of prudential outcomes across institutions.

ICAAP calculation

321. Competent authorities should assess the reliability of the ICAAP calculations against the following criteria:

- a. **granularity:** The calculations/methodologies should allow the breakdown of the calculations by risk type, rather than presenting a single (economic capital) calculation covering all risks. This breakdown should be enabled by the ICAAP methodology itself. Where deemed appropriate by the competent authority estimates may be provided through, for example, marginal contributions calculations for risks that cannot be measured on a standalone basis (e.g. credit concentration risk);
- b. **credibility:** The calculations/methodologies used should demonstrably capture the risk they are looking to address (e.g. the credit concentration risk calculation should use appropriate sector breakdowns that reflect actual correlations and portfolio compositions) and should be based on recognised or appropriate models and prudent assumptions;
- c. **understandability:** The underlying drivers of the calculations/methodologies should be clearly specified. A 'black box' calculation should not be acceptable. Competent authorities should ensure that the institution provides an explanation of the areas of most fallibility of the models used, and how this is accounted for and corrected in the final ICAAP calculation; and,
- d. **comparability:** Competent authorities should consider the holding period/risk horizon and confidence levels (or equivalent measurement) of the ICAAP calculations, adjusting, or requiring that the institution adjusts, these variables for the purposes of facilitating comparability with peers and supervisory benchmarks estimations.

322. Competent authorities should further assess the reliability of the ICAAP calculations by comparing them against the outcome of the supervisory benchmarks for the same risks, and other relevant inputs.

323. An ICAAP calculation should be considered as partially reliable where despite not meeting all the above criteria the calculation still seems highly credible, though this should be on an exceptional basis and accompanied by steps to improve deficiencies identified in the ICAAP calculation.

Supervisory benchmarks

324. Competent authorities should develop and apply risk-specific supervisory benchmarks to further support the determination of risk-by-risk additional own funds requirement, and as

an alternative starting point for the determination of additional own funds where ICAAP calculations are deemed not reliable.

325. The supervisory benchmarks should be developed with the objective of providing a prudent, consistent - calibrated to equivalent holding periods/risk horizon and confidence levels required by Regulation (EU) 575/2013 - transparent and comparable measure with which to calculate and compare the potential own funds requirements of institutions by risk type (excluding risks covered by Regulation (EU) 575/2013).
326. Competent authorities should assess the suitability of any benchmarks applied to institutions and continually review and update them in light of the experience of using them.
327. Given the variety of different business models operated by institutions, the outcome of the supervisory benchmarks may not be appropriate in every instance for every institution. Competent authorities should address this by using the most appropriate benchmark where alternatives are available, and/or by applying judgement to the outcome of the benchmark to account for business model-specific considerations.

Other relevant inputs

328. Competent authorities should use other relevant inputs to support the determination of risk-by-risk additional own funds requirements. Other relevant inputs may include the outcome of risk assessments (following the criteria set out in Title 6), peer group comparisons, risk-specific stress-testing, inputs from macro-prudential (designated) authorities, etc.
329. Other relevant inputs should prompt the competent authority to reassess the appropriateness/reliability of an ICAAP/benchmark calculation for a specific risk, and/or make adjustments to the outcome, where they prompt doubts about its accuracy (e.g. where the risk score implies a significantly different level of risk relative to the calculation, or where peer reviews reveal that the institution differs significantly from peers in terms of the own funds requirement to cover a comparable risk exposure).

7.1.2 Determining own funds or other measures to cover model deficiencies

330. Competent authorities should set additional own funds to cover the risk posed by model deficiencies leading to the potential underestimation of risk where this is determined to be more appropriate than other supervisory measures. Competent authorities should only set additional own funds set to cover this risk as an interim measure while the deficiencies are addressed.

7.1.3 Determining own funds or other measures to cover other deficiencies

331. Competent authorities should set additional own funds to cover the risk posed by control, governance or other deficiencies – identified following the risk assessment outlined in Titles 4 to 6 – where this is determined to be more appropriate than other supervisory measures.

Competent authorities should only set additional own funds requirements to cover these risks as an interim measure while the deficiencies are addressed.

7.1.4 Determining own funds or other measures to cover funding risk

332. Competent authorities should set additional own funds requirements to cover funding risk – identified following the risk assessment outlined in Title 8 – where this is determined to be more appropriate than other supervisory measures.

7.2 Reconciliation with capital buffer requirements and macro-prudential requirements

333. Competent authorities should reconcile the additional own funds requirements against the risks already covered by capital buffer requirements and/or additional macro-prudential requirements. Competent authorities should not set additional own funds requirements where the risk is already covered by capital buffer requirements and/or additional macro-prudential requirements.

7.3 Determination of the TSCR

334. Competent authorities should determine the TSCR as the sum of:

- a. the own funds requirement pursuant to Article 92 of Regulation (EU) 575/2013; and,
- b. the sum of the additional own funds requirements (determined according to criteria set out above), and any additional own funds determined as necessary to cover material inter-risk concentrations.

335. Competent authorities should set a composition requirement for the additional own funds requirements to cover the following risk types of at least 56% of CET1 and at least 75% Tier 1:

- a. elements of credit, market and operational risk (not covered by Regulation (EU) 575/2013);
- b. credit concentration risk and IRRBB;
- c. the risk from model deficiencies that are likely to lead to an under-estimation of the appropriate level of own funds, where additional own funds requirements are used to cover this risk.

336. Competent authorities should determine the composition of additional own funds to cover other risk types at their discretion but with the objective of ensuring a sound coverage of the risk posed.

337. Competent authorities should not consider items and instruments other than those eligible for the determination of own funds (as defined in Part Two of Regulation (EU) 575/2013 Regulation) in the assessment/calculation of the TSCR.

7.4 Articulation of own funds requirements

338. Competent authorities should ensure consistency in setting and communicating additional own funds requirements to the institution and/or where relevant other competent authorities. This should involve at a minimum the communication of the institution's TSCR as a proportion (ratio) of the TREA, broken down in terms of the composition of the requirement.

339. To communicate the TSCR as a ratio competent authorities should articulate it using the following formula (i.e. as a multiple of the 8% TREA requirement set out in Regulation (EU) No 575/2013):

$$TSCR\ ratio = 8\% \times \frac{TSCR \times 12.5}{TREA}$$

340. Exceptions and amendments may be made to incorporate additional own funds requirements set to cover risk exposures not linked to the total balance sheet, and/or to ensure that the additional own funds requirements do not fall below a nominal floor (e.g. as a result of deleveraging), which may be articulated separately.

341. Competent authorities may further articulate the TSCR by breaking out the additional own funds requirements on a risk-by-risk basis, in addition to the overall requirement.

Example of TSCR articulation

As of DATE and until otherwise directed INSTITUTION is required to hold a TSCR of X% of TREA:

- 8% (comprising at least x%CET1 and x%T1) represents own funds requirements set out in Article 92 of the Regulation (EU) No 575/2013;

- X% represents additional own funds in excess of the requirements set out in Article 92 of Regulation (EU) No 575/2013; of which X% (comprising at least x%CET1 and x%T1) is to cover unexpected losses identified through the SREP and X% (comprising at least x%CET1 and x%T1%) is to cover OTHER [e.g. governance concerns] identified through the SREP.

342. To achieve further consistency, competent authorities may additionally communicate to institutions and/or where relevant other competent authorities the OCR and its component parts – the TSCR, the CRD buffer requirements, and additional own funds requirements to cover macro-prudential risks – as a proportion (ratio) of the TREA, broken down in terms of the composition of the requirement.

Example of OCR articulation

As of DATE and until otherwise directed INSTITUTION is required to hold an overall capital requirement (OCR) of X% of TREA, of which at least X% should be CET1, at least X% should be T1.

Of this X% OCR:

- ***X% represents the Total SREP capital requirement (TSCR), which must be met at all times, of which:***

- 8% (comprising at least x%CET1 and x%T1) represents own funds requirements set out in Article 92 of the Regulation (EU) No 575/2013;

- X% represents additional own funds in excess of the requirements set out in Article 92 of Regulation (EU) No 575/2013; of which X% (comprising at least x%CET1 and x%T1) is to cover unexpected losses identified through the SREP and X% (comprising at least x%CET1 and x%T1%) is to cover OTHER [e.g. governance concerns] identified through the SREP.

- ***X% represents the combined Directive 2013/36/EU capital buffer (100%CET1) requirement applicable to INSTITUTION, of which:***

- 2.5% represents the capital conservation buffer requirement;

- X% represents the OTHER [e.g. CyCB and OSII] requirement.

7.5 Assessment of the risk of excessive leverage

343. Competent authorities should assess the risk posed by excessive leverage to the own funds of the institution.

344. In making the assessment, competent authorities should consider the following aspects:

- a. the current level of the leverage ratio compared to peers and, if applicable, the distance of the ratio to the regulatory minimum limit;

- b. the evolution of the institution's leverage ratio, including the foreseeable impact of current and future expected losses on the leverage ratio. Competent authorities should also consider the potential impact on the leverage ratio of current and foreseeable growth of exposures considered in the ratio;
- c. the extent to which there is a risk of excessive leverage arising from different stress events (covered also in Section 7.6 below); and,
- d. whether there could a risk of excessive leverage for specific institutions that are not adequately considered in the leverage ratio.

7.6 Meeting requirements over the economic cycle

345. Competent authorities should determine the adequacy of the institution's own funds (quantity and composition) to cover volatility over the economic cycle and if measures are required to address potential inadequacies.

346. To do so competent authorities should determine that the OCR can be met over the forecast economic cycle (with reference to the institution's base case capital plan and forecast macro-economic developments) and that the TSCR (or any other relevant target ratio set by competent authorities) can be met during a stressed scenario. Any assumptions with regard to macro-prudential requirements over the horizon of the scenario should be agreed with the designated macro-prudential authority. Competent authorities should also consider the impact of a stressed scenario on the institution's leverage ratio.

347. Competent authorities should make the stressed scenario determination through the analysis of stress testing conducted by the institution (ICAAP stress-testing) and competent authorities (supervisory stress-testing), specifically:

- a. the outcome of a 'ICAAP' scenario developed by the institution on the basis of a plausible but severe stress relevant to its business model; and/or,
- b. the outcome of an 'anchor' supervisory scenario(s)/methodologies prescribed by the competent authority.

348. On the basis of establishing a proportionate approach competent authorities may consider limiting the stress-testing to a single scenario ('anchor' or 'ICAAP') for non-Category 1 institutions.

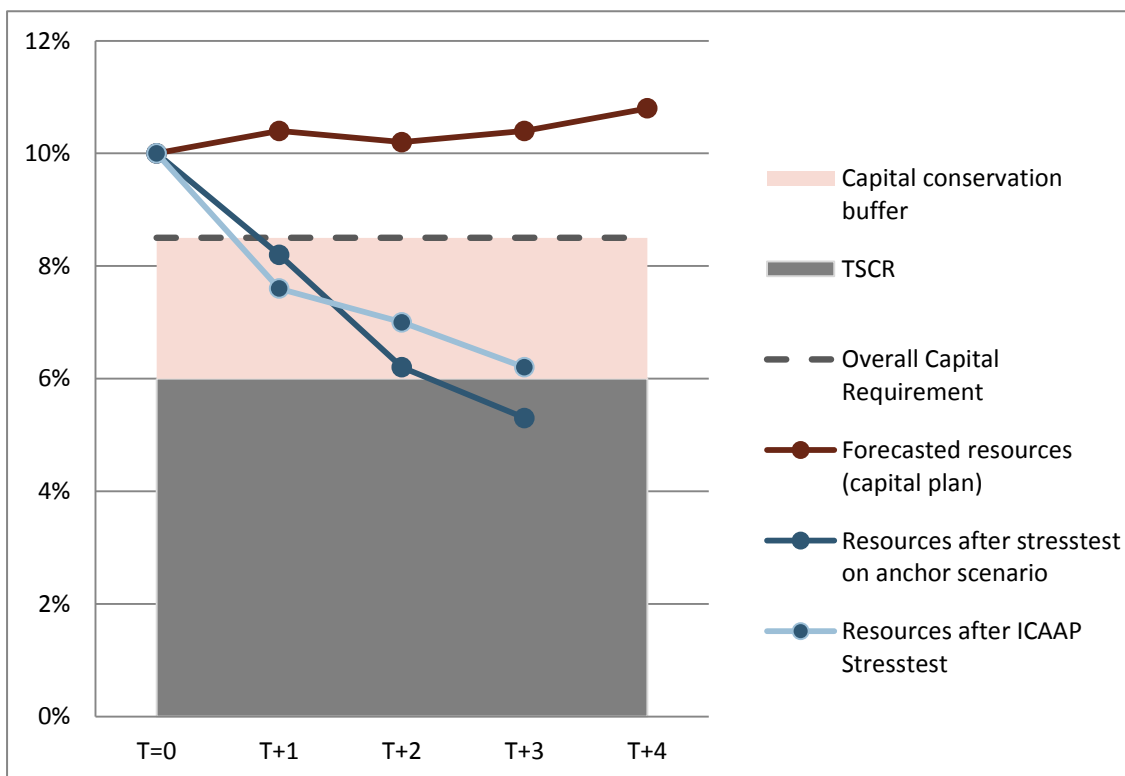
349. Competent authorities should analyse stress-testing covering a forward-looking period of between two to five years, with three years considered the most suitable. The reference point for requirements should be the TSCR (or any other relevant target ratio set by competent authorities). The starting point for resources should be the institution's available own funds at the start of the stress. This should include own funds held by the institution to meet the Capital Conservation Buffer. Any decision by competent authorities to include own

funds held to meet other capital buffers (e.g. the Counter-cyclical buffer, O-SII buffer) should depend on the nature of the scenario and should be agreed – where relevant – with the macro-prudential (designated) authority.

350. Competent authorities should consider the outcome of the different stress-tests conducted (institution's 'ICAAP' scenario, 'anchor' scenario, and any other e.g. EU-wide supervisory stress-testing, where relevant) and make its determination on if available own funds are sufficient to cover its current TSCR (or any other relevant target ratio set by competent authorities) over the course of a period of economic stress, and the impact of the stress on the institution's leverage ratio. The supervisory determination should also consider the appropriateness of mitigating management actions that the institution claims it would take in the eventuality of the stress actually occurring, accepting them and factoring them into its determination where considered credible.

351. Figure 3 illustrates the different elements to be considered.

Figure 3. Illustrative example of changes in capital resources (CET1) over the economic cycle



352. Competent authorities should consider which measures are necessary to address any findings that own funds are unlikely to be sufficient to cover the OCR (during the base case) and TSCR (during the stress), and/or to address findings that the institution's leverage ratio would be negatively affected during the stress.

7.7 Summary of findings and scoring

353. Following the above assessment, competent authorities should form a view on if existing own funds resources ensure a sound coverage of the risks to which the institution is or might be exposed. This view should be reflected in a summary of findings, accompanied by a score using the considerations set out in Table 8.

Table 8. Supervisory consideration for assigning a score to capital adequacy

Score	Supervisory view	Considerations
1	The quantity and composition of own funds held pose no discernible risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution holds a level of own funds comfortably above the OCR and is expected to do so on a forward looking basis. • Stress-testing does not reveal any discernible risk regarding the impact of a severe but plausible economic downturn on own funds. • The free flow of capital between entities in the group, where relevant, is not impeded, or all entities are well capitalised above supervisory requirements. • The institution has a plausible and credible capital plan that has the potential to be effective if required. • The institution's leverage ratio is comfortably above any regulatory minimum and there is no discernable risk of excessive leverage.
2	The quantity and composition of own funds held pose a low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution is near to breaching some of its capital buffers but is still clearly above its TSCR. • Stress-testing reveals a low level of risk regarding the impact of a severe but plausible economic downturn on own funds, but management actions to address this seem credible. • The free flow of capital between entities

		<p>in the group, where relevant, is or could be marginally impeded.</p> <ul style="list-style-type: none"> • The institution has a plausible and credible capital plan that although not without risk has the potential to be effective if required. • The institution's leverage ratio is above any regulatory minimum. There is a low level of risk of excessive leverage.
3	The quantity and composition of own funds held pose a medium level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution is using some of its capital buffers. There is the potential for the institution to breach its TSCR if the situation deteriorates. • Stress-testing reveals a medium level of risk regarding the impact of a severe but plausible economic downturn on own funds. Management actions may not credibly address this. • The free flow of capital between entities in the group, where relevant, is impeded. • The institution has a capital plan that is unlikely to be effective. • The institution's leverage ratio is above any regulatory minimum but stress-testing reveals concerns about the impact of a severe but plausible economic downturn on the ratio. There is a medium level of risk of excessive leverage.
4	The quantity and composition of own funds held pose a high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution is near to breaching its TSCR. • Stress-testing reveals that the TSCR would be breached near the beginning of a severe but plausible economic downturn. Management actions will not credibly address this. • The free flow of capital between entities

		<p>in the group, where relevant, is impeded.</p> <ul style="list-style-type: none"> • The institution has no capital plan, or one that is manifestly inadequate. • The institution’s leverage ratio is near to breaching any regulatory minimum. There is a high level of risk of excessive leverage.
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Title 8. Assessment of risks to liquidity and funding

8.1 General considerations

354. Competent authorities should assess the risks to liquidity and funding that have been identified as material for the institution. The purpose of this title is to provide common methodologies to be considered when assessing individual risks and risk management and controls. It does not intend to be exhaustive and gives leeway to competent authorities to take into account other additional criteria that may be deemed relevant according to their experience and the specificities of the institution.

