

# **ABI response to**

## **EBA consultation on the revised common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing**

EBA Questions:

- 1. What are the respondents' views on the overall amendments and clarifications added to the revised guidelines?**

**ABI welcomes the general review of the Guidelines** since it enhances the current framework by adding more clarity on certain aspects and by ensuring greater harmonization.

It is important that the SREP process reflects differences in size, complexity and business models. **We are still missing specific improvements in terms of proportionality for stress testing.** The concept of “anchor” test is not sufficiently elaborated. For credit risk, it must be clarified if the supervisory stress test for smaller and less complex banks will be formulated in terms of shocks of macroeconomic variables or in terms of shocks of “standardized credit approach” risk factors. In case the first alternative were the prescribed one, care should be taken of the fact that, in general, the above-mentioned category of banks has no satellite models readily available and some “bridge solution” would therefore need to be provided.

We find it important that the Guidelines are adapted as soon as the CRR II and CRD V are agreed upon.

**Furthermore, it has also to be noted that the benefits of diversification are not adequately recognised, both between risks and across geographies.** We consider the approach to Pillar II should not be just a Pillar I plus some add-ons, but a comprehensive overview of the risk profile of an institution. This could only be achieved by assessing the risk holistically using models or approaches which reflect the benefits of no correlation between the different elements. Any assessment that does not take fully into account the benefits of diversification would be limited for the purposes of the SREP. We understand that the framework should incentivise the development of comprehensive models by accepting their use in Pillar II when they meet the supervisory expectations in terms of quality and reliability. Another option could be a simple and comparable methodology that captures the main features of diversification. Even though this would be second best, in our

opinion this would offer a better trade-off between an accurate risk assessment and ensuring harmonization than the current framework.

Finally, we also note that further transparency on the setting and communication to institutions of P2R should be prescribed by the Guidelines

**2. What are the respondents' views regarding 'the interaction between SREP and other supervisory processes, in particular assessment of recovery plans' provided in the 'Background and rationale' section?**

About **the evaluation of the "recovery capacity" as a new criterion for awarding the overall SREP score**, it is not appropriate to include it at the same level as, inter alia, the assessment of the business model and of the internal governance. Rather, the "recovery capacity" should be considered as a subcategory of the assessment of risks to capital and liquidity. Therefore, the criteria in table 13 relating to the recovery capacity should be adjusted.

**3. What are the respondents' views on how the assessment of internal governance and institution-wide controls has been aligned with the revised EBA Guidelines on internal governance (Section 5)?**

**4. What are the respondents' views on the provisions of the newly introduced Pillar 2 Capital Guidance?**

**It would be urgent to specify how the results of supervisory stress tests are used to determine P2G.**

**The draft Guidelines should also clarify the implications of breaching the P2G vis-à-vis other requirements.** In this regard, it would be welcomed that the Guidelines establishes the proper framework to understand the "binding degree" of this guidance/recommendation and in the same vein to include a menu of options available to supervisors in case banks breach the P2G.

**ABI opposes the requirement that imposes to institutions to meet their P2G requirement only with CET1 instruments.** Instead, institutions must be allowed to use other capital instruments as allowed for P2R.

We also understand only to a limited extent the arguments put forward by the EBA at the hearing on 16 January 2018. In EBA's view, P2G in the form of CET 1 is necessary because P2G "protects" the combined buffer requirement.

According to paragraphs 384 et seq., P2G has to be measured so high that sufficient capital is available that even in an adverse stress scenario the TSCR is not breached over a period of at least two years. On the one hand, this would allow to reduce buffer capital in the case of a loss. On the other hand, AT 1 capital instruments are also suitable for absorbing losses. In this way, an adverse scenario that would materialize could initially be absorbed by AT

1 capital without the buffer requirement being affected. But even if the losses extend to the buffer, compliance with the TSCR would still be guaranteed. In our view, the requirement to use only CET 1 for the P2G would be far too conservative, which is why we are strongly in favor of allowing other capital instruments similar to Art. 92 CRR.

The requirement in par 400 is not in line with the recent understanding of the stacking order that is given in par 394 and is also being discussed in the current review of the CRD. As the P2G should first of all assure that institutions do not breach the TSCR in adverse situations, **it should be possible, that a shortfall of AT 1 and T2 capital instruments is covered by P2G.**

In addition to that it should be on the discretion of the competent authority how to communicate the overall capital requirements. It is common practice that some supervisors only communicate a desired CET 1-ratio but not an overall capital requirement. This leeway should be maintained. We therefore ask to delete par 400 and 401 as well as the table in chapter 7.9.

**Double counting of risks should be avoided.** We note that the Table 8. Supervisory considerations for assigning a score to capital adequacy introduces as a new input to determine the capital score and therefore the Pillar 2R whether or not the institution is able to comfortably meet its P2G. According to this, we understand that the same risks that justified a determined Pillar 2G could also impact on Pillar 2R in case the institution is breaching, or close to breach, the Pillar 2G. We see this as a source of double counting since the same risk could be considered twice in Pillar 2 decisions. It should also be added that the notion of “comfortably” is subjective and adds an additional discretionary element to the buffer.

In addition, EBA should also explain which particular aspects of the P2R can also be taken into account in the P2G (paragraph 393).

