EBA/GL/2020/10

23 July 2020

Final report

Guidelines

on the pragmatic 2020 supervisory review and evaluation process in light of the COVID-19 crisis

Contents

1. Executive summary

The COVID-19 pandemic has significantly affected the banking sector as well as, from an operational perspective, competent authorities themselves. Considerable challenges have arisen for competent authorities to conduct the supervisory review and evaluation process (SREP) as described in the Guidelines EBA/GL/2014/13 (the SREP GL) due to the various uncertainties brought about by the crisis. It has become apparent that the 2020 SREP might not embrace a thorough and comprehensive assessment of all the risks and vulnerabilities to which institutions are exposed.

As part of the coordinated response to the COVID-19 pandemic, the European Banking Authority (EBA) outlined in its statement of 22 April 2020 how the principles of effectiveness, flexibility and pragmatism will guide supervisory approaches in relation to the 2020 SREP. However, it also noted that further engagement with competent authorities is necessary to ensure that clarity on such an approach would be made available to safeguard and preserve convergent supervisory approaches and outcomes enabled by the SREP GL in the context of this crisis.

These guidelines, complementing the SREP GL, are addressed to competent authorities and aim to demonstrate how flexibility and pragmatism could be exercised in relation to the SREP framework in the context of this crisis, including the cross-border context. These guidelines establish a special procedure for the supervisory review and evaluation process for the year 2020.

The risk-driven approach put forward by these guidelines builds on the existing requirements of the Capital Requirements Directive and the SREP GL and adapts them to the exceptional circumstances of the COVID-19 pandemic, as well as ensures the exercise of supervisory judgement to the greatest possible extent.

Accordingly, these guidelines focus on the key aspects of SREP and cover the:

(i) focus of the pragmatic SREP;

(ii) overall SREP assessment and scoring;

(iii) supervisory measures; and

(iv) conduct of the SREP in cross-border contexts.

Competent authorities may continue to apply the SREP GL as they currently stand, if they wish to do so. However, there is a need to ensure that competent authorities have the option to apply instead for the alternative specific process for the 2020 exercise, which may be necessary in response to the COVID-19 pandemic and is set out in a harmonised manner in these guidelines.

Due to the urgency of the matter and the limited focus of these guidelines on COVID-19 pandemic-related features, as well as the continued validity of the SREP GL as they stand, the EBA decided not to carry out public consultations or a cost–benefit analysis in this case. The EBA has notified the Banking Stakeholder Group (BSG) of its intention to issue the guidelines but has not requested the BSG's advice.

2. Background and rationale

The EBA is mandated to foster sound and effective supervision and to drive supervisory convergence across the EU arising from the requirements specified in Directive 2013/36/EU and more generally from its obligations under its founding regulation.

There is a need for a pragmatic and effective SREP in 2020 due to the various implications of the COVID-19 pandemic for credit institutions as well as for competent authorities themselves, in particular the operational constraints of banks and supervisors, the considerable uncertainty around the implications of the crisis for institutions' risk profiles and financial soundness, and the burden on banks to implement a wide range of mitigating measures to support the real economy. It is important to benefit from sufficiently similar pragmatic approaches by converging on the key features of the SREP to protect the outcome of the supervisory assessments and at the same time safeguard the minimum scope of the supervisory review to ensure a level playing field across the EU.

Therefore, it is necessary to outline the modality of the implementation of the SREP GL for the particular circumstances of 2020 by setting out the key features of such a pragmatic SREP to ensure that supervisors have sufficient flexibility to adapt their supervisory practices to the new and changing circumstances brought about by the COVID-19 pandemic. At the same time, it is of paramount importance to ensure that the adjustment of the SREP to the current crisis circumstances is carried out in a consistent and convergent manner across the EU, to safeguard and preserve convergent supervisory practices and outcomes, which necessitate the issuance of amended guidelines.

The focused SREP approach ensures the implementation of the overall SREP assessment in the context of COVID-19 through:

- a risk-driven assessment focusing mainly on the most material risks and vulnerabilities driven by the crisis, based on the most recent information received by supervisors; and, in particular,
- the ability of an institution to respond to the challenges brought by the crisis, including operational continuity.

A distinct feature of the pragmatic SREP approach is that, while the institution-specific nature of the exercise is preserved, these guidelines identify a set of risks and vulnerabilities that are deemed the most material in the context of this crisis and place emphasis on the supervisory assessment of these items. The institution-specific nature of the SREP ensures that any additional risk deemed material for an institution in the context of this crisis, in particular market risk, would also be subject to supervisory scrutiny.

Supplementary information sources become particularly valuable in a crisis and are key inputs to the supervisory assessment in 2020. Regular discussions with various functions of the supervised institutions and at various levels are important to help supervisors better understand the implications of the COVID-19 crisis and to gather an institution's view on material changes and key risks and vulnerabilities. Therefore, competent authorities are encouraged to intensify the supervisory dialogue to understand the challenges faced by institutions and their reactions to these.

Under the focused and pragmatic 2020 SREP, due to the various uncertainties brought by the pandemic and until the impact of the crisis on an individual institution's risk profile can be better understood and captured, the risks and viability scores assigned in the previous cycle may be maintained.