355. This title provides competent authorities with set of common elements for the assessment of risks to liquidity and funding.

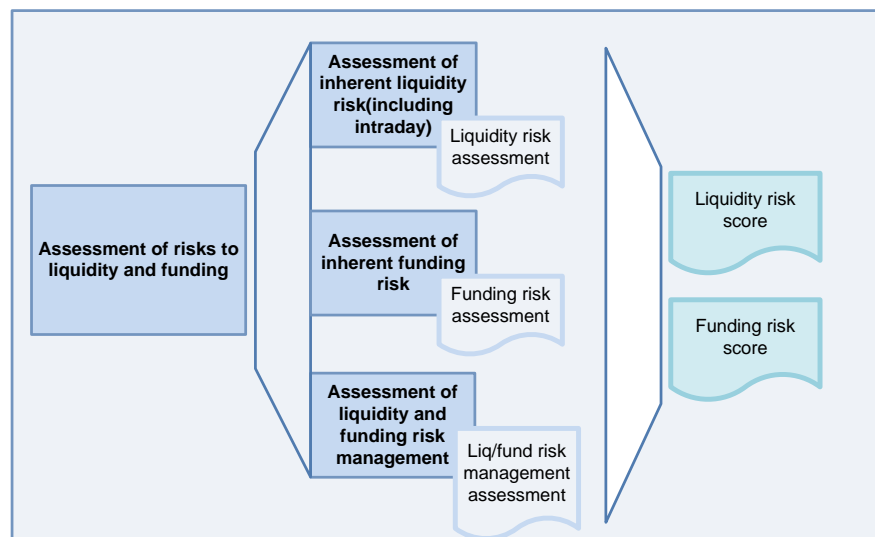
356. The methodology comprises three main components:

- a. assessment of inherent liquidity risk;
- b. assessment of inherent funding risk; and,
- c. assessment of liquidity and funding risk management.

357. In the assessment of risks to liquidity and funding competent authorities should verify the institution's compliance with minimum requirements provided by Regulation (EU) No 575/2013 according to the relevant regulatory approach. However, these guidelines extend the scope of the assessment beyond those minimum requirements aiming to allow competent authorities to form a comprehensive view on the risks.

358. This assessment is represented graphically in Figure 4.

Figure 4. Elements of the assessment of risks to liquidity and funding



359. Following the criteria laid out in this title, competent authorities should assess all three components to come to a view on the level of inherent liquidity and funding risk faced by the institution, and on the quality of the institution's liquidity and funding risk management and controls. Recognising that liquidity risk and funding risk and their management are interconnected and interdependent, the section for the assessment liquidity and funding risk management and controls is common for both risks.

360. In conducting the assessment of risks to liquidity and funding as part of the SREP process, competent authorities may use a combination of information sources, including *inter alia*:

- a. outcomes from the analysis of the institution's business model, in particular those that may help in understanding the key sources of risks to liquidity and funding;
- b. information from the monitoring of key indicators;
- c. supervisory reporting, and particularly the information provided by the institution in its liquidity risk reporting requirements in accordance with Article 415 of Regulation (EU) 577/2013;
- d. outcomes of the various supervisory activities;
- e. information provided by the institution and, where available, ILAAP reports; and,
- f. risks identified by other institutions operating a similar business model (the peer group).

361. In their implementation of the methodologies and common elements set out in this title, competent authorities should identify relevant quantitative indicators and other metrics,

which could be also used for the purposes of monitoring of key indicators as specified in Title 3.

362. The outcome of the assessment of each individual risk should be reflected in a summary of findings, which provides an explanation of the main risks drivers, and a score.
363. In deriving each risk score, competent authorities should take into account the assessment of both the inherent risk and the quality and effectiveness of the institution's management and controls, taking into account that in the case of risks to liquidity and funding the assessment of the risks management and controls is common and unique for both liquidity risk and funding risk.
364. Under the national implementation of the guidelines, different methods may be used by competent authorities to derive the individual risks scores. In some cases, inherent risk levels and the quality of risk management and control may be scored separately, resulting in an intermediate and final score; while in others, the assessment process may not use intermediate scores.

8.3 Assessment of liquidity risk

365. Competent authorities should assess the institution's short- and medium-term liquidity risk over an appropriate set of time horizons, including intraday, in order to ensure that the institution maintains adequate levels of liquidity buffers, both under normal and stressed conditions. This assessment includes following elements:
- a. evaluation of liquidity needs in the short and medium term;
 - b. evaluation of intraday liquidity risk;
 - c. evaluation of liquidity buffer and counterbalancing capacity; and,
 - d. supervisory liquidity stress testing.

Evaluation of liquidity needs in the short and medium terms

366. Competent authorities should assess the institution's liquidity needs in the short and medium terms under both normal and stressed conditions (shocks). They should take into account:
- a. the institution's stressed liquidity needs at different horizons, notably before 30 days, and after 3 to 12 months and in particular the effect on the institution's liquidity needs (net cash outflows) of severe but plausible stresses, to cover idiosyncratic, market-wide and combined shocks; and,

- b. the size, location and currency of the liquidity needs and, where an institution operates in different material currencies, the separate impacts of shocks in the different currencies, to reflect currency convertibility risk.

367. Competent authorities should support the assessment of short term liquidity risk assessment by analysing the liquidity coverage ratio (LCR), once introduced and defined, or liquidity requirements implemented at national level before the LCR introduction, in particular:

- a. whether the institution is correctly reporting its LCR position; and,
- b. whether the LCR adequately identifies the institution the institution's liquidity needs.

368. In evaluating the impact of shocks on the institution's liquidity needs, competent authorities should take into account all material sources of liquidity risk for the institution. In particular, they should take into account:

- a. the possibility that any applicable requirements stemming from Regulation (EU) 575/2013 (including LCR when introduced) do not adequately identify the institution's liquidity needs in the event of the type of stress scenario used for the requirement, including at maturities shorter than 30 days. During the phase-in of the LCR, competent authorities may pay particular attention to the possibility that institutions increase their LCR by engaging in very short-term borrowing and lending, activity that, as long as the requirement is less than 100%, may increase the LCR without reducing the liquidity risk;
- b. risks arising in respect of wholesale counterparties regarding on-balance-sheet items and funding concentrations, and taking into account actions the institution may take to preserve its reputation/franchise;
- c. risks arising in respect of contingent cash flows/off-balance-sheet items (for example, credit lines, margin calls) and activities (for example, liquidity support for unconsolidated special purpose vehicles beyond contractual obligations), taking into account actions the institution may take to preserve its reputation/franchise;
- d. inflows and outflows on a gross basis as well as a net basis: where there are very high inflows and outflows, competent authorities should pay specific attention to the risk to the institution when inflows are not received when expected, even when the net outflow risk is limited;
- e. risks arising in respect of retail counterparties, taking into account actions the institution may take to preserve its reputation/franchise. For this purpose, competent authorities should make use of the methodology on the classification

of retail deposits into different buckets of riskiness, in accordance with Article 421(3) of Regulation 575/2013 for the purposes of liquidity reporting; and,

- f. the risk that excessive risks in the medium- to long-term funding profile will adversely affect the behaviour of counterparties relevant to the short-term liquidity position.

Evaluation of intraday liquidity risk

369. Competent authorities should assess the institution's exposure to intraday day liquidity risk, including the intraday availability of liquid assets given the unpredictable nature of unexpected intraday outflows or lack of inflows. This assessment should take into account:

- a. availability of liquidity which can be accessed during the business day (funds) or can be used within the day (collateral) to meet the intraday liquidity needs;
- b. the extent to which, in the event that the institution suffers stress (financially or otherwise, such as due to IT failures or legal constraints in the transfer of funds), the institution may need additional liquidity to avoid having to defer its own payments (given that counterparties may defer payments and/or withdraw intraday credit lines, including those provided by the institution's correspondent bank or banks);
- c. the possible effect on the institution's liquidity position intraday should a major counterparty suffer an intraday stress event which prevents it from making payments;
- d. where the institution provides correspondent banking services, the possible effect on its liquidity position intraday if a customer being under stress would not receive timely payments from other institutions;
- e. the potential impact on the institution's intraday liquidity position in the event that a market-wide credit or liquidity stress reduces the value of liquid assets that an institution uses to generate liquidity on an intraday basis, whether from the central bank or from correspondents; and,
- f. the potential impact of other drivers of intraday liquidity risk, such as IT failures, legal constraints or human errors.

370. For those jurisdictions where no reporting on intraday risk is yet available, competent authorities should rely on the institution's own analysis of intraday liquidity risk.

Evaluation of liquidity buffer and counterbalancing capacity

371. Competent authorities should assess the adequacy of the institution's liquidity buffer and counterbalancing capacity to meet its liquidity needs within a month as well as over different

time horizons, potentially up to 1 year and including overnight. This assessment should take into account:

- a. the directly available liquidity buffers or the institution's survival period under different stress scenarios;
- b. the overall counterbalancing capacity available to the institution over the full horizon of the relevant stress scenario;
- c. the characteristics, such as severity and duration, of different stress scenarios and horizons considered in evaluating the institution's liquidity needs;
- d. the amount of assets which would need to be liquidated over the relevant time horizons;
- e. whether the actual liquidity buffer and counterbalancing capacity are in line with the institution's liquidity risk tolerance; and,
- f. the classification of liquid assets as specified in the LCR as a reference point, once the LCR is defined and introduced. Competent authorities may deviate from this classification where justified, e.g. by the nature of the risk being addressed or the length and type of the stress in question.

372. Competent authorities should assess the institution's ability to monetise its liquid assets in a timely fashion to meet its liquidity needs during a stress period. They should take into account:

- a. whether the institution tests its market access by selling or repo-ing on a periodic basis;
- b. whether there are high concentrations that may represent a risk of overestimation of the liquidity buffer and counterbalancing capacity;
- c. whether the assets in the buffer are unencumbered, under the control of the relevant staff and readily available to a liquidity management function, and are in an appropriate location relative to where liquidity needs may arise;
- d. whether the denomination of the liquid assets is consistent with the distribution by currency of liquidity needs;
- e. where the institution has borrowed liquid assets, whether it has to return them within the horizon of a short-term liquidity stress, which would mean that the institution would no longer have them available to meet its stressed outflows;

- f. the likely value of committed liquidity facilities, where competent authorities determine that such facilities can to some extent be included in the counterbalancing capacity.

Supervisory liquidity stress testing

373. Competent authorities should use liquidity stress tests, defined and run by the competent authorities, as an independent tool to assess short- and medium-term liquidity risks, with the purpose of:

- a. identifying liquidity risks over different time horizons and under various stress scenarios. Once the LCR is introduced, stress scenarios may be anchored to the 30-day LCR stress assumptions, but competent authorities may extend the scope of their assessment by exploring risks within 30 days as well as over 30 days, and altering the LCR assumptions to reflect risks not adequately covered in the LCR;
- b. informing their own view of liquidity risks in addition to the information from the institution's internal stress tests;
- c. identifying and quantifying specific areas of liquidity risk; and,
- d. informing their view on the overall liquidity risk the institution is exposed to, which will enable them to compare the relative riskiness of institutions. This should include at least a supervisory stress test combining institution-specific and market-wide stress.

374. Competent authorities may assess the likelihood that the institution uses its liquidity buffer and temporary falls below the minimum requirement on the basis of articles 412(3) and 414 of the Regulation (EU) No 575/2013, applying supervisory or institution's liquidity specific stress testing, by using stress scenarios under which they would not expect the institution to fall below the minimum requirements. Supervisors may consider it undesirable for an institution to fall below the minimum requirement under very mild market stress. The scenarios applied for this assessment should typically be less severe (e.g. only market wide stress) than the scenario's used when testing the survivability of the institutions (market wide and systemic).

8.4 Assessment of inherent funding risk

375. Competent authorities should assess the institution's funding risk and whether the medium- and long-term obligations are adequately met with a diversity of stable funding instruments under both normal and stressed conditions. This assessment includes the following elements:

- a. evaluation of the institution's funding profile;
- b. evaluation of risks to the stability of the funding profile;

- c. evaluation of actual market access; and
- d. evaluation of expected change in funding risks based on the institution's funding plan.

Evaluation of the institution's funding profile

376. Competent authorities should assess the appropriateness of the institution's funding profile, including both medium- and long-term contractual and behavioural mismatches, in relation to its business model, strategy and risk tolerance. More specifically, they should take into account:

- a. whether the institution's medium- and long-term obligations are adequately met with a diversity of stable funding instruments, following Article 413 of the Regulation (EU) No 575/2013, and whether its actual mismatches over the relevant time horizons are within acceptable boundaries in relation to the specific business model of the institution;
- b. whether – in light of the competent authority's view on the institution's desired funding profile – the institution's actual funding profile falls short of its desired profile;
- c. (local) regulatory and contractual factors affecting the behavioural characteristics of funding providers (e.g. regulations regarding clearing, bail-in, deposit guarantee schemes, etc., as they may influence the behaviour of funding providers), in particular when there are material changes or differences between jurisdictions in which the institution operates; and,
- d. that maturity transformation will lead to a certain level of mismatches but that these must remain within manageable and controllable boundaries to avoid collapse of the business model during stress or changes in market circumstances.

377. Competent authorities should assess whether potential shortcomings arising from the institution's funding profile, such as maturity mismatches breaching acceptable boundaries, excessive concentrations on funding sources, excessive level of asset encumbrance or inappropriate or unstable funding of long term assets, could lead to an unacceptable increase of institution's cost of funding. They should take into account:

- a. the risk that funding is rolled over at higher interest rates in case there is an excessive dependence on specific sources of funding, the funding necessities of the institution soar, or that the sources of funding perceive the institution as having a riskier profile, especially when it is not likely that those higher costs are transferred automatically to clients; and,

- b. whether an increasing level of asset encumbrance above acceptable limits reduces the access to and increases the pricing of unsecured funding.

Evaluation of risks to the stability of the funding profile

378. Competent authorities should consider factors that may reduce the stability of the funding profile in relation to the type and characteristics of both assets and liabilities. They should take into account:

- a. that specific asset classes will be more significant than others to the institution and/or the system;
- b. the structural maturity mismatch between assets and liabilities in different significant currencies, where applicable, as well as in aggregate, and how currency mismatches overlaying structural maturity mismatches affects the overall risk to the stability of the funding profile; and,
- c. appropriate structural funding metrics (appropriate to the institution's business model). Examples of structural funding metrics may include loan/deposit ratio, customer funding gap and behaviourally adjusted maturity ladder (of which the net stable funding ratio metric is a particular example).

379. Competent authorities should assess risks to the sustainability of the funding profile arising from concentrations in funding sources. They should take the following factors into account:

- a. concentrations in different respects, notably and where applicable: the type of funding instruments used, specific funding markets, single or connected counterparties, and other concentration risks that may affect access to funding in the future (focusing on the markets and instruments relevant to the long-term funding profile and noting that their view on concentration risk in the short-term liquidity profile may be relevant); and,
- b. the risk that asset encumbrance may have an adverse effect on the market's appetite for the unsecured debt of the institution (in the context of the specific characteristics of the market(s) the institution operates in and the institution's business model). Factors for this assessment may include:
 - the total amount of encumbered and/or borrowed assets compared with the balance-sheet;
 - the availability of free assets (unencumbered but possible to encumber) especially when considered in relation to total unsecured wholesale funding;
 - the level of overcollateralisation relative to the capital base; overcollateralisation refers to the extent to which the value of the assets

used to obtain secured funding exceeds the notional amount of funding obtained (e.g. if 120 EUR of assets are used for 100 EUR of secured funding, the overcollateralisation is 20); and,

- the implications of the level of overcollateralisation for the deposit insurance scheme, in the event that the institution fails.

Evaluation of actual market access

380. Competent authorities should be aware of the institution's actual market access and current and future threats to this market access. Several factors need to be taken into account:

- a. any information they are aware of, including from the institution itself, indicating that the institution makes high demands on particular markets or counterparties (including central banks) that are important to it, relative to those markets'/counterparties capacity;
- b. any significant or unexpected changes in the issuance of debt that competent authorities become aware of in each significant market (including in significant currencies); note that competent authorities would expect institutions to alert them to any such changes. They should also assess whether any such changes are due to the strategic choices of the institution or whether they are signs of reduced market access:
- c. the risk that news about the institution may negatively influence the market (perception/confidence) and thus market access. Such news may or may not yet be known to the market; and,
- d. signs that short-term liquidity risks (e.g. when short-term liquidity risk is assessed as high) may reduce the access the institution has to its major funding markets.

