Comments

EBA Consultation Paper - Draft Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing under Directive 2013/36/EU (EBA/CP/2021/26)

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent almost all German banks.

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General comments

We welcome the opportunity to comment on the review of the SREP Guidelines. Before setting out our comments in detail, we would like to make a few general comments on the draft version of the Guidelines:

In general, we welcome both the decision to update the SREP Guidelines and the overarching objectives pursued, namely

- to increase convergence of practices followed by competent authorities across the EU, including their supervisory stress testing processes pursuant to Article 100 CRD and
- to align the SREP Guidelines with other relevant EBA guidelines and technical standards and to update the Guidelines by incorporating tried-and-tested procedures and by taking account of current supervisory practice.

Nevertheless, the draft version of the Guidelines contains specific provisions that go further than the EU Directive (CRD). In addition, the fact that the scope of provisions set out in the Guidelines has been expanded yet again causes concerns that proportionality aspects under Pillar 2 will be pushed further into the background. The detailed requirements, particularly those set out in Titles 5, 6 and 8, in conjunction with the other Pillar 2-related EBA guidelines referred to, which are themselves becoming increasingly extensive and prescriptive, make the catalogue of requirements to be checked too complex overall, especially for smaller to medium-sized institutions. This will, in all likelihood, not only serve to increase the workload for supervisory authorities disproportionately, but will also have an indirect impact on institutions, for example due to increased documentation/reporting requirements, more intensive reviews or the even more frequent use of surveys.

With the adjustments made in Title 2 and the isolated opening clauses in the other Titles, the Guidelines provide only inadequate information on how a streamlined SREP could be structured for smaller institutions that have less complex business activities and are exposed to lower risks. In our view, the mandate set out in Article 97(4a) CRD V, namely the need to specify criteria regarding how supervisory authorities can implement adapted (harmonised) procedures for institutions with a similar risk profile, has also not yet been taken into account.

With regard to the new requirements in Title 7 on the P2R/P2G leverage ratio, we would like to request in general that the supervisory authorities be permitted to address these aspects in a pragmatic and proportionate manner. In our view, the vast majority of institutions do not have any risks of excessive leverage associated with their business models and business activities. As a result, defining a P2R-LR and/or a P2G-LR should only be required in singular cases. Consequently, the additional requirement for the SREP should not produce any unnecessary additional work for supervisory authorities and institutions. Additional information requirements, a separate supervisory leverage ratio stress test or similar measures should only be necessary – if at all – for institutions if the supervisory assessment conducted in accordance with Title 7.3.1 flags up material indications pointing to risks of excessive leverage. At all other institutions, the new requirements should be implemented as part of a process that is as streamlined as possible. We recommend that clarifications be included to this effect.

From a formal perspective, it is not clear why the content of Title 5.2 refers to the revised Guidelines on sound remuneration policies (EBA/GL/2021/04) in terms of content, but at the same time still refers to the previous version from 2015 (EBA/GL/2015/22). As the more far-reaching requirements set out in the updated Guidelines are already used as a basis (e.g. with regard to monitoring the gender pay gap), reference should be adjusted, i.e. made to the 2021 Guidelines. Otherwise, the more far-reaching contents would have to be deleted from the draft.

We would also like to point out that the EBA Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 (EBA/GL/2016/11) have been superseded by the Implementing Regulation laying down implementing technical standards with regard to public disclosures under Part Eight CRR (2021/637). We ask that this be corrected in the appropriate parts of the text.

The same applies to the EBA Guidelines on disclosure of encumbered and unencumbered assets (EBA/GL/2014/03), which were replaced by Implementing Regulation 2021/637.

We also ask that paragraph 625 be deleted, as disclosure requirements in this regard are already extensively covered by Part Eight CRR in conjunction with Implementing Regulation 2021/637.

Specific comments

Title 1. Subject matter, definitions, level of application and implementation

Paragraphs 14 and 15
The planned date of application of the revised SREP Guidelines is not clear. As they are unlikely to be finalised, and the translations made available, until the beginning of 2022, the Guidelines should not enter into force until 1 January 2023.

