

Finance Watch response to the EBA Draft Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing under Directive 2013/36/EU

Brussels, 4 February 2026

General

Q1. What are the respondents' views on the overall amendments and clarifications made to the revised guidelines (across Titles 2 – 12)?

Finance Watch supports the review of the Supervisory Review and Process (SREP) guidelines to account for the last major evolutions regarding financial risks and risk management practices. The current framework (described in Figure 1 of the draft guidelines) remains suitable and covers all relevant components of banks' risk management and governance. While new elements should be incorporated, the existing structure remains fit-for-purpose.

These guidelines should provide supervisors with a clear and streamlined framework, clarifying the expectations for conducting this exercise. As emphasised in the draft, **the SREP should maintain its risk-focused approach**, driven by the assessment of how banks identify and manage material risks. The gradual approach advocated by the European Banking Authority (EBA) in these draft guidelines, due to the current undercapacities of banks to manage ESG risks comprehensively, should not apply to ESG risks that have already been recognised as material, such as environmental risks. As new risk factors have emerged, such as geopolitical tensions, technological, and ESG factors, the EBA should assist supervisors in **developing benchmarks to evaluate banks' current emergent risk management practices**. These benchmarks could draw from common industry practices and cross-disciplinary expertise, such as the expertise of climate scientists for climate risks or geopolitical analysts for geopolitical risks.

The adoption of dynamic, forward-looking methods, such as stress testing, scenario analysis, and sensitivity analysis, has strengthened banks' risk management. However, **environmental risk factors pose intrinsic challenges due to their complexity**¹. Moreover, the non-linear interactions amongst all risk factors, known as **compound risks, can no longer be overlooked**.

¹ Finance Watch, [Bridging the gaps in climate scenarios](#), March 2025



The nascent nature of those risks, the difficulty of assessing their financial impacts, and the challenge of gathering data to quantify them may lead banks to underestimate them. The SREP is therefore a critical tool that should contribute to enhancing banks' risk management practices. **Establishing comprehensive benchmarks to discuss environmental risks with the supervised entities is crucial.** Supervisors should maintain the risk-focused nature of the exercise and ensure that any mismanaged material risks are reflected in the final capital buffer. This aligns with the precautionary principle endorsed by the European Commission for addressing climate change and its related risks.

Further, the clarifications made by the revised Guidelines with regard to the determination of the Pillar 2 requirements in cases where an institution becomes bound by the output floor are essential, in particular in the context of the current simplification debate. On the one hand, these help the supervised institutions and investors to clearly understand the differentiation and provide for transparency of the supervisory capital add-on in this respect. On the other hand, the Guidelines provisions, **supported by the earlier EBA analysis², make it clear that a possible overlap in P2R and model risk covered by the output floor is insignificant and will be addressed by the supervisors in the coming years.** This is an essential input to the current political debate around simplification and banking sector competitiveness, which should not result in weakening of the prudential safeguards.

Q2. What are the respondents' views on the integration of ESG risks and factors across the existing SREP elements in the revised guidelines?

Finance Watch supports the integration of environmental risks in all parts of SREP. Unfortunately, social and governance risks, despite possible disruptive impacts on financial assets, have been deprioritised due to the lack of capacity from banks to include them in their financial risk assessment. The EBA should not completely drop the reference to "ESG risks" to support banks' advancements in understanding and assessing the financial materiality of social and governance risks. Especially, **social risks could be embedded as an amplifier through financial transmission channels of risks related to macroeconomic downturns, geopolitical tensions or environmental events.**

On the integration of environmental risks within the SREP, Finance Watch emphasises that it will be **very challenging for supervisors to assess the quality of banks' risk management without further clarification from the EBA.** The prudential requirements remain largely short-term oriented with risk measurement mostly covering a one-year time horizon and business model analysis extending to three years, both of which are in contrast with the nature of ESG, in

² EBA/Op/2025/01, [Opinion of the European Banking Authority on interaction between Pillar 2 requirements and the output floor](#), January 2025



particular, climate risk poses a practical challenge for supervisors to define appropriate supervisory measures from the microprudential perspective.

While the EBA acknowledges the nascent and forward-looking nature of work on environmental risks, it does not adequately address the current shortcomings in banks' environmental risk management, both in environmental scenario analysis and transition plans. These include gaps in understanding financial transmission channels, the lack of robust and granular data, the underestimation of compounding effects, and the complexity of accounting for climate tipping points. These shortcomings are material, and **if banks themselves don't take into consideration these limitations by adjusting their risk and capital assessment conservatively, supervisors should use proactive measures such as increasing P2R capital** to ensure the financial stability of the institution and the continuity of its activities. For instance, supervisors could introduce a dedicated capital add-on within the P2R to specifically address transition risks arising from exposure to highly-emitting sectors, such as in particular fossil fuels companies³. This approach aligns with the prudent approach for climate risk adopted by the ECB in its supervisory priorities for 2026–2028⁴.