Evaluation of expected change in funding risks based on the institution's funding plan

381. Competent authorities should assess the expected change in funding risks based on the institution's funding plan. This assessment should take into account the following aspects:

- a. the way the institution's funding plan, when executed in full, will affect the institution's funding risks, noting that the execution of the funding plan may increase or decrease the risks in the funding profile; and,
- b. the supervisory view on the feasibility of the plan (as below).

8.5 Assessment of liquidity and funding risk management

382. In order to reach a comprehensive understanding of the institution's liquidity and funding risk profile, competent authorities should also review the governance and risk management framework underlying its liquidity and funding risk. To this end, competent authorities should assess the:

- a. liquidity risk strategy and liquidity risk tolerance;
- b. organisational framework, policies and procedures;
- c. risk identification, measurement, management, monitoring and reporting;
- d. institution's liquidity specific stress testing;
- e. internal control framework for liquidity risk management;
- f. institution's liquidity contingency plans; and,
- g. institution's funding plans.

Liquidity risk strategy and liquidity risk tolerance

383. Competent authorities should assess whether the institution appropriately defines and communicates its liquidity risk strategy and liquidity risk tolerance. They should take into account:

- a. whether the liquidity risk strategy and liquidity risk tolerance are established, approved and updated by the management body;
- b. whether the institution has an appropriate framework in place to ensure that liquidity risk strategy is effectively communicated to relevant staff;
- c. whether the liquidity risk strategy and tolerance are clearly defined, properly documented, effectively implemented and communicated to all relevant staff;
- d. whether the liquidity risk tolerance is appropriate for the institution considering its business model, overall risk tolerance, role in the financial system, financial condition and funding capacity; and,
- e. whether the institution's liquidity risk strategy and tolerance framework is properly integrated within its overall risk appetite framework.

Organisational framework, policies and procedures

384. Competent authorities should assess whether the institution has appropriate arrangements for the governance and management of liquidity and funding risk. For this assessment, competent authorities should take into account:

- a. whether the management body approves the governance and policies for managing liquidity and funding risk and discusses and reviews them regularly;
- b. whether the senior management is responsible for developing and implementing the policies and procedures for managing liquidity and funding risk;
- c. whether senior management ensures monitoring of respective management body decisions;
- d. whether the liquidity and funding risk management framework is internally coherent and ensures a comprehensive internal liquidity adequacy assessment process (ILAAP), when available, and is well integrated into the institution's wider risk management process;
- e. whether the policies and procedures are appropriate for the institution, taking into account its liquidity risk tolerance;
- f. whether the policies and procedures are properly defined, formalised and effectively communicated throughout the institution; and,
- g. whether the policies and procedures include remuneration for key personnel influencing the liquidity and funding profile, such as treasury staff, and whether the policies and procedures ensure the incentives of individual staff members do not conflict with the best interests of the institution.

385. Competent authorities should assess whether the institution has an appropriate organisational framework for liquidity and funding risk management, measurement and control functions, with sufficient human and technical resources for the development and implementation of these functions and to carry out the required monitoring tasks. They should take into account:

- a. whether the liquidity risk control and monitoring systems are controlled by independent control functions;
- b. whether the risk management, measurement and control functions cover liquidity risk in the entire institution (including branches) and in particular all areas where liquidity risk can be taken, mitigated or monitored;

- c. whether the institution has a set of liquidity and funding policy documents that seem adequate in promoting prudent behaviour by the institution's staff and in allowing for an efficient operation of the control functions; and,
- d. whether the institution has appropriate internal written policies and procedures for the management of liquidity and funding risk, as well as the adequacy of the institution's liquidity and funding risk management framework.

386. Competent authorities should assess the adequacy of the institution's approach to maintaining market access in its significant funding markets. They should take into account:

- a. the institution's approach to maintaining an ongoing presence in the markets (testing market access); for specific small institutions or specialised business models the testing of access to markets may not be relevant;
- b. the institution's approach to developing strong relationships with funds providers to lower the risk that its access is reduced; and,
- c. any evidence that the institution would continue to have an ongoing market access in times of stress (even though at such times it may be more expensive for the institution to do so).

Risk identification, measurement, management, monitoring and reporting

387. Competent authorities should assess whether the institution has an appropriate framework and IT systems for identifying and measuring liquidity and funding risk, in line with the institution's size, complexity, risk tolerance and risk-taking capacity. They should take the following factors into account:

- a. whether the institution has implemented appropriate methods for projecting its cash flows over an appropriate set of time horizons, assuming business as usual and stress situations, and comprehensively across material risk drivers;
- b. whether the institution uses appropriate key assumptions and methodologies, which are regularly reviewed, recognising interaction between different risks (credit, market, etc.) arising from both on- and off balance sheet items;
- c. when relevant, whether all material legal entities, branches and subsidiaries in the jurisdiction in which the institution is active are included;
- d. whether the institution understands its ability to access financial instruments wherever they are held, having regard to any legal, regulatory and operating restriction on their use, including, for example, the inaccessibility of assets due to encumbrance on different time horizons.

388. Competent authorities should assess whether institutions have an appropriate reporting framework for liquidity and funding risk. They should take into account:

- a. whether there is a set of reporting criteria agreed by the senior management, specifying the scope, manner and frequency of liquidity and funding risk reporting and who is responsible for preparing the reports;
- b. the quality and appropriateness of information systems, management information and internal information flow supporting liquidity and funding risk management and whether the data and information used by the institution are understandable for the target audience, accurate and usable (e.g. timely, not overly complex, with correct scope, etc.); and,
- c. whether specific reports and documentation containing comprehensive and easily accessible information on liquidity risk are submitted regularly to the appropriate recipients (such as the management body, senior management or an asset-liability committee).

389. Competent authorities should assess the adequacy of the process of measurement of intraday liquidity risk, especially for those institutions that participate in payment, settlement and clearing systems. They should take into account:

- a. whether the institution adequately monitors and controls cash flows and liquid resources available to meet intraday requirements and forecasts when cash flows will occur during the day; and,
- b. whether the institution carries out adequate specific stress testing for intraday operations (where the institution should consider similar scenarios to those set out above).

390. Competent authorities should assess whether the institution has in place an adequate set of indicators regarding the liquidity and funding position, appropriate to the business model and nature, scale and complexity of the institution. They should take into account:

- a. whether the indicators adequately cover the institution's key structural funding vulnerabilities, covering the following aspects, where appropriate:
 - the degree of dependence on a single market or an excessively small number of markets/counterparties;
 - the 'stickiness' of funding sources and behaviour driving factors;
 - the concentration of particular instruments;
 - the concentration of activities in different currencies;

- major maturities concentration and maturity gaps over the longer horizon; and,
- b. whether the indicators are adequately documented, periodically revised, used as inputs to define the risk tolerance of the institution, integrated in management reporting and used for setting operating limits.

Institution's liquidity specific stress test

391. Competent authorities should assess whether an institution has implemented adequate liquidity-specific stress testing to understand the impact of adverse events on its risk exposure and on the quantitative and qualitative adequacy of its liquid assets (refer to EBA Guidelines on stress testing), and to determine whether the institution's liquidity holdings are sufficient to cover risks that may crystallise during different types of stress scenarios and/or to address risks posed by control, governance or other deficiencies. For this purpose, competent authorities should take into account whether the institution's the stress-testing framework is appropriate to:

- a. determine the institution's survival horizon given its existing liquidity buffer and stable sources of funding during a severe but plausible liquidity stress;
- b. analyse the impact of stress scenarios on its consolidated, group-wide liquidity position and on the liquidity position of individual entities and business lines; and,
- c. understand where risks could arise, regardless of its organisational structure and the degree of centralised liquidity risk management.

392. Competent authorities should also assess whether additional tests are needed for individual entities and/or liquidity subgroups that are exposed to significant liquidity risks. These tests should take into account the consequences of the scenarios over different time horizons, including on an intraday basis.

393. Competent authorities should ensure that the institution provides the modelled-impact of different types of stress scenarios as well as a number of sensitivity tests (on the basis of proportionality). Careful consideration should be paid to the assessment of the design of stress scenarios and the variety of shocks simulated in them, taking into account whether the institution, in this design, considers not only the past, but also makes use of hypotheses based on expert judgement. Competent authorities should analyse whether at least the following scenarios are considered:

- a. short-term and prolonged;
- b. institution-specific and market-wide (occurring simultaneously in a variety of markets); and,
- c. a combination of (i) and (ii)

394. An important aspect that competent authorities should consider when assessing the institution's stress testing framework is the modelling of the impact of the hypothetical stress scenario(s) on the institution's cash-flows and on its counterbalancing capacity and survival horizon, and whether the modelling reflects the different impacts that an economic stress may have both on an institution's assets and its in- and outflows.
395. Competent authorities should also assess whether the institution takes a conservative approach in setting stress testing assumptions. Depending on the type and severity of the scenario, competent authorities should consider the appropriateness of a number of assumptions. This may include:
- a. the run-off of retail funding;
 - b. the reduction of secured and unsecured wholesale funding;
 - c. the correlation between funding markets and the diversification across different;
 - d. additional contingent off-balance sheet exposures;
 - e. funding tenors (e.g. where the funding provider has call options);
 - f. the impact of any deterioration of the institution's credit rating;
 - g. FX convertibility and access to foreign exchange markets;
 - h. the ability to transfer liquidity across entities, sectors and countries;
 - i. estimates of future balance-sheet growth; and,
 - j. due to reputational risks, an implicit requirement for the institution to roll over assets and to extend or maintain other forms of liquidity support.
396. Competent authorities should assess the management framework of the institution's liquidity-specific stress testing is appropriate and whether it is properly integrated into their overall risk management strategy. They should take into account whether:
- a. the extent and frequency of stress tests are appropriate to the nature and complexity of the institution, its liquidity risk exposures and its relative importance in the financial system;
 - b. the outcomes of stress testing are integrated into the institution's strategic planning process for liquidity and funding and used to increase the effectiveness of liquidity management in the event of a crisis, including in the institution's liquidity recovery plan;

- c. the institution has an adequate process for identifying suitable risk factors for conducting stress tests, having regard to all material vulnerabilities that can undermine the liquidity position of the particular institution;
- d. assumptions and scenarios are reviewed and updated sufficiently frequently; and,
- e. where the liquidity management of a group is being assessed, whether the institution pays adequate attention to any potential obstacles to the transfer of liquidity within the group.

Liquidity risk internal control framework

397. Competent authorities should assess whether the institution has in place a strong and comprehensive internal limit and control framework and sound safeguards to mitigate or limit its liquidity risk in line with its risk tolerance. They should take into account whether:

- a. the limit and control framework is adequate for the institution's complexity, size and business model and reflects the different material drivers of liquidity risk, such as maturity mismatches, currency mismatches, derivatives transactions, off-balance-sheet items and intraday liquidity risk;
- b. the institution has implemented adequate limits and monitoring systems that are consistent with its liquidity risk tolerance and that make use of the outcomes of liquidity stress tests;
- c. the risk limits are regularly reviewed by the competent bodies of the institution and clearly communicated to all relevant business lines;
- d. there are clear and transparent procedures regarding how individual liquidity risk limits are approved and reviewed;
- e. there are clear and transparent procedures regarding how compliance with individual liquidity risk limits is monitored and how to handle limit breaches (including clear escalation and reporting procedures); and,
- f. the limit and control framework helps the institution to ensure the availability of a diversified funding structure and sufficient and accessible liquid assets.

398. Competent authorities should assess whether the institution has implemented an adequate transfer pricing system as part of the liquidity risk control framework. They should take into account:

- a. whether the institution's transfer pricing system covers all material business activities;

- b. whether the institution's funds transfer pricing system incorporates all relevant liquidity costs, benefits and risks;
- c. whether the resulting mechanism allows management to give appropriate incentives to ensure management of liquidity risk;
- d. whether the transfer pricing methodology and its calibration are reviewed and updated appropriately given the size and complexity of the institution;
- e. whether the transfer pricing system and its methodology are communicated to the relevant staff; and,
- f. as an additional factor, competent authorities may consider whether the institution's policy on incorporating the funds transfer pricing (FTP) methodology into the internal pricing framework is used for assessing and deciding on transactions with customers (this includes both sides of the balance-sheet, e.g. granting loans and taking deposits).

399. Competent authorities should assess whether the institution has adequate controls regarding the buffer of liquid assets. They should take into account whether:

- a. the control framework covers the timely monitoring of the buffer of liquid assets, including the quality of the assets, their concentration, immediate availability to the group entity using the asset to cover liquidity risks and any impediments to their timely conversion into cash; and,
- b. the institution has an appropriate policy on monitoring market conditions that can affect its ability to quickly sell or repo assets in the market.

Liquidity contingency plans

400. Competent authorities should assess whether the institution's liquidity contingency plan (LCP) adequately sets out the policies, procedures and action plans for responding to severe potential disruptions to the institution's ability to fund itself. They should take into account the content and scope of contingency funding measures included in the LCP, and in particular factors such as:

- a. whether the LCP appropriately reflects the institution's liquidity-specific and wider risk profile;
- b. whether the institution has a framework of liquidity early warning indicators which are likely to be effective in enabling the institution to identify deteriorating market circumstances in a timely manner and to determine quickly what actions need to be taken;

- c. whether the LCP clearly articulates all material (potential) funding sources, including the estimated amounts available for the different sources of liquidity and estimated time needed to obtain funds from them;
- d. whether the measures are in line with its overall risk strategy and liquidity risk tolerance; and,
- e. the appropriateness of the role of central bank funding in the institution's LCP. Examples of factors competent authorities may consider could include the institution's views on:
 - the current and future availability of potential alternative funding sources connected to central bank lending programmes;
 - the types of lending facilities, the acceptable collateral and the operational procedures for accessing central bank funds; and,
 - the circumstances under which central bank funding would be needed, to what amount, and for what duration such use of central bank funding would probably be required.

401. Competent authorities should assess whether the actions described in the LCP are feasible in relation to the stress scenarios in which they are meant to be taken. They should take into account factors such as:

- a. the level of consistency and interaction between the institution's liquidity-related stress tests, its LCP and its liquidity early warning indicators;
- b. whether the actions defined in the LCP appear likely to enable the institution to adequately react to a range of possible scenarios of severe liquidity stress, including institution-specific and market-wide stress, as well as the potential interaction between them; and,
- c. Whether the actions defined in the LCP are prudently quantified, in terms of liquidity generating capacity under stressed conditions and the time required to execute them, taking into account operational requirements such as pledging collateral at a central bank.

402. Competent authorities should assess the appropriateness of the institution's governance framework with respect to its LCP. They should take into account factors such as:

- a. the appropriateness of escalation and prioritisation procedures detailing when and how each of the actions can and should be activated;
- b. whether the institution has adequate policies and procedures with respect to communication within the institution and with external parties; and,

- c. the degree of consistency between the LCP and the institution's business continuity plans.

Funding plans

403. Competent authorities should assess whether the funding plan is feasible and appropriate in relation to the nature, scale and complexity of the institution, its current and projected activities and its liquidity and funding profile. They should take into account factors such as:

- a. whether the funding plan is robust in terms of its ability to support the projected business activities under adverse scenarios;
- b. the expected change in the institution's funding profile arising from the execution of the funding plan and whether this is suitable given the institution's activities and business model;
- c. whether the funding plan supports any required or desired improvements in the institution's funding profile;
- d. their own view on the (changes in) market activity planned by institutions in their jurisdiction on an aggregated level, and what that means for the feasibility of individual funding plans;
- e. whether the funding plan is:
 - integrated with the overall strategic plan of the institution;
 - consistent with its business model; and,
 - consistent with its liquidity risk tolerance;
- f. other, additional, elements that competent authorities may consider include:
 - whether the institution adequately analyses and is aware of the appropriateness and adequacy of the funding plan given the institution's current liquidity and funding positions and their projected development. As part of this, competent authorities may consider whether the institution's senior management can explain why the funding plan is feasible and where its weaknesses lie;
 - the institution's policy for determining what funding dimensions and what markets are significant to the institution (and whether it is adequate);
 - the time horizon which the institution envisages for migration to a different funding profile, if required or desired, noting that there can be

risks in both a too quick and a too slow migration towards the end state; and,

- whether the funding plan contains different strategies and clear management procedures for a timely implementation of strategy changes.