Title 2. The common SREP

Title 2.1.1
The complexity criteria pursuant to Article 4(1) no. 145 CRR II were defined primarily for the purposes of granting reporting and disclosure relief and are not necessarily significant/suitable with regard to Pillar 2 aspects. With this in mind, consideration should be given as to whether this classification can be used without restriction for the purposes of the SREP. It would make sense to include an opening clause so that the supervisory authority can also apply other, potentially more relevant criteria and classify an institution as a category 4 institution even if single CRR criteria are not met. Relevant criteria could include those referred to in the "EBA discussion paper on proportionality assessment methodology", such as the institution's business model.

Paragraph 53
According to paragraph 53 "the scope and depth of the review of the individual SREP elements should be tailored to the specific risk profile of the institution" as far as category 4 banks are concerned. While we think that this should be the case for all banks, the wording is not very precise. If the paragraph is to provide relief for small banks, this needs to be described in more specific terms.

Question 1: How could the guidelines be further simplified in a way that appropriate focus of assessment is allowed while preserving the comprehensiveness of the assessment and ensuring that all aspects are sufficiently covered?

Initial starting points for a more streamlined SREP approach are mentioned primarily in paragraphs 54, 56 and 58. These are not sufficient, however, particularly as Table 1 requires an "Assessment of all SREP elements (at least)" every three years, even for smaller institutions. It remains unclear which of the numerous individual aspects set out, inter alia, in Titles 5, 6 and 8 (which are expanded even further by references to further EBA guidelines), supervisors are permitted to disregard or consolidate, for example, when assessing category 3 and category 4 institutions. At the very least, clarification should be included that this refers to the main elements of the SREP and not to all of the individual criteria mentioned in the Guidelines.

Paragraph 54 merely refers to Article 97(4a) CRD V. The EBA was, however, mandated in that Article to define criteria on how supervisory authorities could implement adapted (harmonised) procedures for institutions with a similar risk profile. In our view, this is currently not reflected in the Guidelines. The draft version of the Guidelines as a whole does not yet meet the objective of strengthening proportionality set out in the "Risk Reduction Package Roadmaps" of 21 November 2019.

The CRR II not only differentiates between "small and non-complex" institutions, but also makes distinctions based on capital market orientation, which results in additional relief (at least with regard to disclosure) – the distinction could also be made in these Guidelines.

All applicable standards and guidelines that are currently in force should be known to supervisors as well as to institutions. It is therefore appropriate to add cross-references to them, whilst merely repeating contents from other guidelines in the SREP Guidelines (e.g. as in paragraph 170) should be avoided. The SREP GL would be clearer without these repeated references. If the EBA does see a need to provide an overview of the relevant guidelines, these could simply be stated in the form of a list or table at the beginning of the document.

Title 5. Assessing internal governance and institution-wide controls

<u>Paragraph 101(e)</u>
Based on the draft version of the Guidelines, the authorities are to assess whether a selection and suitability assessment process for the members of the management body and key function holders has been implemented. This means that key function holders are included in the scope of application of the fit and proper requirements – something that we already criticised in the context of the EBA/ESMA Guidelines on the assessment of the suitability of members of the management body and key function holders. Our opinion, however, is that there is no legal basis, especially not in the CRD, for treating key function holders in the same way as members of the management body. As a result, the reference to key function holders should be removed from the SREP Guidelines.

<u>Paragraph 102(c)</u>
The draft states that an assessment is to be performed to determine whether a diversity policy has been implemented and whether the SIs have set quantitative targets for the representation of the underrepresented gender. Institutions that cannot exert any influence over the composition of the supervisory body (especially public-law institutions) cannot ensure any other degree of diversity than that resulting from election outcomes, appointments or by virtue of office. As a result, no requirements that extend beyond existing national requirements should be imposed on institutions and their supervisory

body members. Accordingly, a diversity policy cannot be implemented for supervisory body members in such cases.

Insofar as the implementation of a diversity policy in the management body *and more generally in the institution's recruitment policy* is imposed as a requirement, this is too vague and also extends beyond the requirements underlying the final report on the joint EBA and ESMA Guidelines (ESMA35-36-2319; EBA/GL/2021/06). This is because the aforementioned Guidelines require the implementation of a diversity policy exclusively with regard to the appointment of the management body or the selection of candidates from an appropriately diverse pool of candidates.