Then, concerning transition plans, supervisors should assess their credibility and consistency with the EBA guidelines on the management of ESG risks. These plans will be credible if they rely on credible and up-to-date data, consider targets consistent with a Net-Zero trajectory and match the bank's committed future actions.

Title 2: SREP framework

Q3. What are the respondents' views on the enhanced simplification and proportionality aspects?

As rightfully emphasised by the EBA, application of the proportionality principle should be implemented by applying a common understanding of materiality and a consistent treatment of risk across the EU, which is essential particularly in cross-border cases. Hence, Finance Watch supports the upholding of the existing categorisation of institutions for the SREP purposes. **Supervisory convergence and a robust approach to the monitoring of non-complex institutions are essential to confirm the appropriateness of the reduced frequency of the full-fledged SREP.** The SVB case has demonstrated that in a highly interconnected financial system, a failure even of a smaller institution can have systemic implications. Hence, the emphasis on the meaningful and comprehensive assessment of institutions' viability is essential.

³ Finance Watch, [A prudent approach to climate risk](#), December 2025

⁴ ECB, [Supervisory priorities 2026-28](#), 2025



Q4. What are the respondents' views on the introduction of a high-level escalation framework?

The high-level escalation framework proposed by the EBA is very relevant, and Finance Watch fully supports it. The supervisory response should, indeed, depend on the considerations listed in paragraph 22, highlighting especially the importance of considering the severity of the deficiencies (point b), the ability and intention of the institution to remediate the deficiencies (point c) and the risk of self-reinforcing leading to higher risks (point e). However, the selection of the actions from the high-level escalation framework shouldn't depend on the category (nature, size and complexity) of the institution, which is relevant only for the frequency and engagement intensity of the conducted exercise. Actions by the supervisors to address deficiencies should account only for the characteristics and materiality of these deficiencies, maintaining the risk-focused dimension of the exercise.

Finance Watch proposes to amend paragraph 22 as follows:

"22. When selecting measures, competent authorities should identify the full escalation path, taking into account the information available ~~and the nature, size and complexity of the institution~~. The selection should be guided by the following considerations, as applicable:..."

Title 3: Monitoring of key indicators

Q5. Do you consider the coverage and level of detail of this Title appropriate for its intended Purpose?

Finance Watch supports the inclusion of macroeconomic indicators into the supervisory monitoring and sees the need for a minimum harmonisation of indicators to be included. Macroeconomic and geopolitical shocks impact the whole economy. Hence, macroeconomic indicator monitoring is an essential early-warning system for the banking system, as weak economic fundamentals eventually translate into risks for the banks. The selection of such indicators should be done in collaboration with macroprudential supervisors or alternatively a closer supervisory dialogue should be established between micro- and macroprudential authorities.

Title 4: Business model analysis



Q6. Do you consider the coverage and level of detail of this Title appropriate for its intended Purpose?

The latest EBA Guidelines on environmental scenario analysis request banks to consider ESG impacts on their business model over a time horizon of at least 10 years. ESG risks will interact with other macroeconomic developments and will act as an amplifier of their potential impact. Therefore, under Title 4, **supervisors should assess the sustainability of the institution's strategy and business model no longer over a period of 3 years, but over at least 10 years to account for climate dynamics**. It is important to integrate ESG dynamics under the same scenarios as the institutions' business planning to get a comprehensive understanding of the possible future evolutions of banks' business. Under the current version, the draft guidelines seem to ask supervisors to assess the sustainability of the institution's strategy over a period of 3 years for classic risks and 10 years for ESG risks. This represents an inconsistency and raises the concern that the results of the ESG part of the analysis will not be incorporated into the overall SREP result. The regulator should clarify this point in paragraph 56 b), and change it to "a forward-looking period of at least ~~three~~ 10 years".

Finance Watch supports the inclusion of prudential transition plans in the business model analysis component. These plans are a key tool for understanding a bank's future direction and the risks it may encounter. While it is crucial to consider them when evaluating a bank's future business model, supervisors should first **assess the credibility of the bank's transition plan and its understanding of the risks associated with it**. Competent authorities should confirm that data used by the banks to define their plan are relevant, up-to-date and credible, and that the plan complies with EBA Guidelines on the management of ESG risks. Supervisors should also ensure the consistency between this plan and the bank's future commitments and assess its evolution.

Title 5: Assessing internal governance

Q7. What are the respondents' views on the updated section 5.7 "ICT systems, risk data aggregation and risk reporting"?