404. Competent authorities should assess whether the institution's funding plan is appropriately implemented. They should take into account at least:

- a. whether the funding plan is properly documented and communicated to all the relevant staff;
- b. whether the funding plan is embedded in the day-to-day operations of the institution, especially in the funding decision-making process; and,
- c. in addition, competent authorities may take into account whether the institution is able to reconcile the funding plan with the data provided to competent authorities in the funding plan template.

405. Competent authorities should consider the quality of the institution's processes for monitoring the execution of the funding plan and its ability to react to deviations in a timely manner. For this assessment, competent authorities should take into account factors such as:

- a. the quality of the updates to (senior) management regarding the current status of the execution of the funding plan;
- b. whether the funding plan envisages alternative fallback measures in case of changes in the market conditions; and,
- c. the policy and practice of the institution regarding the regular review and updating of the funding plan when the actual funding raised significantly differs from the funding plan.

8.4 Summary of findings and scoring

406. Following the above assessment, competent authorities should form a view on the institution's risks to funding and liquidity. This view should be reflected in a summary of findings, accompanied by a score using the considerations set out in Tables 9 and 10.

Table 9. Supervisory considerations for a assigning score to liquidity risk

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is no discernible risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • There is no discernible risk arising from mismatches (e.g. between maturity, currency, etc.). • The size and composition of the liquidity buffer is adequate and appropriate. • Other drivers of liquidity risk (e.g. reputation risk, inability to transfer intra-group liquidity, etc.) are not material. 	<ul style="list-style-type: none"> • There is consistency between the institution's liquidity risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for liquidity risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. • Liquidity risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the control framework for liquidity risk are sound. • Limits allow mitigating or limiting liquidity risk are in line with the institution's liquidity risk management strategy and risk appetite/tolerance.
2	There is a low risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • Mismatches (e.g. between maturity, currency, etc.) imply low risk. • The risk from the size and composition of the liquidity buffer is low. • Other drivers of liquidity risk (e.g. reputation risk, inability to transfer intra-group liquidity, etc.) are low. 	
3	There is a medium risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • Mismatches (e.g. between maturity, currency, etc.) imply medium risk. • The risk from the size and composition of the liquidity buffer is medium. • Other drivers of liquidity risk (e.g. reputation risk, inability to transfer intra-group liquidity, etc.) are medium. 	
4	There is a high risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • Mismatches (e.g. between maturity, currency, etc.) imply high risk. • The risk from the size and composition of liquidity buffer is high. • Other drivers of liquidity risk (e.g. reputation risk, inability to transfer intra-group liquidity, etc.) are high. 	

Table 10. Supervisory considerations for assigning a score to funding risk

Risk score	Supervisory view	Considerations for inherent risk	Considerations for adequate management & controls
1	There is no discernible risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • There is no discernible risk from the institution's funding profile and its sustainability. • The risk from the stability of funding is not material. • Other drivers of funding risk (e.g. reputation risk, access to funding markets, etc.) are not material. 	<ul style="list-style-type: none"> • There is consistency between the institution's funding risk policy and strategy and its overall strategy and risk appetite. • The organisational framework for funding risk is robust with clear responsibilities and a clear separation of tasks between risk takers and management and control functions. • Funding risk measurement, monitoring and reporting systems are appropriate. • Internal limits and the control framework for funding risk are sound.
2	There is a low risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The risk from the institution's funding profile and its sustainability is low. • The risk from the stability of funding is low. • Other drivers of funding risk (e.g. reputation risk, access to funding markets, etc.) are low. 	
3	There is a medium risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The risk from the institution's funding profile and its sustainability is medium. • The risk from the stability of funding is medium. • Other drivers of funding risk (e.g. reputation risk, access to funding markets, etc.) are medium. 	
4	There is a high risk of significant prudential impact on the institution having considered the level of inherent risk and the management and controls.	<ul style="list-style-type: none"> • The risk from the institution's funding profile and its sustainability is high. • The risk from the stability of funding is high. • Other drivers of funding risk (e.g. reputation risk, access to funding markets, etc.) are high. 	

Title 9. SREP liquidity assessment

9.1 General considerations

407. Competent authorities should determine through the SREP Liquidity Assessment whether the liquidity held by the institution ensures an appropriate coverage of risks to liquidity and funding assessed according to Title 8. Competent authorities should also determine through the SREP Liquidity Assessment if the setting of specific liquidity requirements is necessary to capture risks to liquidity and funding to which an institution is or might be exposed.
408. Where following Article 8 of the Regulation (EU) 575/2013, an institution and/or all or some of its subsidiaries in the Union have been waived from the application of the Part 6 (Liquidity) of the Regulation (EU) 575/2013, and it is supervised as a single liquidity sub-group, competent authorities should conduct their SREP liquidity assessment at the level of the liquidity sub-group.
409. Competent authorities should consider the institution's liquidity buffers, counterbalancing capacity and funding profile, as well as its ILAAP and arrangements, policies, processes and mechanisms for the measurement and management of liquidity and funding risk, as a key determinate of the institution's viability. This determination should be summarised and reflected in a score, according to the criteria set out at the end of this title.
410. The outcomes of the ILAAP, where applicable and relevant, should inform the competent authority's conclusion on liquidity adequacy.
411. Competent authorities should conduct the SREP liquidity assessment process following the next steps:
- a. overall assessment of liquidity
 - b. determination of the need for specific liquidity measures;
 - c. quantification of potential specific liquidity requirements – benchmark calculations;
 - d. articulation of specific liquidity requirements; and,
 - e. determination of the liquidity score.

9.2 Overall assessment of liquidity

412. To assess whether the liquidity held by an institution ensures an appropriate coverage of risks to liquidity and funding competent authorities should use the following sources of information:

- a. the institution's ILAAP;
- b. the outcomes of the assessment of liquidity risk;
- c. the outcomes of the assessment of funding risk;
- d. the outcome of supervisory benchmark calculation; and
- e. other relevant inputs (from on-site inspections, peer group analysis, stress-testing etc.).

413. Competent authorities should consider the reliability of the institution's ILAAP, including metrics for liquidity and funding risk used by the institution.

414. When assessing whether the institution's ILAAP framework – including, where relevant, internal methodologies for the calculation of internal liquidity requirements – competent authorities should assess it against at least the following criteria:

- a. credibility: whether the calculations / methodologies used properly capture the risks they are looking to address; and,
- b. understandability: whether there is a clear break down and summary of the underlying components of the ILAAP calculations.

415. For the assessment of the institution's liquidity adequacy, competent authorities should also combine their assessment on liquidity risk and funding risk. They should in particular take into account of findings regarding:

- a. risks not captured by liquidity requirements set out in Regulation (EU) 575/2013, including intraday liquidity risk and liquidity risk beyond the 30 days time horizon;
- b. other risks not adequately captured and measured by the institution, either as underestimation of outflows, overestimation of inflows, overestimation of liquidity value of buffer assets or counterbalancing capacity, and unavailability from an operational point of view of liquid assets (they are not available for sale, they are encumbered etc.);
- c. specific concentrations of counterbalancing capacity and/or funding by counterparty and/or product/type;

- d. funding gaps in specific maturity buckets, in the short, medium and long term;
- e. appropriate coverage of funding gaps in different currencies;
- f. cliff effects; and,
- g. other relevant outcomes of the supervisory liquidity stress tests.

416. Competent authorities should translate this overall assessment into a liquidity score, which should reflect the view of competent authorities on the threats to the institution's viability that may arise from risks to liquidity and funding.

9.3 Determination of the need of specific liquidity requirements

417. Competent authorities should decide on the necessity of specific liquidity supervisory requirements addressed to the institution based on the on their supervisory judgement, taking into account the following:

- a. the institution's business model and strategy and the supervisory assessment of them;
- b. the institution's ILAAP;
- c. the supervisory assessment of risks to liquidity and funding, including the assessment of inherent liquidity risk, inherent funding risk and liquidity and funding risk management and controls, taking into account the possibility that risks and vulnerabilities identified may exacerbate each other; and,
- d. potential systemic liquidity risk.

418. When competent authorities conclude that specific liquidity requirements are needed to address liquidity and funding concerns, they should decide on the application of quantitative requirements, as covered in this title, and/or on the application of qualitative requirements, covered in Title 10 of the guidelines.

419. When setting structural, long term supervisory requirements, competent authorities should consider the need for additional short/medium term requirements as an interim solution, in order to mitigate the risks that persist while the structural requirements produce the desired effects.

420. Where competent authorities conclude that there is a high risk that the institution's cost of funding will increase unacceptably, they should consider measures, including setting additional own funds requirements (as covered in Title 7) or requesting changes to the funding structure, to mitigate funding cost risk.

9.4 Supervisory quantification of potential specific quantitative liquidity requirements

421. Competent authorities should develop and apply liquidity supervisory benchmarks as quantitative tools to support their assessment on whether the liquidity held by the institution ensures a sound coverage of risks to liquidity and funding. They should be used to provide a prudent, consistent, transparent and comparable benchmark with which to calculate and compare specific quantitative liquidity requirements of institutions.

422. Competent authorities, when developing liquidity supervisory benchmarks, should taking into account the following criteria:

- a. benchmarks should be prudent, consistent and transparent;
- b. benchmarks should be developed leveraging on the supervisory assessment of risks to liquidity and funding and on the supervisory liquidity stress tests; liquidity supervisory stress test should be a core part of the benchmark;
- c. benchmarks should provide comparable outcomes and calculations, in order to be able to compare quantifications of liquidity requirements for institutions with similar business model and risk profiles; and,
- d. benchmarks should help supervisors to specify the adequate level of liquidity for an institution.

423. Given the variety of different business models operated by institutions, the outcome of the supervisory benchmarks may not be appropriate in every instance for every institution. Competent authorities should address this by using the most appropriate benchmark where alternatives are available, and/or by applying judgement to the outcome of the benchmark to account for business model-specific considerations.

424. Competent authorities should assess the suitability of any benchmarks applied to institutions and continually review and update them in light of the experience of using them.

425. The NSFR, pending its implementation, may be used as an anchor point for setting specific quantitative liquidity requirements on stable funding if needed.

426. In those cases where competent authorities have not developed their own benchmark for the quantification of specific quantitative liquidity requirements, competent authorities can apply a benchmark using the following steps:

- a. comparative analysis, under stressed conditions, of net cash outflows and eligible liquid assets over a set of time horizons, up to one month (including overnight), from one month to three months, and from three months up to one year. For this purpose, competent authorities should project net outflows (gross outflows and

inflows) and counterbalancing capacity throughout different maturity buckets, considering stressed conditions (for example, prudent valuation under stress assumptions of liquid assets, versus current valuation under normal conditions and after a haircut), building a stressed maturity ladder for the year ahead;

- b. based on the assessment of the stressed maturity ladder, estimation of the survival period of the institution;
- c. determination of the desired/supervisory minimum survival period, taking account of the institution's risk profile and market and macroeconomic conditions; and,
- d. when the desired/supervisory minimum survival period is longer than the institution's current survival period, competent authorities may estimate additional amounts of liquid assets to be held (additional liquidity buffers) by the institution in order to extend its survival period to the minimum required.

427. A key input to the competent authority's benchmarks for the quantification of specific quantitative liquidity requirements will be the data collected through the supervisory reporting under Article 415 of Regulation (EU) No 575/2013 on liquidity and on stable funding on an individual and a consolidated basis and on additional liquidity monitoring metrics. The design of benchmarks will be influenced by the contents of this reporting and the implementation of benchmarks will depend on when the reporting is available.

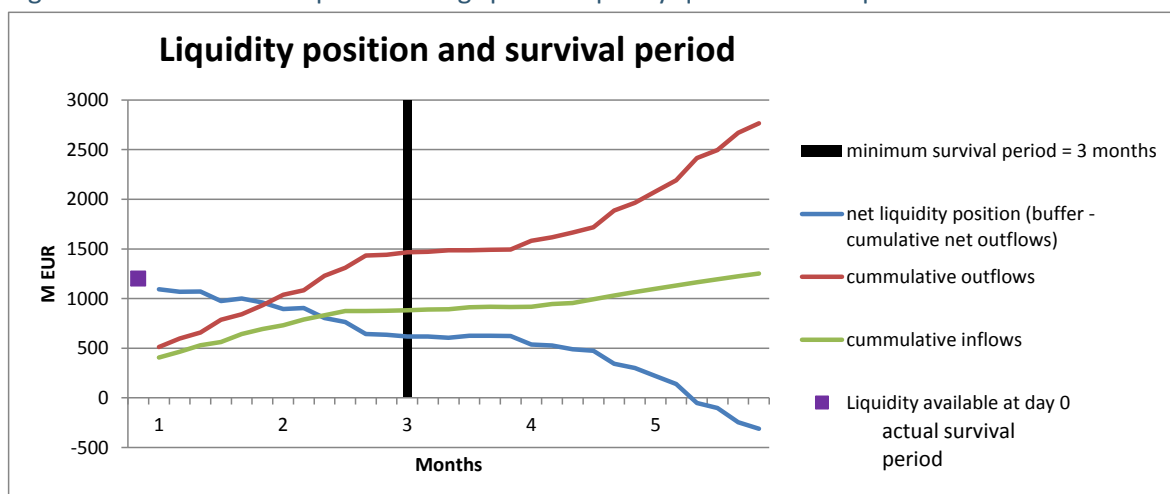
428. Below are some examples of the proposed approach:

- a. Example 1: Institution with an initial liquidity buffer of 1,200 EUR. Cumulative inflows and cumulative outflows estimated under stressed conditions are projected through a time horizon of 5 months. During this time horizon the institution makes use of the liquidity buffer in each point of time when inflows fall below outflows. The result is that under the stressed conditions defined, the institution would be able to survive 4.5 months, which is above the minimum survival period set out by supervisors (in this example – 3 months):

Table 11. Illustrative example of benchmark for liquidity quantification

Time horizon in months	cummulative outflows	cummulative inflows	cummulative net outflows	net liquidity position (buffer - cumulative net outflows)	Liquidity available at day 0
					1,200
1	511	405	106	1,094	
	598	465	133	1,067	
	659	531	128	1,072	
	787	563	224	976	
	841	642	199	1,001	
2	933	693	240	960	
	1,037	731	306	894	
	1,084	788	295	905	
	1,230	833	397	803	
	1,311	875	435	765	
3	1,433	875	558	642	
	1,440	876	564	636	
	1,465	882	583	617	
	1,471	889	582	618	
	1,485	891	594	606	
4	1,485	911	574	626	
	1,492	916	576	624	
	1,493	916	577	623	
	1,581	918	663	537	
	1,618	945	673	527	
5	1,666	956	710	490	
	1,719	993	726	474	
	1,885	1,030	856	344	
	1,965	1,065	900	300	
	2,078	1,099	980	220	
5	2,192	1,131	1,061	139	Survival period
	2,415	1,163	1,252	-52	
	2,496	1,194	1,302	-102	
	2,669	1,224	1,445	-245	
	2,764	1,253	1,511	-311	

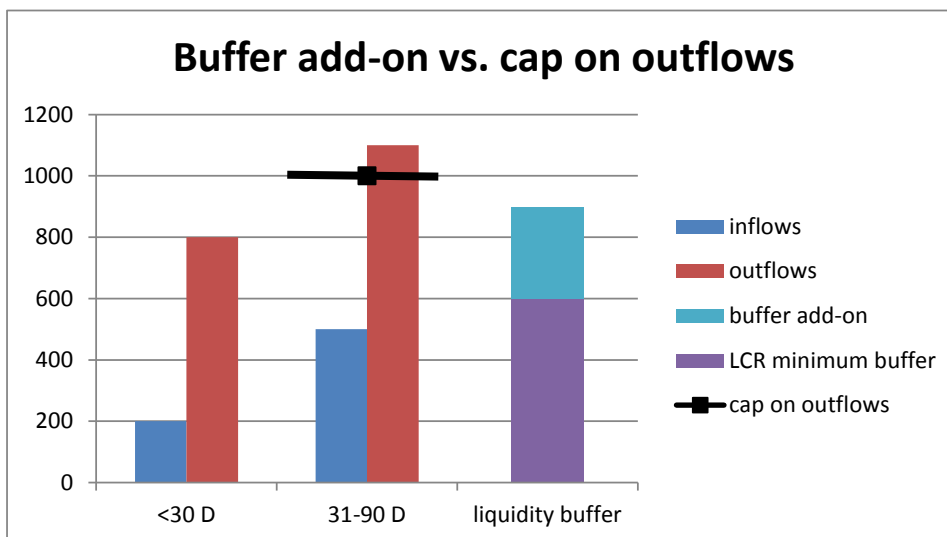
Figure 5. Illustrative example of setting specific liquidity quantitative requirements



- b. Example 2: The supervisory minimum survival period is set in 3 months. An alternative measure to setting a minimum survival period, which can also address the supervisory concern that the gap between inflows and outflows is unacceptably high, is to set a cap on outflows. In the figure below, the mechanism to set a cap on outflows is showed through the black horizontal bar. An institution

is required to reduce its outflows to a level below the cap. The cap can be set on one or more time buckets and on net outflows (after correcting for inflows) or on gross outflows. The alternative of adding a buffer requirement instead is shown in the third column:

Figure 6. Illustrative example of setting specific liquidity quantitative requirements



9.5 Articulation of specific quantitative liquidity requirements

429. In order to appropriately articulate the specific quantitative liquidity requirements, competent authorities should use one of the following approaches:

1. Approach 1 - Require a Liquidity Coverage Ratio higher than the regulatory minimum (when such a ratio is introduced by national or EU regulation) of such size that identified shortcomings are sufficiently mitigated;
2. Approach 2 - Require a minimum survival period of such length that identified shortcomings are sufficiently mitigated. The survival period can be set either directly, as a requirement, or indirectly, by setting a cap on the amount of outflows over the relevant time buckets considered. Competent authorities may require different types of liquid assets (e.g. central bank eligible assets), to cover risks not (adequately) captured by the LCR;
3. Approach 3 - Require a minimum total amount of liquid assets or counterbalancing capacity, either as a minimum total amount or as a minimum amount in excess of the applicable regulatory minimum, of such size that identified shortcomings are sufficiently mitigated. Competent authorities may set requirements on the composition of liquid assets,

including operational requirements (e.g. direct convertibility to cash, or deposit of the liquid assets at the central bank).