The institution's recruitment policy in general has, at the very most, an indirect impact on the composition of the management body and is non-discriminatory anyway, also due to existing statutory requirements on non-discrimination. The extension of the diversity policy contained in the draft, which according to the aforementioned joint EBA and ESMA Guidelines should also include aspects such as educational background, age and geographical provenance, to include the institution's general recruitment policy is not necessary to achieve the objective of a balanced composition of the management body set out in the joint EBA and ESMA Guidelines. A general recruitment policy that differentiates based on the aspects defined in the diversity policy (e.g. age) in order to achieve the most diverse workforce possible is also likely to conflict with national and European anti-discrimination regulations. The wording following the half sentence *"the management body has implemented a diversity policy to promote diversity on the management body"* should therefore be deleted, simplifying the Guidelines at the same time.

<u>Paragraph 104(e)</u>

The requirement that institutions must have implemented independent internal whistleblowing procedures and processes that allow employees to submit information *anonymously* does not match the requirements set out in the underlying EU Whistleblowing Directive 2019/1937. Whereas, pursuant to Article 9(1a) in conjunction with Article 16, the European Directive only refers to ensuring *confidentiality of identity*, the current draft assumes the option of submitting information anonymously as part of an internal procedure. Ensuring anonymity is not, however, required by the underlying European legal act. This is also understandable and makes sense, because anonymous reports make it more difficult, or even impossible, to clarify the facts of a case, as it is not possible to ask the whistleblower further questions about his/her report. There is also no need to guarantee the whistleblower full anonymity, as he or she is afforded sufficient protection from reprisals by the safeguards provided for in the Whistleblowing Directive/the national transposing act.

Consequently, there is no basis for applying a different standard to the SREP Guidelines. Confidentiality of identity should also be used as a standard here by revising paragraph 104(e) as follows:

> *„[…], die es ermöglichen, Informationen unter Wahrung der Vertraulichkeit der Identität zu übermitteln.*"
>
> or
>
> *„[…] that allow information to be submitted while ensuring that the confidentiality of the identity is protected.*"

<u>Paragraph 104(h)</u>

Pursuant to the draft version of the provision, the authorities are to check that the institutions ensure that there is no discrimination of staff and that there are equal opportunities for all genders. In our view, this does not require the institutions to have their own anti-discrimination policies in place to achieve this objective.

Paragraph 107(b)
The risk management function is supposed to ensure that the risk strategy is complied with. In our view, this is not something that can be ensured by the risk management function alone. Rather, compliance with the risk strategy is also the responsibility of the management body and the senior management team, in particular. We therefore request that the word "promotes" be used instead of "ensures".

Paragraph 112(h)
The reference to the head of compliance in this sub-item should be deleted, as this function is responsible for monitoring compliance with legal regulations and does not have to be involved in risk management decisions by default.

Paragraph 129(a), paragraph 137 *inter alia*
The requirements could be misinterpreted as meaning that there always has to be a link between a bank's internal stress test results and its risk appetite and limits. In our view, this would go too far. Institutions should check their stress test outcomes to identify potential impetus for their risk management. The results are generally not, however, suitable for overall bank management in normal periods, and stress effects resulting from internal bank processes do not have to be backed by internal capital in the ICAAP. In this respect, a distinction is to be made between risk measurement and management on the one hand, and stress testing on the other.
With this in mind, it would generally make more sense to use the wording "internal stress tests done in the context of capital and liquidity risk management" instead of "stress tests done for ICAAP and ILAAP purposes".

Title 6. Assessing risks to capital

Paragraph 158
The addition of step-in risk should be dispensed with. The risks described in BCBS 423 are sufficiently covered by the categories previously mentioned (reputational risk, strategic and business risk). As the governance guidelines do not mention step-in risks, they should not be included in the SREP Guidelines either.

Paragraph 145 (old version) and paragraph 146 (old version)
Unlike the standardised CRR requirements, Pillar 2 and the ICAAP are designed to ensure that risk assessment and management is institution-specific. As a result, we are opposed to the deletion of paragraphs 145 and 146, as we consider it preferable to maintain the flexibility that is necessary and meaningful here. There are various risk sub-categories that cannot be clearly allocated to a specific risk type and whose allocation can also vary from institution to institution. The excessively detailed division of risks into sub-categories does not make sense across the board either. Details and examples of this can be found in our comments on paragraphs 181 and 238.
The SREP should follow the individual risk categorisation for all institutions that implement an ICAAP that is transparent and appropriate overall. Based on the information available to us, this is precisely why the risk taxonomy developed by the EBA is to be used for internal supervisory purposes only and is not to be disclosed to the banking industry.