General comment on Title 5: We refer to Finance Watch proposals on enhancing the remuneration guidelines for institutions to foster long-term decision-making and business model sustainability - see the position paper "Strengthening corporate governance rules for sound risk management practices"⁵.

⁵ Finance Watch, [Strengthening corporate governance rules for sound risk management practices](#), November 2025



Title 6.2: Assessment of credit and counterparty risk

Q8. Do you consider the coverage and level of detail of this Title appropriate for its intended Purpose?

Finance Watch supports the EBA's vision for integrating environmental factors and associated risks into credit risk management. To avoid any misunderstanding, ESG risks should clearly be mentioned in the relevant risk sub-categories of credit risk in paragraph 140:

"140. To assess the nature of credit risk, competent authorities should consider at least the following subcategories of credit risk by carrying out a more detailed assessment of those subcategories which are considered most relevant for the institution:

j. ESG risks, initially prioritising environmental risks."

Moreover, it is essential to consider forward-looking and distinct time horizons when assessing environmental risks. The EBA should specify that **ESG factors face radical uncertainty**, which makes them complex to model. Supervisors should ensure that **conservative estimates have been made by the banks to minimise the impact of this uncertainty** in the modelling. We recommend the following adjustment to paragraph 149:

"149. When assessing the impact of ESG factors and ESG risks on the inherent credit risk, competent authorities should aim at taking into account the specific characteristics of these risks such as their forward-looking nature, **their radical uncertainty** and distinct impacts over various time horizons and developing their capacity to factor in these characteristics into their assessment, giving priority to environmental factors and risks."

Title 6.3: Assessment of market risk

Q9. Do you agree with the treatment proposed to account for transfer pricing risk in the context of trading book activities? Please elaborate.

NA

Title 6.4: Assessment of operational risk

Q10. What are the respondents' views on the integration of the EBA GL on ICT risk assessment under the SREP (EBA/GL/2017/05) and DORA aspects?

NA



Q11. What are the respondents' views on the introduction of operational resilience (section 6.4.5)?

NA

Title 6.5: Assessment of IRRBB and CSRBB

Q12. What are respondents' views on the additional section on CSRBB and the combined score for IRRBB and CSRBB?

NA

Title 7: SREP capital assessment

Q13. What are the respondents' views on the proposed assessment of the interaction between Pillar 1 and Pillar 2 requirements and on the proposed approach for operationalising concerning cases where an institution becomes bound by the output floor?

The Pillar 2 framework enables banks to adopt a more dynamic and forward-looking approach compared to Pillar 1. This is particularly well-suited for addressing emerging risks, such as ESG and technological factors. Additionally, the Pillar 2 approach allows for the consideration of compounding effects among multiple risk factors. Therefore, the Pillar 2 approach needs to be fostered to enable a comprehensive risk management of the institution's own risks. It will require transparent engagement between banks and supervisors and a clear, consistent, risk-sensitive supervisory process.

Determination of Pillar 2 Requirement (P2R)

Finance Watch agrees with the specification of risks to be covered by the P2R provided by the EBA in paragraph 301: the risk of expected or unexpected losses not sufficiently covered under the Pillar 1 approach, model deficiencies of internal approaches, and other deficiencies in risk management approaches. Concerning risk not sufficiently covered under the Pillar 1 approach, such as emerging risks, **the EBA should clearly mention under the section "7.1 General considerations" that, as the modelling and assessment of these risks still face a lot of uncertainties, competent authorities should follow a prudent approach to reduce the potential impact of these uncertainties** on the financial health of an institution and to ensure institution's business model sustainability. We made a case for climate risk by proposing to



increase P2R capital to cover climate risk (application of a buffer to cover transition risks from stranded assets)⁶, see our response to question 2 above.

Under paragraph 311, the EBA should clarify in which cases supervisors could deem a bank's ICAAP calculation as being "highly credible" despite not meeting all the criteria of paragraph 309. Particularly, if the second criterion of paragraph 309 (credibility) is not fully met, the bank's ICAAP cannot be considered reliable even partially. Therefore, **not meeting the credibility criteria of paragraph 309 should lead to precautionary supervisory measures such as the ones described in Table 16** (Potential and non-exhaustive supervisory measures for capital adequacy), ensuring, de facto, the resilience of the institution.

Supervisory benchmarks and other relevant inputs

The development of prudent, consistent, transparent and comparable benchmarks to challenge and assess bank ICAAP calculations for material risks will be highly beneficial for the supervisors, fostering transparency in their engagement with supervised institutions and facilitating more time-efficient conclusions. We also support the use of other relevant inputs, such as peer-group comparisons and reports from other supervisory authorities. When applying to cross-disciplinary risks, such as geopolitical, climate, biodiversity, social, etc, benchmarks and relevant inputs should include reports or insights from respective subject matter experts. We propose to add a point in the paragraph below:

305. "Competent authorities should rely on the following sources of information:

d. for emerging risks, reports from relevant expert bodies, such as the European Environment Agency or the European Scientific Advisory Board on Climate Change (for environmental risks in particular)."