430. Competent authorities may articulate specific quantitative requirements on stable funding by requiring a minimum level of stable funding in terms of the NSFR.

431. In order to ensure consistency, competent authorities should articulate specific quantitative liquidity requirements in such a manner as to deliver broadly consistent prudential outcomes across institutions, noting that the types of requirements specified may differ across institutions for idiosyncratic reasons. In addition to the quantity, this articulation should specify the expected composition and nature of the requirement. In all cases it should specify the supervisory requirement and any applicable Directive 2013/36/EU requirements. Liquidity buffers and counterbalancing capacity held by the institution to meet supervisory requirements should be available for use by the institution during times of stress.

432. When setting and communicating the specific quantitative liquidity requirements to the institution, competent authorities should ensure that they are immediately notified by the institution in the event that it does not meet these requirements, or does not expect to meet these requirements in the short-term. Competent authorities should ensure that this notification is submitted without undue delay by the institution, accompanied by a plan developed by the institution for the timely restoration of compliance with the requirements. Competent authorities should assess the feasibility of the institution's restoration plan and take appropriate supervisory measures if the plan is not considered as feasible. Where the plan is considered feasible competent authorities should: determine any necessary interim supervisory measure based on the circumstances of the institution; monitor the implementation of the restoration plan; and, closely monitor the institution's liquidity position, requesting the institution to increase if necessary its reporting frequency.

433. Notwithstanding the above, competent authorities may also set qualitative requirements in the form of restrictions/caps/limits on mismatches, concentrations, risk appetite, quantitative restrictions on the issuance of secured loans, etc., following the criteria set under Title 10 of the guidelines.

434. Below some examples on the different approaches for the articulation of specific quantitative liquidity requirements:

Example of specific requirements articulation

As of 1st January 2015 and until otherwise directed, Bank X is required to:

- a. Approach 1 – ensure that its counterbalancing capacity is at all times equal to or higher than 125% of its liquidity net outflows as measured in the Liquidity Coverage Ratio.**

- b. Approach 2 – ensure that its counterbalancing capacity results at all times in a survival period that is greater than or equal to 3 months, measured by the internal liquidity stress test / the Maturity Ladder / specific metrics developed by the supervisor.**
- c. Approach 3:**
- **ensure that its counterbalancing capacity is at all times equal to or higher than EUR X billion; or**
 - **Ensure that its counterbalancing capacity is at all times equal to or higher than EUR X billion in excess of the minimum requirement under the Liquidity Coverage Ratio.**
- d. Approach 4 - ensure that its stable funding is at all times equal to or higher than EUR X billion in excess of the minimum requirement under the Net Stable Funding Ratio.**

9.6 Summary of findings and scoring

435. Following the above assessment, competent authorities should form a view on if existing liquidity resources ensure a sound coverage of the risks to which the institution is or might be exposed. This view should be reflected in a summary of findings, accompanied by a score using the considerations set out in Table 12.

436. For the purposes of the joint decision (where relevant), competent authorities should use the liquidity assessment and score to determine if the liquidity resources are adequate.

Table 12. Supervisory considerations for assigning a score to liquidity adequacy

Score	Supervisory view	Considerations
1	The institution's liquidity position and funding profile pose no discernible risk to the viability of institution.	<ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are comfortably above specific supervisory quantitative requirements and are expected to remain so on a forward looking basis. • The composition and stability of longer term funding (>1 year) pose no discernible risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is not impeded, or all entities have a

		<p>counterbalancing capacity and liquidity buffers above supervisory requirements.</p> <ul style="list-style-type: none"> • The institution has a plausible and credible liquidity contingency plan that has the potential to be effective if required.
2	<p>The institution's liquidity position and/or funding profile pose a low level of risk to the viability of the institution.</p>	<ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are above the specific supervisory quantitative requirements, but there is a risk they will not remain so. • The composition and stability of longer term funding (>1 year) pose a low level of risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is or could be marginally impeded. • The institution has a plausible and credible liquidity contingency plan that although not without risk has the potential to be effective if required.
3	<p>The institution's liquidity position and/or funding profile pose a medium level of risk to the viability of the institution.</p>	<ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are deteriorating and/or are below specific supervisory quantitative requirements, and there are concerns about the institution's ability to restore the compliance with these requirements in a timely manner. • The composition and stability of longer term funding (>1 year) pose a medium level of risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is impeded. • The institution has a liquidity contingency

		plan that is unlikely to be effective.
4	The institution's liquidity position and/or funding profile pose a high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution's counterbalancing capacity and liquidity buffers are rapidly deteriorating and/or below the supervisory specific quantitative requirements, and there are high concerns about the institution's ability to restore the compliance with these requirements in a timely manner. • The composition and stability of longer term funding (>1 year) pose a high level of risk in relation to the activities and business model of the institution. • The free flow of liquidity between entities in the group, where relevant, is severely impeded. • The institution has no liquidity contingency plan, or one that is manifestly inadequate

Title 10. Overall SREP assessment and application of supervisory measures

10.1 General considerations

437. This title covers the combination of the findings of the assessments of the SREP elements into the Overall SREP assessment. It also addresses the application by competent authorities of supervisory measures to address deficiencies identified through the assessment of the SREP elements. Competent authorities may apply supervisory measures set out in Directive 2013/36/EU (Article 104 and 105), national law, and, when applicable, early intervention measures as specified in Article 27 of Directive 2014/59/EU, or any combination of the above.

438. Competent authorities should exercise their supervisory powers on the basis of deficiencies identified during the individual SREP elements and taking into account the Overall SREP assessment, considering the following:

- a. the materiality of the deficiencies/vulnerabilities and the potential prudential impact from not addressing the issue (i.e. is it necessary to address the issue with a specific measure);
- b. if the measures are consistent/proportionate with their overall assessment of a particular SREP element (and Overall SREP assessment);
- c. if the deficiencies/vulnerabilities have already been addressed/covered by other measures;
- d. if other measures would achieve the same objective with less administrative and financial impact on the institution;
- e. the optimal level and duration of application of the measure to achieve the supervisory objective; and,
- f. the possibility that risks and vulnerabilities identified may be correlated and/or self-reinforcing, meriting an increase in the severity of supervisory measures.

439. When applying supervisory measures to address specific deficiencies identified in the assessment of SREP elements, competent authorities should take into account overall quantitative own funds and liquidity requirements to be applied based on the criteria set out in Titles 7 and 9.

440. Competent authorities may take supervisory measures directly linked to the outcomes of any supervisory activities (e.g. on-site examinations, assessments of the suitability of members of the management body and key functions, etc.), where the outcomes of such activities necessitate immediate application of supervisory measures to address material deficiencies.

10.2 The Overall SREP assessment

441. In determining the Overall SREP assessment competent authorities should consider the findings from the assessments of the SREP elements, specifically:

- a. the risks to which the institution is or may be exposed;
- b. the likelihood that the institution's governance, controls deficiencies and/or business model or strategy are likely to exacerbate or mitigate these risks, or expose the institution to new sources of risk;
- c. whether the institution's own funds and liquidity resources provide a sound coverage of these risks; and
- d. the potential for positive and negative interaction between the elements (e.g. competent authorities may consider a strong capital position as a potential mitigant for certain concerns identified in the area of liquidity and funding, or by contrast, that a weak capital position may exacerbate concerns in that area).

442. On the basis of these considerations competent authorities should determine the institution's viability, defined as its proximity to a point of non-viability on the basis of the adequacy of its own funds and liquidity resources, governance, controls and/or business model or strategy to cover the risks to which it is or may be exposed.

443. On the basis of this determination, competent authorities should:

- a. take supervisory measures necessary to address concerns (in addition to specific measures taken to address specific findings of the SREP assessments);
- b. determine future supervisory resourcing and planning for the institution, including with reference to if the institution should be placed in the Supervisory Examination Programme;
- c. determine the need for early intervention measures specified in Article 27 of Directive 2014/59/EU; and,
- d. determine if the institution can be considered as 'failing or likely to fail' in the meaning of Article 32 of Directive 2014/59/EU

444. The Overall SREP assessment should be reflected in a score using the considerations set out in Table 13 and clearly documented in an annual summary of the Overall SREP assessment.

This annual summary should also include the Overall SREP score and scores for elements of the SREP, and any supervisory findings made over the course of the previous 12 months.

Table 13. Supervisory considerations for assigning the Overall SREP score

Score	Supervisory view	Considerations
1	The risks identified pose no discernible risk to the viability of the institution.	<ul style="list-style-type: none"> • The institution's business model and strategy do not raise concerns. • The internal governance and institution-wide control arrangements do not raise concerns. • The institution's risks to capital and liquidity raise no discernible risk of a significant prudential impact. • The composition and quantity of own funds held do not raise concerns. • The institution's liquidity position and funding profile does not raise concerns.
2	The risks identified pose a low level of risk to the viability of the institution.	<ul style="list-style-type: none"> • There is a low level of concern about the institution's business model and strategy. • There is a low level of concern about the institution's governance or institution-wide control arrangements. • There is a low level of risk of significant prudential impact from risks to capital and liquidity. • There is a low level of concern about the composition and quantity of own funds held. • There is a low level of concern about the institution's liquidity position and/or funding profile.
3	The risks identified pose a medium level of risk to the viability of the institution.	<ul style="list-style-type: none"> • There is a medium level of concern about the institution's business model and strategy. • There is a medium level of concern about the institution's governance or institution-wide control arrangements. • There is a medium level of risk of significant prudential impact from risks to capital and liquidity. • There is a medium level of concern about the composition and quantity of own funds held by the institution. • There is a medium level of concern about

		<p>the institution's liquidity position and/or funding profile.</p> <ul style="list-style-type: none"> • The institution may have started to draw on the menu of options in its recovery plan.
4	The risks identified pose a high level of risk to the viability of the institution.	<ul style="list-style-type: none"> • There is a high level of concern about the institution's business model and strategy. • There is a high level of concern about the institution's governance or institution-wide control arrangements. • There is a high level of risk of significant prudential impact from risks to capital and liquidity. • There is a high level of concern about the composition and quantity of own funds held by the institution. • There is a high level of concern about the institution's liquidity position and/or funding profile. • The institution may have drawn on a significant number of the options in its recovery plan.
F	The institution is considered as 'failing or likely to fail'.	<ul style="list-style-type: none"> • There is an immediate risk to the viability of the institution. • The institution is meeting the conditions for 'failing or likely to fail', as specified in Article 32(4) of Directive 2014/59/EU¹.

445. When determining that the institution is 'failing or likely to fail', reflected in an Overall SREP score 'F', competent authorities should engage with the resolution authorities in order to consult on findings following the procedure set out in Article 32 of Directive 2014/59/EU.

¹ In particular, the competent authority is of a view that (1) the institution infringes or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority including but not limited to because the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds; (2) the assets of the institution are or there are objective elements to support a determination that the assets of the institution will, in the near future, be less than its liabilities; or (3) the institution is or there are objective elements to support a determination that the institution will, in the near future, be unable to pay its debts or other liabilities as they fall due.

It is noted that Article 32(2)(d) of Directive 2013/59/EU also identifies extraordinary public support criteria for the determination of whether institutions is 'failing or likely to fail', but this criteria is not considered for the purposes of SREP and determination done by the competent authorities.

10.3 Application of capital measures

446. Competent authorities should impose additional own funds requirements following the process criteria described in Title 7.

447. In addition to the additional own funds requirements expressed through TSCR, depending on the vulnerabilities and deficiencies identified in the assessment of SREP elements, competent authorities may apply other capital measures. Such additional measures may include:

- a. requiring the institution to use net profits to strengthen own funds in accordance with Article 104(1)(h) of Directive 2013/36/EU;
- b. restricting or prohibiting distributions or interest payments by the institution to shareholders, members or holders of Additional Tier 1 instruments where the prohibition does not constitute an event of default of the institution in accordance with Article 104(1)(i) of Directive 2013/36/EU; and/or
- c. requiring the institution to apply a specific treatment of assets in terms of own funds requirements in accordance with Article 104(1)(d) of Directive 2013/36/EU.

10.4 Application of liquidity measures

448. Competent authorities should impose specific liquidity requirements following the process and criteria described in Title 9.

449. In addition to specific quantitative requirements, depending on the vulnerabilities and deficiencies identified in the assessment of risks to liquidity and funding, competent authorities may also apply other liquidity measures. Such additional measures may include:

- a. imposing specific liquidity requirements, including restrictions on maturity mismatches between assets and liabilities in accordance with Articles 104(1)(k) of Directive 2013/36/EU; and/or,
- b. imposing other administrative measures, including prudential charges, in accordance with Article 105 of Directive 2013/36/EU.

10.5 Application of other supervisory measures

450. To address specific deficiencies identified in the assessment of SREP elements, competent authorities may consider applying measures that are not directly linked to quantitative capital or liquidity requirements. This section provides a non-exhaustive list of possible supervisory measures that can be applied based on Articles 104 and 105 of Directive 2013/36/EU.

Business model analysis

451. Supervisory measures to address deficiencies identified in the BMA are likely to involve requiring the institution to adjust governance and control arrangements to help with the implementation of the business model and strategy, or limiting certain business activities.

452. In accordance with Article 104(1)(b) of Directive 2013/36/EU, competent authorities may:

- a. require the institution to make adjustments in risk management and control arrangements, or governance arrangements in order to match the pursued business model or strategy, including by means of:
 - adjusting the financial plan assumed in the strategy, if not supported by internal capital planning or credible assumptions;
 - requiring changes to organisational structures, reinforcement of risk management and control functions and arrangements to support the implementation of the business model or strategy; and/or,
 - requiring changes and reinforcement of IT systems to support the implementation of the business model or strategy.

453. In accordance with Article 104(1)(e) of Directive 2013/36/EU, competent authorities may require the institution to make changes to the business model or strategy where:

- a. these are not supported by the appropriate organisational, governance, or risk control and management arrangements;
- b. these are not supported by capital and operational plans, including allocation of appropriate financial, human or technological (IT) resources; and/or,
- c. the strategy leads to an increase of systemic risk, or poses a threat to financial stability.

454. In accordance with Article 104(1)(f) of Directive 2013/36/EU competent authorities may:

- a. require institutions to reduce risk inherent in the products they manufacture/distribute, including by means of:
 - requiring changes to the risks inherent in certain product offerings; and, or
 - requiring improvements to the governance and control arrangements around product development and maintenance;
- b. require the institution to reduce risk inherent in its systems, for example by means of:

- requiring improvements of the systems, or increasing the level of investments or speeding-up the implementation of new systems; and/or,
- requiring improvements to the governance and control arrangements around system development and maintenance.

Internal governance and institution-wide controls

455. Supervisory measures to address the deficiencies identified in the assessment of internal governance and institution-wide controls may focus on requiring the institution to strengthen governance and control arrangements, or reducing risk inherent in its products, systems and operations.

456. In accordance with Article 104(1)(b) of Directive 2013/36/EU, competent authorities may:

- a. require the institution to make changes to its overall governance arrangements and organisation, including by means of requiring:
 - changes in the organisational or functional structure, including reporting lines;
 - amendments of risk policies, or how these are developed and implemented across the organisation; and/or,
 - an increase in the transparency of governance arrangements;
- b. require the institution to make changes in the organisation, composition or working arrangements of the management body;
- c. require the institution to strengthen its overall risk management arrangements, including by means of requiring:
 - changes in (reduction of) risk appetite, or the governance arrangements around setting risk appetite, and the development of the overall risk strategy;
 - improvements to ICAAP or ILAAP procedures and models, where such are not deemed fit for purpose;
 - enhancement of stress testing capacities and the overall stress testing programme; and/or,
 - enhancements in contingency planning;
- d. require the institution to strengthen internal control arrangements and functions, including by means of requiring:

- the independence and adequate staffing of risk control and internal audit functions; and/or,
 - improvements to the internal reporting process, ensuring that there is appropriate reporting to the management body;
- e. require the institution to enhance information systems or business continuity arrangements, for example by requiring:
- improvements in the reliability of systems; and/or,
 - development and testing of business continuity plans.