Paragraph 181
The proposed adjustment creates three additional sub-categories of credit risk which we doubt make sense:

- Equity risk in the banking book: While it is currently still possible to obtain IRBA approval for equity risks, this will no longer be possible in the course of the implementation of Basel III in Europe, also because virtually no institutions have made use of this option. This is also because this risk is not a conventional credit risk. Depending on the investment (e.g. listed shares), the focus from a supervisory perspective could also be more on market risks. It should therefore be possible for the "competent authority" to take this into account in the SREP.
- Real estate risk: In line with the definition provided in paragraph 201, we understand this risk as referring to the investment (price) risk that arises when investing in the institution's own real estate (on its own balance sheet or via subsidiaries). These investments can also be seen as an opportunity to broaden and diversify an institution's earnings and, in doing so, make a business model more sustainable. In this respect, it is not primarily or necessarily a credit risk, but could also be classified as a risk category in its own right ("other risks" in accordance with paragraph 158) or addressed as a sub-category of market risk.
- Model risk for regulatory approved models: In the context of credit risk, this can only refer to IRBA and CCR models under Pillar 1 that have been approved by the supervisory authorities. Scenarios in which risks are underestimated are not to be expected on a large scale due to the ongoing model review process, which also looks at ongoing compliance with the qualitative minimum requirements. As a result, this category can be deleted. In addition, any model deficiencies can already be addressed using add-ons under Pillar 1 (meaning that the additional wording in paragraph 385 can also be dispensed with). It can also be assumed that these risks are already taken into account sufficiently in Pillar 2 by addressing model risks as operational risks.

At the very least, opening clauses allowing the option of individual allocation should be added.

Paragraph 196
The text mentions the EBA Guidelines on loan origination and monitoring. The footnote, however, refers to the EBA Guidelines on non-performing and forborne exposures. It should be clarified which guidelines are being referred to here.

Paragraph 238
The proposed adjustment provides for the introduction of new market risk sub-categories including non-delta risk, basis risk and market liquidity risk. Without wishing to call the potential materiality of these risks into question, there is nevertheless no need for these separate sub-categories, as they are already covered by the sub-categories a. to e. The separation of these sub-categories is not consistent with practical application within the institutions. As a result, we ask that they be deleted.
In our view, it would also be preferable if the definition of market risk and the associated sub-categories were based consistently on the relevant risk drivers and did not use other criteria, such as assignment to the trading book. This could then ensure more consistent treatment of the different types of market risk (for example, all equity and credit spread risks could be included in market risk, regardless of whether the corresponding positions belong to the trading or banking book).

Alternatively, and as suggested earlier, the deletion of paragraphs 145 and 146 could be dropped; these paragraphs could also be applied to other risk types so as to enable greater flexibility and take better account of cases particular to the institution where appropriate, and also to create the option of a purely economic assessment in Pillar 2.

<u>Title 6.4</u>
AML/TF: While the intention to incorporate AML and TF aspects is understandable, any overlap with risks covered and capitalised in the normative perspective ("Pillar 1") as operational risk must be avoided. It is also unclear how exactly AML and TF are included in the SREP scores.

<u>Paragraph 329</u>
Based on the proposed provision, it would appear that CSRBB is to be treated as a separate risk category. This is not consistent with predominant industry practice and institutions should not be asked to treat or report it as a separate risk: some institutions, for example, do not treat credit spread risks as a separate type of risk in their internal (market price risk) procedures, but rather as an integral component of interest rate risk and, consequently, of overall market price risk. Other institutions address credit spread risks separately from IRRBB as a component of counterparty credit risk for measurement and management purposes. This means that no specific supervisory requirements should be imposed on where, or using which procedures, institutions have to measure and manage their credit spread risks as a general rule.