**Overlaps between P2G and other applicable macro-prudential measures should be avoided. In this sense, competent authorities should consider the extent to which the existing combined buffer requirements and other applicable macro-prudential measures already cover risks revealed by stress testing.** Competent authorities should offset P2G against the capital conservation buffer (CCB), as P2G and CCB overlap in nature. Furthermore, while no overlap is in principle expected between P2G and the countercyclical capital buffer (CCyB), competent authorities should, in exceptional cases, offset P2G on a case-by-case basis against the CCyB based on the consideration of underlying risks covered by the buffer and factored into the design of the scenarios used for the stress tests, after liaising with the macro-prudential authority.

**Capital resources should be above the P2G requirement in day-to-day business operations (no crisis) and the latter should therefore only be anchored in risk management as an early warning signal.** In the event of a crisis, it must be possible to temporarily fall below the P2G requirement without having to make an automatic decision about a recovery state. P2G should therefore not affect the recovery plan.

5. **What are the respondents' views regarding disclosure of P2G (paragraph 403), having in mind the criteria for insider information?**

**ABI recommends not requiring the disclosure of P2G.** Pillar 2 disclosure requirements should be limited to P2R, which can be relevant for investors since it has an impact on the Maximum Distributable Amount.

Notwithstanding this, concerns arise from the possibility that local authorities (e.g. market authorities) may require the disclosure of P2G, which is likely to create disclosure pressure across the markets and possibly make the requirement binding. In this sense, **ABI recommends to EBA to specify that P2G disclosure should not be required by local authorities under any circumstances.**

6. **What are the respondents' views on the introduction of supervisory stress testing in the revised guidelines (Section 12)?**

**Supervisory stress testing:**

The concepts of “baseline” and “adverse” scenarios should be defined more precisely. In addition, the links between both scenarios with the EBA stress test exercise should be clarified. Additionally, it should be emphasized that the stress test should not become an excessive administrative burden taking into account the size and the business model of banks according to the proportionality principle.

It should clearly be a role for supervisory stress testing to challenge institutions' own stress testing and to support supervisors' decisions. There must however be a **balance between the emphasis put on supervisory stress tests in decision-making and the quality of the whole stress testing process.**

Stress testing is becoming a maturing discipline, but in a supervisory stress test where different participating institutions use different models, **it may still be a challenge to make reliable comparisons between institutions.** Such comparisons should therefore be used carefully. Supervisory bodies in different countries require stress test results with different degree of details and on different forms and formats. It might be more efficient and time-saving – both for the participating institutions and for the supervisors – to establish a general interface organised like a database.

For the purposes of supervisory dialogue with institutions regarding the outcomes (point 584.c), **more transparency would be appreciated in terms of the identified sources or deficiencies** which leads to supervisory measures.

ABI welcomes the initiatives to **encourage the dialogue with colleges of supervisors overseas when applying supervisory stress testing to cross-border groups** (point 585). In particular, paying attention on scenarios definitions and the range of risk factors provided.

Regarding the publication of results of supervisory stress test, although this is always done by Competent Authorities, banks should consent the publication after checking that the final version is consistent with the final submission. In this regard, in point 586 which covers the publication process should be complemented with comments on that respect.

ABI is supportive on the recommendation addressed to Competent authorities according to consider appropriate timelines for conducting supervisory stress tests.

### **Stress test results as an input to calibrate P2G:**

**ABI is of the opinion that supervisory stress test outcomes may serve as a relevant input for determining P2R/P2G.** In that sense and concerning point 580, **ABI does not see the relevance of establishing a predefined target capital ratio by competent authority that defines a pass or fail.** It should be noted that such approach was last applied in 2014's EBA wide stress test exercise where no SREP program was in place.

When determining the size of Pillar 2 Guidance, the EBA draft guidelines set (paragraph 395) that competent authorities should consider the year when maximum stress impact occurs in relation to the starting point and time horizon of the scenario of stress tests. **A more holistic view on how losses are distributed over the forward-looking time horizon would be needed.** In this sense, the EBA proposal which focuses on the year when maximum stress impact could, in some cases, distorts the results.

Regarding paragraphs 385<sup>1</sup> and 580<sup>2</sup> in ABI's opinion, **the criteria that justify the following circumstances;** (1) Banks participating in the same wide-stress test exercise may have different target-levels depending on the jurisdiction; and (2) Banks participating in the same wide-stress test exercise, even in the same jurisdiction, may have different target-levels justified by idiosyncratic reasons, **should be more objectified and harmonized.** Otherwise, the EBA guidelines would leave supervisors with wide leeway to size the pillar 2G without the due transparency between the supervisor and the specific institution.

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<sup>1</sup> Paragraph 385 states: "*In cases where a pre-defined target ratio is set for a system-wide stress test (including country level stress tests) as referred to in paragraph 580, the competent authorities should assess the adequacy and quality of the institution's own funds also considering such target ratio*" and;

<sup>2</sup> Paragraph 580 states: "*Competent authorities may also consider setting pre-defined target capital ratios, especially in the context of system-wide stress tests (including country level stress tests), or setting general or idiosyncratic thresholds. In such cases, those must be suitable by taking into account the supervisory objectives....*"