457. In accordance with Article 104(1)(g) of Directive 2013/36/EU competent authorities may require the institution to:

- a. make changes to remuneration policies; and/or,
- b. limit variable remuneration as a percentage of net revenues.

Credit and counterparty risk

458. Supervisory measures to address the deficiencies identified in the assessment of the credit and counterparty risk and the associated management and control arrangements are likely to focus on requiring the institution to reduce the level of inherent risk or strengthening management and control arrangements.

459. In accordance with Article 104(1)(b) of Directive 2013/36/EU competent authorities may require the institution to:

- a. involve more actively the Management Body or Committees thereof in relevant credit decisions;
- b. improve credit risk measurement systems;
- c. improve control on credit processes; and/or,
- d. enhance collateral management, evaluation and monitoring.

460. In accordance with Article 104(1)(d) of Directive 2013/36/EU competent authorities may require the institution to:

- a. apply a specific provisioning policy, and – where allowed by accounting rules and regulation – require it to increase provisions;
- b. apply floors (or caps) to internal risk parameters and/or risk weights used for the purposes of calculating risk exposure amounts for specific products, sectors or types of obligors;

- c. apply higher haircuts to the value of collateral; and/or,
- d. hold additional own funds to compensate for the difference between the accounting value of provisions and prudent valuation of assets (outcome of the asset quality review) indicating expected losses not covered by the accounting provisions.

461. In accordance with Article 104(1)(e) and (f) of Directive 2013/36/EU competent authorities may require the institution to:

- a. reduce large exposures or other sources of credit concentration risk;
- b. tighten credit granting criteria for all or some product or obligor categories; and/or
- c. reduce the exposure to, or acquire protection for, specific facilities (e.g. mortgages, export finance, commercial real estate, securitisations, etc.), obligors categories, sectors, countries, etc.

462. In accordance with Article 104(1)(j) of Directive 2013/36/EU competent authorities may require the institution to enhance the quality and frequency of reporting on credit risk to the management body and senior management.

Market risk

463. Supervisory measures to address the deficiencies identified in the assessment of market risk and the associated management and control arrangements are likely to focus on requiring the institution to reduce the level of inherent risk or to strengthen management and control arrangements.

464. In accordance with Article 104(1)(b) of Directive 2013/36/EU competent authorities may require the institution to :

- a. address deficiencies identified with regard to the institution's ability to identify, measure, monitor and control market risk, including by means of:
 - enhancing the performance of the institution's internal approaches, or of its backtesting or stress testing capacity;
 - enhancing the quality and frequency of the market risk reporting to the institution's senior management; and/or,
 - requiring more frequent and deeper internal audits of the market activity.

465. In accordance with Article 104(1)(e) of Directive 2013/36/EU competent authorities may:

- a. restrict the investment in certain products when the institution's policies and procedures do not ensure that the risk from those products will be adequately captured and controlled;
- b. require the institution to present a plan to gradually reduce its exposures in distressed assets and/or illiquid positions; and/or,
- c. require the divestment of financial products when the valuation processes of the institution do not ensure conservative valuations that comply with the standards of Regulation (EU) No 575/2013.

466. In accordance with Article 104(1)(f) of Directive 2013/36/EU competent authorities may:

- a. require the institution to reduce the level of inherent market risk (through hedging or sale of assets) when significant shortcomings have been found in the institution's measurement systems; and/or,
- b. require the institution to increase the amount of derivatives settled through central counterparties (CCP).

Operational risk

467. Supervisory measures to address the deficiencies identified in the assessment of operational risk and the associated management and control arrangements are likely to focus on requiring the institution to reduce the level of inherent risk or strengthening management and control arrangements.

468. In accordance with Article 104(1)(b) of Directive 2013/36/EU competent authorities may:

- a. require the institution to involve more actively the management body or committees thereof in operational risk management decisions;
- b. require the institution to consider inherent operational risk for new products and systems approval; and/or,
- c. require the institution to improve operational risk identification and measurement systems.

469. In accordance with Article 104(1)(e) and (f) of Directive 2013/36/EU competent authorities may:

- a. require the institution to reduce the extent of outsourcing; and/or,
- b. require the institution to mitigate operational risk exposures (e.g. via insurance, introduction of more control points etc.).

Interest rate risk from non-trading activities

470. Irrespective of the requirement to hold additional own funds pursuant to Article 104(1)(a), competent authorities should consider the application of supervisory measures in the following cases:

- a. if interest rate risk from non-trading activities is present and material (see Title 8);
- b. when the outcomes of SREP reveal any deficiency in the institution's assessment of the inherent level of IRRBB and the associated management and control arrangements; or,
- c. the institution is reporting that its economic value may decline by more than 20% ('standard shock') of own funds as a result of a sudden and unexpected change in interest rates in accordance with Article 98(5) of Directive 2013/36/EU.

471. In accordance with Article 104(1)(b) of Directive 2013/36/EU, competent authorities may:

- a. require the institution to take action to address deficiencies identified in the institution's ability to identify, measure, monitor and control interest rate risk from non-trading activities risk, for example to:
 - o enhance its stress testing capacity; and/or,
 - o enhance reporting of the liquidity management information to the institution's management body.

472. In accordance with Article 104(1)(f) of Directive 2013/36/EU, competent authorities may require the institution to apply variations to internal limits aimed at reduction of the risk inherent in activities, products and systems.

473. In accordance with Article 104(1)(j) of Directive 2013/36/EU, competent authorities may require additional or more frequent reporting of the institution's IRRBB positions.

474. The measure(s) used in response to the application of the standard shock should depend on the complexity of the calculation method used and the appropriateness of the standard shock and the level of the economic value. If the reduction in economic value is determined by a relatively straightforward or standard method of calculation, competent authorities may initially request additional, possibly internal, information. If, however, the reduction is based on the outcome of a more complex model about which the competent authorities has greater information, it may reach an assessment of the appropriate measure(s) more quickly. In the latter case, the choice of the measure should take into account the results of the IRRBB assessment performed in accordance with Title 6 of these guidelines.

Liquidity risk

475. In accordance with Article 104(1)(k) of Directive 2013/36/EU, competent authorities may:

- a. impose requirements on the concentration of the liquid assets held, including by means of:
 - the composition of the institution's liquid assets profile, including in respect of counterparties, currency, etc.; and/or,
 - caps, limits or restrictions on funding concentrations;
- b. impose restrictions on short-term contractual or behavioural maturity mismatches between assets and liabilities, including by means of:
 - limits on maturity mismatches (in specific time buckets) between assets and liabilities;
 - limits on minimum survival periods; and/or,
 - limits on dependency on certain short-term funding sources, such as money market funding.

476. In accordance with Article 104(1)(j) of Directive 2013/36/EU, competent authorities may:

- a. Impose a requirement for the institution to provide more frequent reporting on liquidity positions, including by means of:
 - the frequency of liquidity coverage and/or net stable funding reporting; and/or,
 - the frequency and granularity of other liquidity reports, such as 'additional monitoring metrics'.

477. In accordance with Article 104(1)(b) of Directive 2013/36/EU, competent authorities may:

- a. Require action to be taken to address deficiencies identified with regard to the institution's ability to identify measure, monitor and control liquidity risk, including by means of:
 - enhancing its stress testing capacity and hence its ability to identify and quantify material sources of liquidity risk to the institution;
 - enhancing its ability to monetise its liquid assets;
 - enhancing its liquidity contingency plan and liquidity early warning indicators framework; and/or,

- enhancing reporting of liquidity management information to the institution's management body.

Funding risk

478. In accordance with Article 104(1)(k) of Directive 2013/36/EU, competent authorities may:

- a. require action to be taken to amend the institution's funding profile, including by means of:
 - reducing its dependency on certain (potentially volatile) funding markets, such as wholesale funding;
 - reducing the concentration of its funding profile, with respect to counterparties, peaks in the long-term maturity profile, (mismatches in) currencies, etc.; and/or,
 - reducing the amount of its assets that are encumbered, potentially differentiating between total encumbrance and overcollateralisation (e.g. for covered bonds, margin calls, etc.).

479. In accordance with Article 104(1)(j) of Directive 2013/36/EU, competent authorities may:

- a. require additional or more frequent reporting on the institution's funding positions, including by means of:
 - the frequency of regulatory reporting relevant for the monitoring of the funding profile (such as the NSFR report and 'additional monitoring metrics'); and/or,
 - the frequency of reporting on the institution's funding plan to the supervisor.

480. In accordance with Article 104(1)(b) of Directive 2013/36/EU, competent authorities may:

- a. Require actions to be taken to address deficiencies identified with regard to the institution's control of funding risk, including by means of
 - enhancing reporting of management information regarding funding risk to the institution's governing body;
 - restating or enhancing the funding plan; and/or,
 - placing limits on its risk appetite/tolerance;
- b. Enhance its stress testing capabilities, including by means of requiring the institution to cover a longer stress horizon.

10.6 Interaction between supervisory and early intervention measures

481. In addition to the supervisory measures referred to in this title, competent authorities may apply early intervention measures as specified in Article 27 of Directive 2014/59/EU, which are intended to supplement the set of supervisory measures specified in Articles 104 and 105 of Directive 2013/36/EU.

482. Competent authorities should apply early intervention measures without prejudice to any other supervisory measures, and when applying early intervention measures, should choose the most appropriate measure(s) to ensure a response proportionate to the particular circumstances.

10.7 Interaction between supervisory and macro-prudential measures

483. Where an institution is subject to macro-prudential measures, the competent authorities should assess:

- a. whether by virtue of the institution using supervisory approved models for the calculation of own funds requirements the specific vulnerability/deficiency targeted by the macro-prudential measure is omitted from the effects of the measure due to its design features (e.g. if the macro-prudential measure increases risk weights to certain exposure classes, meaning the measure would only cover institutions applying the standardised approach to the calculation of minimum own funds requirements for credit risk, and therefore institutions applying IRB approaches would not be directly affected); and,
- b. whether the macro-prudential measure adequately addresses the underlying risks/vulnerabilities/deficiencies of a particular institution, where relevant.

484. Where the macro-prudential measure, due to its design specificities, does not capture a particular institution (as discussed above), the competent authorities may consider extending the effects of the measure directly to that institution (e.g. by applying the equivalent risk weights for certain classes of exposures targeted by the macro-prudential measure).

485. Where the SREP assessment determines that the macro-prudential measure does not adequately address the underlying level of risk or deficiencies present in the institutions (i.e. the institution is exposed to or poses a higher level of risk than the level targeted by the macro-prudential measure, or the deficiencies identified are more material than those targeted by the measure), competent authorities should consider supplementing the macro measures with additional institution-specific measures.

Title 11. Application of SREP to cross-border groups

486. This title addresses the application of the common SREP procedures and methodology as specified in these guidelines in relation to cross-border groups and entities. It also provides links with the joint assessment and decision process to be performed according to Article 113 of Directive 2013/36/EU.

11.1 Application of SREP to cross-border groups

487. Following the scope of the application of the guidelines as discussed in Title 1:

- a. consolidating supervisors should perform the initial assessment of the parent undertaking and the group of institutions on the consolidated level; and,
- b. competent authorities should perform the initial assessment on the level of the entities under their supervision (solo, or sub-consolidated, where relevant).

488. Where these guidelines are applied to the subsidiaries of a cross-border group, competent authorities of subsidiaries should for their initial assessment primarily consider institutions on a solo basis, i.e. assess the business model, strategy, internal governance and institution-wide controls, risks to capital and liquidity, and capital and liquidity adequacy of an entity as it would a stand-alone institution. The findings from such initial assessments, where relevant, should also include identification of key vulnerabilities in the cross-border context, which in this instance may be related to the reliance of an institution on its parent/group for funding, capital, technological support etc. In initial assessments done on the solo level, competent authorities should also reflect strengths and mitigating factors related to the entity being part of the group, which may be related to group technological support, financial support arrangements etc.

489. The results of any such initial assessment of SREP elements, including, if identified, views on key dependencies on the parent/group, should serve as an input into the joint assessment and decision process following the requirements of Article 113 of Directive 2013/36/EU; and therefore should be discussed by the competent authorities within the framework of the colleges of supervisors established pursuant to Article 116 of Directive 2013/36/EU.

490. Following the discussions within the framework of colleges of supervisors and outcomes of the joint assessment process, competent authorities should finalise their respective SREP assessment making necessary adjustments based on the outcomes of the college discussions.

491. Where a competent authority's initial assessment has revealed specific deficiencies related to intra-group positions (e.g. high concentration of exposures towards the parent

undertaking, reliance on intra-group funding, concerns over the sustainability of an entity's strategy etc.) negatively affecting the overall viability of the entity on a stand-alone basis, competent authorities within the framework of the colleges of supervisors should discuss whether the final assessment of an entity should be changed considering the overall group dimension, including the consolidated group business model, strategy and existence and specificities of intra-group financial support arrangements.

492. Competent authorities should discuss and coordinate within the framework of colleges of supervisors the following:

- a. planning, including frequency, and timelines, for performing the assessment of various SREP elements for the consolidated group and its entities in order to facilitate preparation of the group risk and liquidity risk reports required for the joint decisions as stipulated in Article 113 of Directive 2013/36/EU;
- b. details of the application of benchmarks used for the assessment of SREP elements;
- c. inputs required from the institution at consolidated and entity level in order to conduct the assessment of SREP elements, including ICAAP and ILAAP reports, where relevant;
- d. outcomes of the assessment, including SREP scores assigned to various elements, and the Overall SREP assessment and Overall SREP score at the consolidated and entity level. When discussing the assessment of individual risks to capital and liquidity competent authorities should focus on the risks that are identified as material for the respective entities; and,
- e. planned supervisory and early intervention measures, if relevant.

493. When preparing the summary of the Overall SREP assessment for the cross-border group and its entities, competent authorities should structure it in a way that would facilitate filling in the templates for the SREP report, Group risk report, Liquidity risk assessment and Group liquidity risk assessment report templates required for the purposes of joint decision under Article 113 of Directive 2013/36/EU.

11.2 SREP capital assessment and institution-specific prudential requirements

494. The determination of capital adequacy and requirements following the process described in Title 7 for cross-border groups is part of the joint decision process between the competent authorities pursuant to Article 113 of Directive 2013/36/EU.

495. The exercise of supervisory powers and the taking of supervisory measures, including with regard to imposing additional own funds according to Article 104(1)(a) at the consolidated or

individual entity level as specified in Title 7 should be subject to the joint decision between the competent authorities pursuant to Article 113 of Directive 2013/36/EU.

496. Where competent authorities set additional own fund requirements as provided in Article 104(1)(a) of Directive 2013/36/EU on the basis of Article 103 to institutions with similar risk profiles in a consistent way across its jurisdiction, this should be part of the joint decision under Article 113 of Directive 2013/36/EU for cross-border groups and entities.

497. In the context of the discussions on the adequacy of the level of own funds and determining additional own funds requirements, competent authorities should consider:

- a. the assessment of the materiality of risks and deficiencies identified between the consolidated and individual entities levels (i.e. what are the risks material to the group as a whole, or only to an entity) and required level of own funds required to cover such risks;
- b. where deficiencies identified are common across all entities (e.g. same governance deficiencies present in all entities, or deficiencies in the models used across several entities), coordinating the assessment and supervisory response, in particular, deciding whether measures should be imposed on the consolidated level, or also in proportion at the level of entities, where common deficiencies are present;
- c. outcomes of ICAAP assessments and views on the reliability of ICAAP calculations and their use as an input in determining additional own funds requirements;
- d. outcomes of the supervisory benchmark calculations used for determining additional own funds requirements for all entities within the group and on the consolidated level; and,
- e. additional own funds requirements to be imposed on entities and at the consolidated level in order to ensure consistency of final own funds requirements and need for down-streaming of own funds from the consolidated to entity levels.

498. For the purposes of determining TSCR as specified in Title 7, competent authorities should consider the same level of application as the joint decision requirements under Article 113 of Directive 2013/36/EU. In particular, the TSCR and other capital measures, if applicable, should be set on the consolidated and solo level for entities operating in other Member States. For the sub-consolidated level, the TSCR and other capital measures should cover only the parent undertaking of the sub-consolidated group in order to avoid double counting of additional own funds requirements considered by competent authorities for subsidiaries in other Member States.