Title 7. SREP capital assessment

<u>Paragraph 366</u>
The wording of this paragraph could be misleading. We ask for clarification that the wording is intended to refer to the existing requirements under the CRR (and not to a new category of additional own funds requirements for unexpected losses). Suggested wording:
"When setting additional own funds requirements for the risk of unexpected losses <u>according to paragraph 365(a)</u> …"

<u>Paragraph 368</u>
While we welcome the opening clause that has been added here, the current wording could be interpreted too narrowly. We recommend that the second sentence be adjusted as follows:

"In ~~exceptional~~ cases where it is <u>not necessary in view of the institution's risk profile or</u> overly burdensome, especially for small institutions, to meaningfully disentangle the amount of capital considered adequate for two or more types of risk quantified together, competent authorities should comply with the first sentence of this paragraph on a best effort basis, using …"

According to paragraph 368, the risk categories set out in Articles 79 to 85 CRD under Pillar 2 are to be compared with the corresponding Pillar 1 risk categories as part of what is known as the risk-by-risk approach (with Pillar 1 as the floor). We do not consider the aforementioned Pillar 1 floor to make sense, as it fails to take existing excessive risk exposures under Pillar 1 into account, especially when standardised supervisory approaches (for example, the current and the future CRR III credit risk standardised approach) are used, which is why we propose that this requirement be deleted. Apart from this, the risk categories set out in Articles 79 to 85 (credit risk and CCR, residual risk (referring to the reduced effectiveness of CRM techniques), concentration risk, securitisation risk, market risk, IRRBB and OpRisk) also contain individual categories for which this sort of comparison does not make sense, or is not even possible in the first place. It should be dropped for the residual risk and concentration risk categories at the very least:

- "Residual risk" is an intrinsic part of the "credit risk and CCR" category and is already covered adequately by that category in quantitative terms. In addition, it is virtually impossible to separate this risk.
- "Concentration risk" is not a risk category in its own right. Even if it were possible to quantify these risks under Pillar 2, there are no capital requirements for the purposes of a comparison under Pillar 1.

A supplementary note on the IRRBB: As is generally known, there are no explicit capital requirements for IRRBB in Pillar 1. A "comparison" in the narrower sense of the term cannot be made here, meaning that it should also be omitted.

Paragraph 388

Article 104a(1e) CRD V does not set any deadline by which a P2R should be imposed on an institution after repeated non-compliance with the P2G. There is neither a legal basis nor are there objective grounds for requiring a P2R to be imposed after two years at the latest. The supervisory authorities should be granted a certain degree of flexibility and this specification should be dropped.

Question 2: Do you think that the proposed overall framework for setting additional own funds requirements appropriately incorporates the ICAAP information and estimates?

No. Based on the current draft, unfortunately only a loose connection between the ICAAP, as the basis for the supervisory analysis, and the final P2R would remain. The idea currently is for the ICAAP to also serve as a quantitative basis for the SREP. From our perspective, this sort of fundamental approach still makes sense, as explained above. This is now to be replaced by wording such as "take into consideration", "use" or "support" which would create scope for an arbitrary approach for the SREP that goes much too far and leaves the door wide open for supervisors to establish very different approaches to "their" SREP. Consequently, the idea runs contrary to the idea of a consistent European approach to the SREP being adopted by the competent authority and could serve to distort competition. The degrees of freedom created here – presumably, among other things, to open up considerable scope for supervisory benchmark models (paragraph 369(c)) – clearly go too far.

Most banks have been investing in the reliability of their ICAAPs for decades. Strengthening the institutions' ICAAPs has always been an important goal for the supervisors, which is why the ICAAP should remain the main starting point for the quantification of individual risks and the determination of the P2R. Only overall inadequate and unreliable ICAAPs should be supplemented by supervisory benchmarks. In all other cases, the imprecise nature of benchmarks would lead to overly conservative measures if they were to be introduced. The EBA should therefore describe in detail when ICAAPs are deemed to be generally unreliable and when, as a result, benchmarks are to be introduced, while in all other cases the ICAAP should be the main starting point for the determination of the P2R. As a result, we take the view that the sources of information referred to in paragraph 369 should only be used as supplementary sources; the primary role of the ICAAP should be retained.

Question 3: Do you agree with the proposed clarifications on the assessment of the risk of excessive leverage?

