At a Glance

Banking Union Working Group: selected issues (January 2016)

I. Focus / frequency

The individual risks of a bank are the object of a cyclical assessment called supervisory review and evaluation process (SREP).

For significant institutions that evaluation is carried out at least once a year by the ECB's Joint Supervisory Teams. For less significant institutions, the National Competent Authorities carry out the evaluation under the overall oversight of the ECB.

II. Approach / scope

The SREP is in principle designed as a holistic, all-encompassing evaluation which combines a quantitative and a qualitative approach, and hence relies to some extent on the subjective judgment and experience of the supervisor.

The evaluation is structured along four main components: business model assessment; internal governance and risk management; risks to capital; and risks to liquidity and funding.

All risks to which a bank is exposed shall be included, including those that are revealed by stress testing and those that the bank itself poses to the financial system.

III. Common methodology

On 19 December 2014, the European Banking Authority EBA published a Guideline for common SREP procedures which is applicable since 1 January 2016.

The ECB/SSM already applied those common SREP procedures in 2015 for the 120 largest banking groups in the euro area, replacing various national methodologies that were rather diverse.

IV. Consequences / communication of results

Supervisors can impose a wide range of measures as a result of a SREP, including additional capital (Pillar 2) requirements, liquidity requirements or changes to risk management practices. In urgent cases supervisory measures can already be imposed on the spot.

In general, however, the various elements of the evaluation shall feed into an overall assessment and scoring. The results of the evaluation are communicated to the banks in form of SREP decisions that also specify the need for specific remedial actions.

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On 5 January, the ECB commented on its webpage that the 2015 SREB evaluations of SSM-supervised banks have been finalised.

However, the individual SREP decisions are not made public, nor has the ECB summarised and published the outcome of the evaluations on an aggregate level.

The overall effect of the 2015 SREP exercise in terms of additional capital requirements was, however, described in a speech held by Sabine Lautenschläger, Vice-Chair of the Supervisory Board of the SSM at a conference in Frankfurt on 17 November 2015: *"Using our SREP methodology for the first time this year, the average pillar 2 capital requirements have slightly increased compared to the previous year by a margin of 30 basis points without buffer effects..."*.

Ignazio Angeloni, Member of the SSM's Supervisory Board, talked about the pros and cons of publishing the results more openly in a speech held in Dublin on 27 November 2015: *"In some cases, supervisory judgements placed in the public domain without proper caution may increase the uncertainty surrounding individual (weaker) institutions, with risks also to financial stability. These arguments carry weight but must be compared to the advantages of transparent communication. Ultimately, the SREP aims to ensure that banks have adequate prudential safeguards in relation to their level of risk. ...Thus, an appropriate degree of disclosure may enhance market confidence and encourage investment decisions, actually reducing uncertainty"*.

In the EU, the practice regarding the publication of results is, however, still somewhat diverse. The decision to publish Pillar 2 requirements is left to the supervisory authorities; according to Article 438(b) of the CRR, banks may be are required to disclose the SREP results, including the composition of the additional own funds, upon demand from the relevant competent authority. According to the ECB, the Danish FSA publishes SREP capital add-ons for all banks, plus summaries of on-site supervisory examinations, and Sweden's Finansinspektionen discloses SREP capital add-ons (the Swedish Nordea bank, for example, has issued a press release outlining the results of its 2015 SREP exercise). The United Kingdom's Prudential Regulation Authority has also taken a more liberal approach and allows banks to voluntarily disclose some information on their Pillar 2 capital requirements. On 26 November 2015, the Italian regulator CONSOB ordered Italian banks to inform the market immediately if, following the SREP, at least one of their capital ratios falls below the level required by the ECB.

V. Maximum Distributable Amount

If a SREP finds that certain risks are not sufficiently covered by capital, competent authorities must impose additional (Pillar 2) capital requirements. As long as regulatory capital requirements are not fully met, banks are in principle not allowed to make pay-outs to holders of (CET 1) capital.

The details on the restrictions on distributions are set out in Article 141 of the CRD. In light of different possible interpretations, EBA published an opinion on 18 December 2015, recommending that the calculation of the Maximum Distributable Amount be calculated taking into account both Pillar 1 and Pillar 2 capital requirements, and that the Commission should review the respective article for the sake of greater clarity. The SSM, in any case, applies the approach recommended by EBA.