11.3 SREP liquidity assessment and institution-specific prudential requirements

499. For the purpose of Article 113 (1) (b) of Directive 2013/36/EU competent authorities should consider 'matters' as significant and/or 'findings' as material at least where:

- a. quantitative specific liquidity requirements are proposed by competent authorities; and,
- b. measures other than quantitative specific liquidity requirements are proposed by competent authorities and the score assigned to liquidity risk and/or funding risk is a '3' or '4'.

11.4 Application of other supervisory measures

500. Competent authorities responsible for the supervision of cross-border groups and their entities should discuss and coordinate, where possible, application of all supervisory and early intervention measures to the group and/or its material entities, in order to ensure that most appropriate measures are consistently applied to the identified vulnerabilities taking into account the group dimension, including inter-dependencies and intra-group arrangements as discussed above.

Title 12. Final provisions and implementation

501. Competent authorities should implement these guidelines by incorporating them in their supervisory processes and procedures by 1 January 2016.

502. Specific provision in these guidelines are subject to the following transitional arrangements, though competent authorities may accelerate this transition at their own discretion:

- a. implementation of the approach to the diversification between risks (paragraph 320) and the composition of own funds to cover TSCR (paragraph 336) is not required until 1 January 2019; and,
- b. implementation of supervisory benchmarks for determining liquidity adequacy and the articulation of quantitative liquidity requirements linked to the LCR and NSFR (paragraphs 422 to 435 of Title 9) is not required until the relevant requirements of Regulation (EU) 575/2013 are specified and introduced.

Annexes

Annex 1. Operational risk. Examples of the link between losses and risk drivers

In order to illustrate how operational risk manifests itself, it is necessary to understand the relationship between the drivers of a specific risk event and the impact (i.e. outcome) of the risk event. Some examples are given in the schematic which follows².

	Driver	Risk Event	Impact Types (Outcomes)
People	Arson - a deliberate act committed by a person	Fire – the event	<ul style="list-style-type: none"> • Death/Injury • Financial Loss/Cost • Property Damage • Customer Disruption
Process	Manual Error	Inaccurate Accounts	<ul style="list-style-type: none"> • Financial Loss • Reworking accounts
Systems	IT Software Fault	ATMs shutdown/unavailable	<ul style="list-style-type: none"> • Customer complaints • Recompense • Reputational damage • Regulatory censure
External	Very severe ice storm	Buildings inaccessible / Invocation of contingency arrangements	<ul style="list-style-type: none"> • Customer disruption • Financial Loss • Repair costs

² Root cause gives rise to a risk event resulting in impact or multiple outcomes, some of which are quantifiable.

Annex 2. Operational risk taxonomy

The purpose of the Operational Risk Taxonomy is to assist supervisors in identifying and assessing the material risks that exist within an institution. An outline of the Taxonomy is set out below:

Event Type	Taxonomy Risk Types		
Internal fraud	Information/Data Security	Insider trading	Legal Risk
	Theft, Forgery, Embezzlement	Bribery and Corruption	
	Unauthorised Transactions	Tax evasion	
External Fraud	Money Laundering	Forgery and Check Kiting	
	Hacking/Information Security	Physical Security	
	Unapproved Account Access		
Employment Practice & Workplace Safety	Employee Relations		
	Insurance and Liability		
Clients, Products, & Business Practice	Product Defects	Fiduciary Duty Breach	
	Mis-selling	Account Churning	
	Client Limit Breach	Antitrust Breach	
Business Disruption and System failures	IT and Communications Failure	Human Resources and Skills Gap	
	Outsourcing	Project & Change Risk	
	Industrial Relations Disputes		
Damage to Physical Assets	Natural Disaster		
Execution, Delivery & Process management	Flawed/Incomplete Data	Incomplete Legal Documents	
	Compliance failure	Process Flaws	

Annex 3. References and regulatory requirements regarding internal governance and institution-wide controls

1. Articles 73-74, 88, 91-96, 98 of Directive 2013/36/EU
2. EBA Internal Governance Guidelines (GL44)
3. EBA Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2012/06)
4. EBA Guidelines on stress testing (GL32)
5. EBA Guidelines on Remuneration Policies and Practices (2010)
6. EBA Regulatory Technical Standards on the assessment of recovery plans to Article 6 of Directive 2014/59/EU
7. EBA Regulatory Technical Standards on the content of recovery plans pursuant to Article 5 of Directive 2014/59/EU
8. EBA Guidelines on the applicable notional discount rate for variable remuneration (EBA/GL2014/01)
9. EBA Regulatory Technical Standards on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile under Article 94(2) of Directive 2013/36/EU
10. EBA Draft Regulatory Technical Standards on classes of instruments that are appropriate to be used for the purposes of variable remuneration under Article 94(2) of Directive 2013/36/EU
11. Basel Committee on Banking Supervision Principles for effective risk data aggregation and risk reporting, January 2013
12. Financial Stability Board Principles for An Effective Risk Appetite Framework, November 2013

Annex 4. References and regulatory requirements regarding risks to capital

Credit and counterparty risk

1. Capital requirements for credit risk - General principles (Articles. 107-110 of Regulation (EU) No 575/2013)
2. Pillar 1 own funds calculations – Standardised approach (Articles 111-141 of Regulation (EU) No 575/2013)
3. Internal approach for calculating own funds requirements - Internal Ratings Based Approach (Articles. 142-191 of Regulation (EU) No 575/2013)
4. Credit risk mitigation (Articles 192-241 of Regulation (EU) No 575/2013)
5. Securitisation (Articles. 242-270 of Regulation (EU) No 575/2013)
6. Counterparty credit risk (Articles 271-311 of Regulation (EU) No 575/2013)
7. Own funds requirements for settlement risk (Articles. 378-380 of Regulation (EU) No 575/2013)
8. Exposures to Transferred Credit Risk (Articles 404-410 of Regulation (EU) No 575/2013)
9. Large exposure regime (Articles 395-401 of Regulation (EU) No 575/2013)
10. Supervisory reporting on forbearance and non-performing exposures (EBA Technical Standards)

Market risk

1. General requirements for the trading book (Articles 102-106 of Regulation (EU) 575/2013)
2. Pillar 1 own funds calculations (Articles 325-377 of Regulation (EU) 575/2013)
3. Own funds requirements for credit valuation adjustment risk (Articles 381-386 of Regulation (EU) 575/2013)
4. Internal approach for calculating own funds requirements for specific risk of debt instruments in the trading book (Article 77(3) of Directive 2013/36/EU)
5. Risk of shortage of liquidity (Article. 83(2) of Directive 2013/36/EU)
6. Basis risk (Article 83(3) of Directive 2013/36/EU)

7. Underwriting position (Article 83(3) of Directive 2013/36/EU)
8. Stress test carried out by institutions using internal models (Article 98(1)(g) of Directive 2013/36/EU)
9. Valuation adjustments in positions held in the trading book (Article 98(4) of Directive 2013/36/EU)

Operational risk

1. General requirements for operational risk management (Articles 76-78 and 85 Directive 2013/36/EU)
2. General principles governing the use of different approaches for calculating own funds requirements (Articles 312-314 Regulation (EU) 575/2013)
3. Basic Indicator Approach (315-316 Regulation (EU) 575/2013)
4. Standardised Approach (317-320 Regulation (EU) 575/2013)
5. Advanced measurement approaches (321-324 Regulation (EU) 575/2013)
6. Principles for the sound management of operational risk (Basel Committee on Banking Supervision)

Interest rate risk from non-trading activities

1. General requirements for the Interest risk arising from non-trading activities (Article 84 of Directive 2013/36/EU)
2. Impact on economic value of a change in interest rates of 200 basis points (Article 98(5) of Directive 2013/36/EU)

Annex 5. References and regulatory requirements regarding risks to liquidity and funding

1. Liquidity (Articles 411-428 of Regulation (EU) No 575/2013)
2. Phase-in of liquidity requirements (Articles 460-461 of Regulation (EU) No 575/2013)
3. Exercise of the delegation to the Commission (Article 462 of Regulation (EU) No 575/2013)
4. Reports and review – Liquidity requirements (Article 509 of Regulation (EU) No 575/2013)
5. SREP process - Liquidity risk (Article 86 of Directive 2013/36/EU)
6. Supervisory measures and powers – Specific liquidity requirements (Article 105 of Directive 2013/36/EU)
7. EBA Guidelines on liquidity buffers and survival periods
8. EBA Guidelines on retail deposits subject to different outflows for purposes of liquidity reporting under Regulation (EU) No 575/2013

5. Accompanying documents

5.1 Draft Cost- Benefit Analysis

Problem identification

Article 107 of Directive 2013/36/EU mandates the EBA to draft guidelines to ‘further specify’ common procedures and methodologies for the supervisory review and evaluation process.

The key problem that this mandate looks to address is the inconsistent application of supervisory review processes and methodologies by competent authorities. This results in inconsistent supervisory outcomes for institutions across the Union with similar risk profiles and business exposures. Such inconsistencies can reduce the smooth function of the single market and undermine European financial stability, particularly where the processes and methodologies address concerns of national political economy rather than the prudential soundness of institutions.

Objectives

In interpreting the broad Article 107 Directive 2013/36/EU mandate the EBA – with reference to its statutory obligations – defines its primary objective as the development of guidelines that increase the consistency and quality of supervisory practices, and hence of their outcomes. As part of this objective the EBA also recognises the need to conjoin going concern supervisory activities as set out in Directive 2013/36/EU with the shift to gone concern activities for institutions that are failing or likely to fail as set out in Directive 2014/59/EU.

This means the observable effect of adoption of the guidelines should be that institutions with similar systemic impact, risk profiles, business models, and geographic exposures are reviewed and assessed by competent authorities in a consistent way and subject to broadly consistent supervisory expectations, actions and measures, both in business as usual and failing or likely to fail situations.

The EBA identifies five principle areas where competent authorities currently operate divergent national approaches, or do not have an existing approach, where convergence through the guidelines is required to fulfil the above objective:

1) SREP processes, definitions and scoring

Establishing common processes – including the common risk elements for assessment in the SREP – definitions and scoring will allow for the guidelines to contribute to:

- an improvement in supervisory standards across the Union by updating practices in light of weaknesses revealed in existing approaches by the financial crisis;

- improved trust and communication between competent authorities participating in colleges for cross-border institutions; and,
- the monitoring of the consistency of supervisory outcomes for institutions with similar risk profiles across the Union.

2) Categorisation of institutions by systemic impact

Systemic impact categorisation is identified as a precursor to ensuring a convergence in approaches to supervisory intensity and proportionality, with the greatest supervisory resources and expectations focused on the most systemically important institutions, decreasing down the scale of less systemically important institutions.

3) Approach to assessing and setting capital requirements

A common approach to determining and setting capital requirements is a necessary prerequisite to achieving broadly consistent prudential outcomes for institutions with similar risk profiles. Some of the largest variations in national transpositions of previous iterations of Directive 2013/36/EU were in the area of capital requirements and consequently there is significant divergence across the Union. This is predominantly in the way additional capital requirements are determined, the nature of capital requirements, and the way they are formulated and communicated. Aside from improving the functioning of the single market, a common approach as specified in the guidelines is necessary to ensure the policy objectives of the buffers introduced by Directive 2013/36/EU are met, given the potential for certain existing national approaches to undermine their effectiveness.

4) Approach to assessing and setting liquidity measures

The supervisory setting of liquidity measures is a new requirement of Directive 2013/36/EU. The objective of setting out a common approach is to establish the same high level standards across the Union given this is a risk area for which many competent authorities have no existing formal national approach, and to facilitate the reaching of a joint decision of liquidity measures required for cross border EEA institutions by Directive 2013/36/EU.

5) Conjunction of going concern supervision and recovery and resolution

There is a regulatory overlap between Directive 2013/36/EU and Directive 2014/59/EU in the space of the determination of when an institution can be considered as 'failing or likely to fail'. It is critical for the guidelines to account for this interaction and ensure there is a regulatory continuum between 'business as usual' and a 'failing or likely to fail' situation since – based on Member State discretions in Directive 2014/59/EU – responsibility over supervision of 'failing or likely to fail' institutions may shift from the competent authority to the resolution authority.

Competent authorities have participated in an analysis of the costs and benefits of convergence in the above five areas through adoption of these guidelines for themselves, institutions that they supervise (i.e. the collective cost and benefit for the banking industry in their country), and other stakeholders (i.e. wider society). This analysis is weighted based on the size of the Member State that the competent authorities represent. The outcome of this analysis is detailed below and summarised in Table 14.

Policy options: analysis and comparison / preferred options

1) Common definitions, processes and scoring

Options

The following policy options were considered:

- i. *Use the existing definitions, processes and scoring as defined in EBA GL 39 for the Joint Risk Assessment for cross-border institutions;*
- ii. *Develop entirely new definitions, processes and scoring; or,*
- iii. *Use EBA GL 39 as a starting point but amend and expand.*

Using the existing definitions, processes and scoring outlined in GL 39 (i) would have the least resource impact on competent authorities. However these existing guidelines do not reflect changes in the regulatory environment (e.g. introduction of bank recovery and resolution concepts). Furthermore, since this effectively would mean retaining the status-quo this would not appear compliant with European legislators' request that the EBA 'further specify' processes. Developing entirely new definitions, processes and scoring (ii) would result in an unnecessary re-invention of the wheel since in many areas GL 39 remains fit for purpose as a starting point.

By contrast option (iii) has the benefit of building upon existing processes present in Member States, themselves the outcomes of early EBA guidelines on cross-border aspects of the SREP process. This reduces to some extent the costs competent authorities are likely to face in terms of compliance with the SREP GLs. It also reduces the burden on institutions in terms of understanding the new processes. Consequently it was decided to follow option (iii) to the extent that the definitions, processes and scoring outlined in GL 39 were compatible with the wider objectives of the SREP GLs.

Details of preferred option

The guidelines propose common definitions, processes and scoring applicable to the SREP. The common processes – of which the definitions are a necessary extension – cover the key elements for assessment that competent authorities must cover during a SREP (business model risk, governance and controls, risks to liquidity and funding, risks to capital, and liquidity and capital assessment), the scope of the assessment, and the application of proportionality. The common scoring introduces a four (1 to 4) grade scoring approach (as per GL 39) competent authorities

should apply and indicators to use when applying the score for each element and the overall SREP assessment (with an additional indicative score of 'F' for the overall SREP assessment for institutions considered as failing or likely to fail). The guidelines do not cover how competent authorities should organise themselves internally, how supervision should be organised or conducted (e.g. onsite or offsite) or prescribe scoring aggregation methodologies, reflecting areas best felt left to the discretion and judgement of the authorities given the specificities of national banking systems.

Current national approaches

While the same terms for the SREP are generally used by competent authorities – deriving from Basel, Directive 2013/36/EU or GL 39 terminology – the underlying definitions and expectations can vary considerably. For example, a 'SREP update' may constitute a full re-assessment of the all elements of the SREP, or alternatively a more cursory review of known developments against existing findings.

All competent authorities undertake the assessment of risks to capital and governance and controls risk, broadly following the same criteria as laid down in Directive 2013/36/EU or associated Basel/EBA guidance. Most competent authorities assess business and strategic risk, though the assessment tends to be quantitative with the objective of determining own funds to cover earnings volatility, and consequently treated alongside risks to capital. Only a handful of competent authorities apply business model analysis as a separate qualitative element to support other elements of the SREP, as proposed in these guidelines. Similarly while all competent authorities assess liquidity risk, only a small minority have developed the liquidity risk assessment as a separate element of the SREP, as proposed by these guidelines (which themselves reflect the focus on liquidity risk as a separate risk element in the Regulation (EU) No 575/2013/Directive 2013/36/EU).

The majority of competent authorities use a four-grade scoring system for individual risk areas. Authorities using more than four grades map the scores to the four grade system required for colleges (following EBA GL 39). Ratings have very similar definitions among competent authorities (low risk/good control to high risk/poor control).

Cost/benefit analysis

The processes and scoring proposed by the guidelines are substantially those already used by competent authorities, albeit the grouping of the risks facing the institution into four principle risk elements for assessment represents a change. More substantially, the requirement to assess business model and strategic risk from a qualitative, forward-looking perspective will require a change of approach from many competent authorities, which may have resource implications. Equally the requirement to assess and address risks to liquidity and funding will place additional burdens on many competent authorities. However in both cases the requirement emerges from new provisions in Directive 2013/36/EU rather than these guidelines.

The introduction of a common, comprehensive assessment framework for business model and strategic risks, largely absent prior to the financial crisis, is expected to improve supervisory outcomes by improving the comprehensiveness of risk assessments. The adoption of consistent terminology and processes for assessing and scoring risks should foster greater mutual trust and assurance between competent authorities that the same risks types are being addressed with the approach, with comparable outcomes. This should have a beneficial impact on cross-border institutions through greater supervisory transparency and requirements, and reduce the risk of ring-fencing by competent authorities justified by the current lack of shared trust/understanding relating to different existing national approaches to assessing risk

Competent authorities assess the costs to themselves of implementing common definitions, processes and scoring will be equal to the benefit gained, while for institutions the benefits will slightly outweigh the costs, and for other stakeholders the benefits will more noticeably outweigh the costs.