In general, we recommend that the supervisory authorities adopt a pragmatic approach to assessing risks of excessive leverage. In our view, the business models and business activities of the vast majority of institutions do not entail such risks, and imposing a P2R-LR and/or a P2G-LR should ultimately only be necessary in singular cases. Additional information requirements, a separate supervisory leverage ratio stress test or similar measures are only likely to be necessary – if at all – for institutions if the supervisory assessment flags up material indications pointing to risks of excessive leverage. For all other institutions, the requirements relating to the leverage ratio should be implemented as part of a system that is as streamlined as possible so as not to produce any unnecessary additional work for supervisory authorities and institutions alike. The reference in paragraph 397 to the fact that available sources of information should be used should be positioned more prominently within the text and, where appropriate, further information should be added on proportionate implementation options.

In addition, the relevant requirements should make it clearer that a P2R-LR and P2G-LR that is greater than zero does not need to be set by default (e.g. by adding "where necessary / applicable" in paragraphs 394, 398, 404 b, 409 b, 411 and 424). A P2R-LR should only be applied to outlier institutions with a demonstrable risk of excessive leverage, meaning that this can only be the exception and not the rule. In our view, the competent supervisory authorities should also only take action to mitigate the risk of excessive leverage if it is possible to demonstrate that this could have a significant negative impact on the *sustainability* and *viability* of the business model <u>and</u> if this risk, which is potentially inherent in the institution's business model, is not already addressed by other action taken by the institution or under Pillar 1. The competent supervisory authority should adopt a neutral stance vis-à-vis business models as a matter of principle. This should be clarified in paragraphs 392/393.

In order to foster a better understanding of the various capital requirements/ratios (P2R, TSCR, OCR, P2G, P2R-LR, TSLRR, OLRR, P2G-LR), it would be helpful to include a graphic of the two "stacks" based on the previous Figure 6.

<u>Paragraph 393</u>
We do not agree with the vast majority of the proposed examples. Letters a. to d. of paragraph 393 mention a number of "aspects" that are to be taken into account when assessing the "risk of excessive leverage", even though these aspects have no legal basis. In the relevant Article 4(1) no. 94 CRR, this risk is defined relatively narrowly as follows:
'risk of excessive leverage' means the risk resulting from an institution's vulnerability due to leverage or contingent leverage that may require unintended corrective measures to its business plan, including distressed selling of assets which might result in losses or in valuation adjustments to its remaining assets'

This definition is based on the central assumption that the observed institution-specific leverage ratio includes the risk that corrective action will be required due to a potential breach of the minimum leverage ratio requirement of 3%, which could lead to additional (fire sale) losses. Situations in which the institution operates close to the lower limit or has to tolerate a very volatile leverage ratio due to the nature of the business model can therefore be identified as causes of the "risk of excessive leverage". These situations are covered by c. and d. In our opinion, however, neither the three aspects mentioned under a. nor the aspects in point b. can be summarised under the level 1 definition set out above, meaning that they have to be removed.

The content of a. and b. is also partly unclear/incomprehensible, for example:

- Paragraph 393(a)(i) It remains unclear how supervisors will decide whether the products concerned are optimisations or not. The minimum requirement for the leverage ratio was only introduced with CRR 2 with effect from 28 June 2021. Daily SFT value reporting has also been introduced. Before requesting SREP measures, this future reporting should be monitored and evaluated; if any anomalies emerge, the supervisory authority should ensure transparency which would then serve as a starting point for dialogue between the supervisory authority and the bank.

- Paragraph 393(a)(iii) There is no definition of what "highly exposed" means.
- Paragraph 393(b) Non-compliance with the leverage ratio should not be addressed within the P2R-LR, but needs to be addressed by other regulatory measures. Otherwise, compliant exclusions as defined in the CRR should not be undermined by the SREP GL.

Furthermore, Article 429a CRR explicitly provides for exemptions for authorised exposure. We fear that the exceptions provided for by the legislator will be undermined by these Guidelines. The use of those exceptions cannot be regarded as evidence of a risk of excessive leverage per se. In this context, it must only be verified that the prerequisites for making use of an exception are met. The leverage ratio is a non-risk sensitive measure by nature and the SREP Guidelines should not try to make it risk sensitive by introducing adjustments that were deliberately not taken into account when establishing the leverage ratio.

Competent authorities should perform a test run in the upcoming SREP cycle to double check whether the defined approach can be applied proportionately. Setting binding P2R-LRs should only follow as a second step.