This addition is aligned with the provisions of the CRD Article 76(2) which mandate the use of the report of the European Scientific Advisory Board for the purposes of ESG risk management and transition planning.

Interaction with the Output floor

Finance Watch welcomes the clarifications for operationalising the Pillar 2 requirements in cases where an institution becomes bound by the output floor. The interaction between P2R and the output floor needs to be managed to avoid double-counting. Finance Watch agrees with the EBA that while the review of the overlap between P2R and the output floor is assessed, the P2R should

⁶ Finance Watch, [A prudent approach to climate risk](#), December 2025



be applied to the Unfloored Total Risk Exposure Amount (U-TREA), but **only for the P2R components related to model deficiencies from the use of internal models** accounted in the previous SREP exercise. The output floor ensures a minimum level of conservatism and comparability across banks regarding their TREA and is not designed to capture other risks not covered by Pillar 1, which are covered by other components of P2R. The clarifications provided in the revised Guidelines are helpful for the supervised institutions and investors to clearly understand the differentiation and provide for transparency of the supervisory capital add-on in this respect. On the other hand, the Guidelines provisions, supported by the earlier EBA analysis, make it clear that a possible overlap in P2R and model risk covered by the output floor is likely insignificant. We support the EBA's willingness to review the interaction between P2R and the Output Floor "without delay, and no later than the end date of the next SREP", to get a closer assessment of which model deficiencies will already be covered by the output floor and then should be removed from P2R.

Interaction with capital buffers

335. Finance Watch argues that P2R and P2G don't fit the same objective as capital buffers (CCB, CCyB, G-SIB, SyRB). P2R and P2G are tailored to individual institutions and designed to address idiosyncratic risks faced by banks. In contrast, macroprudential buffers aim to bolster financial stability through the mitigation of potential systemic risks by building additional loss-absorption capacity or preventing risk build-up. For example, a natural catastrophe may pose a direct financial risk to specific banks, while climate change could trigger a broader societal shift, creating systemic risks that affect the entire banking sector. From an individual bank's perspective, such systemic risks cannot be assessed as they fall outside its immediate control, require the views of contagion channels through the financial sector, and a holistic view to assess the real size of the shock. Therefore, competent authorities must address these risks by requiring all relevant banks to build additional financial capacity, safeguarding the entire system from a systemic failure.

Determination of Pillar 2 Guidance (P2G)

Supervisors must consider compound risks (ie. simultaneous or consecutive events that cause non-linear impacts on banks' balance sheets) in their supervisory stress tests to have a comprehensive assessment of institutions' ability to withstand stress. We propose the following amendment to paragraph 356:

"356. For the purpose of determining P2G, competent authorities should also consider the extent to which stress scenarios cover all the material risks contributing to the P2R in TSCR. Competent authorities should in particular have regard to the fact that macroeconomic downturn scenarios



may not entirely capture some risks, for example pension risk, **non-linear interactions with other risk factors**, or some elements of credit concentration risk (e.g. single name concentration), that may amplify potential losses under the tested adverse scenarios.”

Title 8: Assessing risks to liquidity and funding and SREP liquidity and funding assessment

Q14. What are the respondents’ views on the merger with the ‘SREP liquidity assessment’ and the merger of the scores into a combined liquidity and funding adequacy score?

NA

Title 9: Overall SREP assessment and communication

Q15. What are the respondents’ views in relation to enhanced communication aspects?

NA

Title 10: Application of the SREP to cross-border groups

Q16. Do you consider the coverage and level of detail of this Title appropriate for its intended Purpose?

Finance Watch supports the evaluation of the viability of a group at the aggregated level, as well as at the level of its individual entities. Concerning the viability of the whole group, cross-border consolidation of all exposures within financial conglomerates is a key basis for evaluating material risks. While the current review rightly covers capital adequacy and excessive leverage, **it should also address risk concentration and contagion channels that emerge from integrating all entities of a group**. A stronger, more systematic focus on both cross-border and cross-sectoral entities within a group would improve supervisors’ capacity to identify and manage emerging risks from a prudential perspective.

Title 11: Supervisory stress testing

Q17. Do you consider the coverage and level of detail of this Title appropriate for its intended Purpose?

NA





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Title 12: Assessing third-country branches

Q18. Do respondents consider the guidance for the assessment of third-country branches appropriate and sufficiently clear?

NA



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