2) Categorisation by systemic impact

Options

The following policy options were considered:

- i. Limit systemic categorisation to two categories.*
- ii. Specify four categories with quantitative metrics governing in to which category an institution will be placed.*
- iii. Specify four categories with qualitative descriptions to guide competent authorities in to which category an institution will be placed.*

Option (i), and a variation on it that would see three categories introduced, was considered sub-optimal on the basis that in Member States with larger banking sectors it is necessary to be able to further differentiate between 'large' and 'small' institutions, with larger and smaller variations of these two main categories (1-2 and 3-4, respectively).

Option (ii) addresses the need for four categories, and is the most likely to ensure consistent outcomes across the Union by establishing specific quantitative metrics to determine categories. However it was not considered appropriate on the basis that: a) quantitative metrics alone are not capable of covering all aspects of an institution's potential impact on the financial system (for example capturing all aspects of its role in the payments system); and, b) it is not possible to develop a single set of metrics that capture the very wide range of business models and banking structures that exist across the Union.

It was decided to follow option (iii) but to introduce a 'hard' requirement for the most systemically important institutions by requiring that all G-SII/O-SIIs are placed in Category 1. This ensures that for the institutions that pose most risk to the European financial system there is a

consistent approach. For other institutions the appropriate use of the discretion granted to competent authorities can be monitored by the EBA to ensure consistency occurs over the medium-term, should issues be identified.

Details of preferred option

The guidelines propose that competent authorities should categorise institutions between 1 and 4 based on the impact on the financial system of their failure (systemic impact). The categorisation criteria allows competent authorities a fairly broad range of discretion except around the most systemically important institutions (Category 1), which includes any G-SIIs or O-SIIs identified using criteria laid out in separate EBA regulatory technical standards.

Requirements around the application of proportionality are principles-based with the exception of maximum cycles for assessing all elements of the SREP by category (e.g. one year for a full assessment of Category 1 institutions, three years for Category 3 & 4).

Current national approaches

A high proportion of competent authorities use groups/categories of institutions for the purposes of taking a proportionate approach to the application of SREP. Most commonly competent authorities use four categories for this breakdown.

The criteria used for determining the breakdown are typically more granular and specific than those proposed in the guidelines, linking quantitative metrics (size, market share), substitutability, and product range.

Other less common approaches used are based on cross-border activities, used of standardised or model-based approaches to calculating capital requirements, or the legal form of the institution (specialised bank, cooperative bank etc.).

Almost all competent authorities currently conduct the SREP annually on institutions they supervise, though the scope of the SREP can vary based on the category of the institution or its riskiness from continuous or annual full scale to a simple yearly review or sectoral review.

Cost/benefit analysis

With the exception of the categorisation of G-SIIs and O-SIIs, which is a separate requirement of Directive 2013/36/EU and therefore out of scope of this impact assessment, the guidelines offer sufficient flexibility to allow competent authorities to structure their supervisory resource framework to account for national circumstances within the guidelines. Not least, as noted, it is not necessary for competent authorities to use all four categories if this does not reflect the structure of the banking sector (for example, if a banking sector is highly concentrated with only G-SIIs/O-SIIs in the market, no categorisation is required (as all institutions are by definition category 1)).

While the level of discretion retained by competent authorities around categorisation prevents full harmonisation this may in any event not be achievable/desirable given the very wide variety of national banking systems present across the Union. Meanwhile, introducing a common categorisation allows for monitoring, by systemic importance, of: the risk profile; proximity to non-viability; and, prudential treatment of similar institutions, across the Union. This can help improve the functioning of the single market and allow for more targeted regulatory decision-making linked to proportionality in the banking sector (e.g. going forward EU and national authorities can link decisions, recommendations etc. to specific categories of institutions).

Competent authorities assess the costs to themselves and other stakeholders of implementing the common categorisation of institutions will be less than the benefit gained, while for institutions the costs and benefits will be equal.

3) Approach to assessing and setting capital requirements

Options

The following policy options were considered:

- i. Set capital requirements and assess resources on the basis of the ICAAP.*
- ii. Set capital requirements and assess resources on the basis of a range of sources of information, without addressing the legal nature of requirements or composition of resources.*
- iii. Set capital requirements and assess resources on the basis of a range of sources of information, specifying the legal nature of requirements and composition of resources.*

As a starting point for considering the best option it was noted that, given the heterogeneity of existing national approaches, no single option offers the benefit of resulting in the same or lower supervisory resource requirements across the board: any of the above options will result in a sizeable number of competent authorities having to change their existing approach.

Option (i) was not considered appropriate. Experience over recent years has demonstrated that the capability and appetite of institutions to make an objective assessment of the risks that they face and capital they should hold against those risks is not always adequate from a societal perspective. Consequently while the ICAAP can be a key source of information – recognising that there are many examples of good practice – it is not appropriate for it to be the de facto basis of the assessment. While option (ii) addresses the ICAAP concern it leaves open another issue: the inconsistent treatment of Pillar 2 risks resulting in the inconsistent prudential treatment of institutions with similar risk profiles. Addressing this issue is difficult if the nature of Pillar 2 requirements and the standards on the calculation of requirements and resources are not further specified.

By contrast option (iii) – the preferred option – does allow the guidelines to further address this issue. This is in line with amendments to Directive 2013/36/EU requiring that Pillar 2 risk are addressed with additional own funds requirements, and the introduction of Directive 2013/36/EU buffers, which require the specific treatment of Pillar 2 requirements (nature and composition) in order to ensure that their policy objectives are met and that double counting of capital requirements is avoided.

Details of preferred option

The guidelines propose a common approach to determining additional capital requirements by taking the institution's ICAAP as a starting point for risks not covered by the Pillar 1 calculation, and where that is not assessed as reliable using risk-by-risk supervisory benchmarks as a starting point. Additional capital requirements should be binding requirements, always applied in addition to the Regulation (EU) No 575/2013 minimum requirements. The composition of capital requirements should reflect the policy objective, in some cases reflecting the Pillar 1 requirement, and in all cases should be regulatory own funds only.

Current national approaches

There is a wide range of approaches adopted by competent authorities to the assessment and setting of capital requirements, based on differing interpretations and transpositions of previous iterations of Directive 2013/36/EU.

In terms of methodologies the broad split is between competent authorities that follow a Pillar 1-plus approach, with capital add-ons calculated in addition to Pillar 1 requirements for risks not captured by the Pillar 1 calculation, or a 'holistic' ICAAP approach, in which capital requirements are determined independently from the Pillar 1 calculation and subsequently translated into add-ons where the Pillar 1 requirement is not found to be sufficient to cover all risk exposures.

In both cases the supervisory view of the composition (quality) of the Pillar 2 capital requirement can vary, as can the approach to setting capital requirements, which can be: formulated according to resources or requirements, linked to the denominator or numerator, a legally binding minimum or target expectation.

Cost/benefit analysis

The cost will vary based on the current national approach used (as set out above). While for competent authorities that have traditionally relied on a 'holistic' ICAAP assessment in order to ensure a sound capital coverage of risks, the proposed guidelines represent a change in terms of supervisory measures, in terms of resources the change will be less significant as the type of assessment (of reliability of ICAAP calculations) should be broadly the same. However, additional supervisory resources will be required for these competent authorities to periodically calculate the supervisory benchmarks for institutions – where this does not already occur – in order to provide an alternative to the ICAAP calculation. Further resources will be required – at least at the

outset of adoption of the guidelines – to develop and implement the supervisory benchmarks, notwithstanding support that the EBA is expected to provide in this regard.

With the composition of own funds instruments and Pillar 1 calculations now maximum harmonised under the Regulation (EU) No 575/2013, variations in the treatment, quantification and composition of Pillar 2 requirements is the principle source of variations in the prudential treatment of institutions with similar risk profiles in different Member States within the Union. The variation can be stark and create an uneven playing field as well as, potentially, lower prudential standards, with consequent impacts for financial stability within the Union. Adoption of the guidelines should help drive a convergence of prudential outcomes across the Union, improving the functioning of the single market and helping to ensure greater financial stability.

Competent authorities assess the costs to themselves and institutions of implementing the common approach to setting capital requirements will be equal to the benefit gained. For other stakeholders the benefits will be greater than the costs.

4) Approach to assessing and setting liquidity and funding risk measures

Options

The following policy options were considered:

- i. A two- step approach of initially assessing liquidity risk and funding risk, and in a second step, the institution's counterbalancing capacity and liquidity buffers.*
- ii. A holistic approach of assessing liquidity risk and funding risk already taking into consideration counterbalancing capacity and liquidity buffers.*

Option (i) would be aligned with the approach followed in the guidelines for risks to capital and capital adequacy, where for each type of risk, the inherent risk and risk management and controls are initially assessed; with the adequacy of available own funds to cover the risk assessed as a second step. The second step would include, in the case of liquidity, benchmarks to set potential additional liquidity quantitative requirements. This option was considered as suboptimal as it would mean an artificial split into two steps of an assessment that usually takes place simultaneously in one step.

Option (ii) is consistent with emerging supervisory practices in most member states and fits best with the specific nature of liquidity and funding risk, where the level of risk faced by the institution depends not only on the projected net cash outflows but also on the liquidity buffers and counterbalancing capacity available to the institution in order to meet those net outflows under situations of stress. Consequently it was decided to follow option (ii).

Details of preferred option

The guidelines propose that competent authorities, when assessing liquidity risk and funding risk, should assess the risk that an institution cannot meet its financial obligations as they fall due

either at all or without incurring unacceptable losses. For this purpose, the guidelines provide a set of common elements to be considered when assessing liquidity and funding risk and risk management and controls, including the internal liquidity assessment process (ILAAP).

The guidelines also provide guidance on determining whether the liquidity held by the institution is adequate or not, and benchmarks for setting additional quantitative liquidity requirements, or a range of other possible liquidity supervisory measures that can be applied in order to address shortcomings identified.

Current national approaches

The majority of competent authorities assess liquidity risk and funding risk by taking into consideration simultaneously the net cash outflows and maturity mismatches faced by the institution and the counterbalancing capacity and liquidity buffers available to compensate them.

While a majority of competent authorities currently apply a general methodology for the assessment of the institution's internal governance and management and controls, with specific details on individual risks (including liquidity risk), there are some authorities that have already gone further, implementing a specific methodology for the assessment of the institution's internal liquidity governance and management framework.

The application of supervisory liquidity measures, including additional quantitative liquidity requirements, is new for the majority of competent authorities, which so far have been addressing the liquidity and funding risk shortcomings through additional own fund requirements, with some exceptions.

Cost/benefit analysis

The preferred option is in line with the emerging approach adopted or being adopted by most competent authorities. The level of detail envisaged in the guidelines is nevertheless larger than in most of current national approaches, and this may lead to an increase in the resources needed. Counter-balancing this, the EBA has published the ITS on additional liquidity monitoring metrics, that, together, with the regulatory reporting established by the Regulation (EU) No 575/2013, will provide competent authorities with important sources of information to carry out this assessment.

The cost of implementing the methodology for the assessment of the ILAAP framework will vary depending on the nature of existing national methodologies: additional supervisory resources will be required for those competent authorities (the majority of them) that do not currently have a specific methodology in this regard.

The provisions on supervisory measures are likely to have significant organisational and resource implications for competent authorities (notwithstanding such implications are in any event somewhat unavoidable given the liquidity requirements in the level one texts of Regulation (EU) No 575/2013).

More generally, inadequate liquidity resources, and by extension supervisory monitoring of the issue, was a key driver of institutions' failure during the financial crisis. Adoption of the guidelines will allow for a consistent approach to addressing the risk across the Union, improving both supervisory outcomes and the functioning of the single market by enhancing trust and understanding between competent authorities.

Competent authorities assess the costs to themselves of implementing the common approach to setting liquidity requirements will be less than the benefit gained. For institutions the costs will be slightly higher than the benefits, and for other stakeholders the benefits will be slightly higher than the costs.

5) Conjunction of going concern supervision and recovery and resolution

Options

The following policy options were considered:

- i. *Limit the SREP to the assessment of the risk profile of the institution.*
- ii. *Incorporate the assessment of the institution's viability based on the threat to its financial resources given the risks to which it is or may be exposed.*

Option (i) reflects the existing approach in the large majority of competent authorities. However since it did not directly address the determination of failing or likely to fail it was not considered appropriate. Specifically, a supervisory emphasis on the risk profile does not necessarily determine the viability of an institution; an institution can be exposed to very high risks but thanks to also having very high financial resources it is able to bear these risks without being at risk of failure.

Option (ii) was the preferred option as it shifts the emphasis from the scale of the risk exposure the institution faces to the assessment on if the institution is able to cover this risk through its financial resources. This allows competent authorities to more appropriately determine if the institution can be considered failing or likely to fail.

Details of preferred option

The guidelines bridge the gap between Directive 2013/36/EU and Directive 2014/59/EU in the space of determining whether an institution can be considered as 'failing or likely to fail'. The guidelines introduce the concept of the Overall SREP assessment and score, through which supervisors not only assess the risks facing the institution on a going concern basis but also factor into the assessment the institution's ability to mitigate that risk (through capital and liquidity resources, governance and controls and/or business strategy). The outcome of the assessment is a supervisory determination on the institution's viability and consequent likelihood of failure, which can inform requirements emerging from Directive 2014/59/EU and facilitate early coordination and cooperation between the competent authority and the authority responsible for

the resolution of failing institutions (should they be different). Thus the guidelines allow competent authorities to make the assessment required by Directive 2014/59/EU within the SREP framework without introducing a parallel supervisory process.

Current national approaches

The area of recovery and resolution is new for competent authorities, resulting from regulatory initiatives from the FSB, Basel and subsequently Directive 2014/59/EU. Consequently there are few firmly established national approaches in this area, with only a very limited number of competent authorities having adopted a formal recovery and resolution regime prior to Directive 2014/59/EU.

Cost/benefit analysis

While establishing a resolution regime itself may be burdensome on competent authorities, the provisions in the guidelines on assessing the viability of an institution simply build upon existing SREP assessment standards around risk profiling and capital and liquidity adequacy assessment and therefore should not present additional resources requirements for competent authorities.

By assessing not only the risk profile of an institution but also its overall viability in the context of its financial resources, competent authorities will be able to better plan their supervisory/recovery and resolution activities and to better assess the overall level of risk in the financial system resulting from the viability of individual institutions.

Competent authorities assess the costs to themselves of implementing going concern supervision with recovery and resolution will be equal to the benefits gained. They assess that the same is true for institutions. However for other stakeholders the benefits will be slightly greater than the costs.

Table 14. Summary of the cost/benefit analysis

<u>Costs</u>	<u>Benefits</u>

Competent authorities		
1: SREP processes, definitions and scoring	Medium	Medium
2: Categorisation of institutions by systemic impact	low	Medium to low
3: Approach to assessing and setting capital requirements	Medium	Medium
4: Approach to assessing and setting liquidity measures	Medium	High to Medium
5: Conjunction of going concern supervision and recovery and resolution	Medium	Medium
Institutions		
1: SREP processes, definitions and scoring	Low to negligible	Low
2: Categorisation of institutions by systemic impact	Medium	Medium
3: Approach to assessing and setting capital requirements	Medium to low	Medium to low
4: Approach to assessing and setting liquidity measures	Medium	Medium to low
5: Conjunction of going concern supervision and recovery and resolution	Low	Low
Other stakeholders		
1: SREP processes, definitions and scoring	Negligible	Low
2: Categorisation of institutions by systemic impact	Low	Medium
3: Approach to assessing and setting capital requirements	Low to negligible	Medium to low
4: Approach to assessing and setting liquidity measures	Low	Medium to low
5: Conjunction of going concern supervision and recovery and resolution	Negligible	Low to negligible

5.2 Overview of questions for Consultation

1. Do the guidelines specify the SREP process sufficiently? Are there areas where the EBA should aim for greater harmonisation, or where more flexibility would be appropriate?
2. Do you agree with the proportionate approach to the application of the SREP to different categories of institutions? (Title 2)
3. Are there other drivers of business model / strategy success and failure that you believe competent authorities should consider when conducting the BMA? (Title 4)
4. Does the breakdown of risk categories and sub-categories proposed provide appropriate coverage and scope for conducting supervisory risk assessments? (Title 6)
5. Do you agree with the use of a standard approach for the articulation of additional own funds requirements to be used by competent authorities across the Union? (Title 7)
6. Do you agree that competent authorities should be granted additional transition periods for meeting certain capital and liquidity provisions in the guidelines (Title 12)?