Question 4: Do you think that the assessment of dimensions and indicators described in this explanatory box would also be relevant for the assessment of the risk of excessive leverage? Are there any other elements / indicators that you are using in the assessment of this risk?

No, further indicators do not seem to be appropriate. As a result, we welcome the fact that the examples discussed in the explanatory box are not included in the draft SREP Guidelines, as none of them can be summarised under the authoritative definition of "risk of excessive leverage" provided in Article 4(1) no. 94 CRR. In our opinion, a link to "leverage risk" based on the CRR definition cannot be meaningfully drawn in these examples. What is more, the aspects mentioned are already taken into account elsewhere.

Question 5: Can you provide examples of situations which in your view might require CET1 instead of other capital instruments to cover potential losses in relation to P2R and P2R-LR?

The proportion of CET1 for the P2R specified in Article 104a CRD V and the requirements for the P2R-LR comply with the requirements set out in Article 92 CRR. In our opinion, more stringent requirements (i.e. higher CET1 ratios) are generally not necessary and should be limited to justified individual cases, as provided for in the wording of the Directive. We do not believe that there are any generally applicable examples of situations or that there is any need for more detailed regulations.

Question 6: Would you consider the introduction of a standardised template for the communication to the supervised institution of the outcome of the SREP to be beneficial?

The competent authorities should be encouraged to provide a structured template for the communication of P2R, P2R-LR, P2G and P2G-LR. The main driver of the structure of such templates should be transparency. Institutions need **detailed information on the basis/methods for determining** the Pillar 2 capital requirements imposed so they can address them appropriately. That is, institutions must be informed which risk types, deficiencies, benchmarks, etc. contribute to the given determination of P2R, etc. and to what extent. In this context, a list of all items/risks examined (including references) would increase comparability and traceability for institutions. Overall, benchmarking across institutions, where performed, and benchmarking results should be made more transparent.

Setting standardisation objectives aside, however, it is crucial to maintain the individual assessment and diversity of the institutions and business models. Since these can differ from country to country, and in order to allow NCAs to adopt a proportionate approach for the smaller institutions they supervise, no standardised EU-wide template should be imposed as a requirement and the transparency requirements should be tightened up instead. Best practice examples could also be provided where appropriate to work towards greater convergence and comparability of the SREP throughout the EU.

Question 7: What are your views on the guidance for setting P2G and P2G-LR? Is it sufficiently clear?

Title 7.7.1
When it comes to P2G-LR it is rather unclear how the static balance sheet assumption as given in the EU-wide stress test could form a proper basis for the exploration of a leverage ratio under stress, which would already be misleading from a theoretical point of view.

There is no clear guidance for setting a P2G-LR. We suspect that the LR-related risk is overestimated and that, in consequence, the P2G-LR is set too high. Paragraph 423 states that the "level of P2G-LR should protect against the breach of TSLRR in the adverse scenario". On the other hand, paragraph 429 sets out that the P2G should cover at least the maximum stress impact. Regardless of how far the starting point was above the minimum requirements or how far the minimum requirements were exceeded in the stress scenario, the outcome would be very different.

We ask that it be clarified that there is generally no room for (non-institution specific) minimum (floor) P2G and P2G-LR.

In principle, we welcome the methodological freedom afforded to the competent supervisory authorities in "translating" supervisory stress test results into an own funds recommendation (P2G), as it allows the competent supervisory authority to give adequate consideration to special national features of the banking sector or of certain institutions (e.g. deposit protection schemes). In substantive terms, we believe that the danger is that a risk will be counted several times. We believe that the aspects below should be added to the text in principle:

1) **Static balance sheet assumption** (paragraph 430): The use of the static balance sheet assumption (SBA) in supervisory stress testing means that risks can sometimes be systematically overestimated for certain institutions and business models. In this respect, we explicitly welcome the option to adjust the own funds recommendation (P2G) in paragraph 430 (2nd sentence) to avoid a misleading semblance of precision, or to avoid the stress test method/results being

dependent on mechanistic aspects. In addition, competent authorities should adopt a neutral stance vis-à-vis business models as a matter of principle (see also answer to question 3) and should not put any business model at a systematic disadvantage due to the use of the SBA. Paragraph 430 should be supplemented to this effect.

2) **Climate risk** (paragraph 433): At present, there is still no established market practice for the systematic identification and assessment of climate risk. In our opinion, merely expanding the list of the possible risks that increase the potential losses associated with an adverse stress scenario does not help to refine risk identification and assessment for climate risk, but rather creates greater uncertainty in the assessment process for supervisors and institutions alike. As a result, we currently take a critical view of the addition of "climate risk" in paragraph 433.

3) **Transparency vis-à-vis institutions** (paragraph 436): In general, it should be transparent for institutions which of the factors set out in paragraph 432 is decisive for the purposes of determining the own funds recommendation (P2G) for each institution. Paragraph 436 should be supplemented accordingly.

<u>Paragraph 437</u>
In our view, keeping the provision introduced in 2018, stating that the P2G is to be met using CET1, is not permissible. The wording of Article 104b CRD V adopted in 2019 only focuses on own funds overall. Working papers on the CRD review reveal that the majority of member states had favoured the introduction of a "soft" recommendation with regard to the P2G. As a result, an expectation to meet P2G with CET1 only within the SREP Guidelines is not consistent with the intention of the EU legislator and is lacking any legal basis. This tightened requirement should be deleted and the wording should be based on own funds in line with the CRD V.

Question 8: What are your views on possible disclosures, which may be attached to P2G and/or ranges of buckets in case they are identified?

It is not clear from the question which type of disclosure is meant here. As a result, we will address several potential aspects:

The disclosure of buckets or "ranges of P2G add-ons" by the supervisory authority could make sense in principle as a way of communicating to the markets. Such publications by the supervisory authorities should, however, be limited to large, capital market-oriented institutions. In any case, we do not encourage that individual results of single institutions be published.

Our view is that extending the disclosure requirements for institutions with regard to individual P2G would clearly not make sense, which is why we reject such a proposal. The disclosure requirements have only just been revised extensively and in full as part of the CRR II in conjunction with Implementing Regulation 2021/637, meaning that they reflect the current needs from a Pillar 3 perspective. Small and non-complex, as well as non-capital market-oriented other institutions were granted considerable relief by law as part of this process, as the disclosed data is generally not accessed (cf. EP, 2016/0360A(COD) of 11 December 2017). With this in mind, we also consider the disclosure regulations in the CRR II to be entirely sufficient.

Question 9: What are your views on the capital instruments potentially used to cover losses in relation to P2G-LR? Please provide the rationale or specific examples for your views.

The structure of the leverage capital requirement as a Tier 1 requirement should also be applied for the purposes of the P2G-LR.

From a conceptual point of view, we fully agree that using Tier 1 to meet the P2G-LR upholds consistency within the leverage ratio stack based on Tier 1, and would leave the calculation coherent and straightforward. As a result, we ask for clarification in paragraph 437 that the P2G-LR is expected to be met using Tier 1 capital.

Title 8. Assessing risks to liquidity and funding

Paragraph 493
The requirement for concentration limits goes too far for smaller and medium-sized institutions. Proportionality aspects should be taken into account here. As a result, the passage should be revised accordingly.

Paragraph 494
According to paragraph 494, supervisors should assess whether "LCP describes clearly that the LCR liquidity buffer is designed to be used in case of stress…". While we believe that true usability of buffers under stress is desirable, the current design of the LCR and other buffers contradicts that and needs to be revamped. Paragraph 494 is not a viable solution to the flaws of the LCR, and the abovementioned wording should be deleted.

Title 10. Overall SREP assessment and application of supervisory measures

Title 10.5
A statement should be added clarifying that any action considered should first of all be reviewed for appropriateness and that, if it is imposed, the institution should be provided with reasons why.

Title 10.7
The requirements for dealing with P2G non-compliance could unnecessarily complicate flexible action in response to exceptional circumstances (such as the COVID-19 pandemic). It is worth questioning whether there is a need for a general obligation for institutions to notify the competent authority of a revised capital plan and to submit it (paragraphs 582 and 583(a)). There are no corresponding requirements in the CRD. Scenarios in which institutions fail to meet their P2G soon come to light based on the quarterly reporting data (Monitoring of key indicators in accordance with Title 3). The supervisory authority can then check on a case-by-case basis whether the shortfall is acceptable due to general or institution-specific circumstances, and can decide whether it wants to obtain further information, and if so, what further information specifically, from the institution.