These guidelines respond to exceptional developments by adapting the conduct of the SREP to the special circumstances brought by the crisis, including (i) the challenges faced by banks with regard to their operations, (ii) the unprecedented uncertainties around the financial implications of COVID-19 on customers and on the credit institutions themselves, and (iii) changes in supervisory approaches due to competent authorities' own challenges to conduct microprudential supervision in the usual manner. Therefore, competent authorities should be able to adjust the scope, frequency and intensity of supervisory engagement during 2020 to reflect the special circumstances characterising this exercise.

Drawing supervisory conclusions on the viability of an institution and its ability to meet the capital and liquidity requirements is paramount in a crisis. According to the current regulatory framework on crisis management, the SREP scores are used as, inter alia, triggers for applying early intervention measures under the Bank Recovery and Resolution Directive, as well as for determining whether an institution is 'failing or likely to fail'. Therefore, these guidelines introduce a consistent approach for the overall SREP assessment of the viability of an institution that in 2020 will reflect the conclusions of the supervisory review conducted according to these guidelines with the exercise of supervisory judgement.

In terms of the supervisory measures applied in the 2020 cycle, the guidelines express a preference for qualitative measures in the first instance. Due to the pragmatic nature of the 2020 SREP, the Pillar 2 requirements (P2R) could remain stable, if it is appropriate, and should be met by the institution at all times.

As the determination of the Pillar 2 Guidance (P2G), according to the SREP GL, is closely linked to the outcome of supervisory stress tests to address the supervisory concerns of meeting the capital requirements over the economic cycle, in the current context there is considerable uncertainty over the adverse scenario that could materialise, as well as over an individual institution's sensitivity to it. In addition, the postponement of the EU-wide stress test to 2021 would leave competent authorities without a major quantitative input to rely on in 2020. Therefore, these guidelines ensure the possibility for competent authorities to leave P2G stable in 2020, if so warranted by the abovementioned uncertainties.

Similarly to capital buffers that are designed to absorb losses and ensure continued lending to the economy during a downturn, the usability of the P2G is important to ensure that institutions can provide the necessary support to households and the corporate sectors. These guidelines acknowledge the usability of the P2G in the current circumstances and provide for an enhanced supervisory follow-up to ensure eventual restoration.

Regardless of the periodic SREP assessment, competent authorities are encouraged to apply supervisory measures where needed to address immediate concerns arising from the continuous assessment of risks.

These guidelines facilitate a consistent approach in connection with cross-border banking groups, as the identification of a set of key risks and vulnerabilities as included in these guidelines will inform the group risk/liquidity risk assessments conducted in supervisory colleges and will support competent authorities in arriving at a shared view on the most material risks in the context of this crisis, taking into account institutions' specific considerations.

Irrespective of the possible simplifications introduced in the 2020 SREP and in particular in times of crisis, when the circumstances are far from normal, joint supervisory conclusions on the available, as well as the required, level of capital and liquidity have to be drawn in colleges of supervisors. The approach towards the joint decisions in supervisory colleges should be aligned with the streamlined nature of the pragmatic SREP, while preserving the mandatory content of joint decisions as set out by Commission Implementing Regulation (EU) No 710/2014.

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1. Compliance and reporting

Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010[1] for the year 2020 (pragmatic 2020 SREP). In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must make every effort to comply with the guidelines.

2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by 25 September 2020. In the absence of notification by this deadline, the competent authority will be considered by the EBA to be non-compliant with these guidelines. Notifications should be sent by submitting the form available on the EBA website with the reference 'EBA/GL/2020/10'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to the EBA.

4. Notifications will be published on the EBA website, in line with Article 16(3).

[1] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

2. Subject matter, scope and definitions

Subject matter

5. These guidelines specify the pragmatic application of Guidelines EBA/GL/2014/13 (the SREP Guidelines) for the supervisory review and evaluation process for the SREP 2020 cycle.

Addressees

6. These guidelines are addressed to competent authorities as defined in point i of Article 4(2) of Regulation (EU) No 1093/2010.

3. Implementation

Date of application

7. These guidelines apply from 23 July 2020.

4. 2020 SREP in light of the COVID-19 crisis

8. In the SREP Guidelines, a new paragraph 15a is inserted after paragraph 15 as follows:

   ‘Competent authorities may adjust the assessments for the 2020 SREP cycle to reflect the exceptional circumstances entailed by the COVID-19 pandemic and ensure an adjusted application of these guidelines during the COVID-19 crisis. Where doing so, competent authorities should ensure that their adjustments comply with ANNEX 4.’

9. In the SREP Guidelines, a new ANNEX 4 is inserted after ANNEX 3 as follows:

“ANNEX 4

Focus of the 2020 SREP in light of the COVID-19 crisis

1. For the identification of the most relevant risks and vulnerabilities for institutions in the context of the COVID-19 crisis the following information from institutions should be seen as the main input of the SREP, as appropriate:

   a. material changes;

   b. key risks and vulnerabilities;

   c. the ICAAP and the ILAAP.

2. The ICAAP and ILAAP should provide support to competent authorities’ overall assessment of the institution’s soundness and viability. Competent authorities may request updated ICAAP/ILAAP information, if they consider that information relevant for the application of these guidelines has become obsolete; otherwise, competent authorities should be able to rely on information already available.

3. The institution-specific nature of the supervisory review should not be affected by the pragmatic 2020 SREP.

4. When focusing their pragmatic 2020 SREP assessment, competent authorities should have regard to the following risks/risk controls as appropriate:

   - credit risk, in particular credit risk management and trends in and coverage of provisioning;

- liquidity and funding risk;
- operational risk with a focus on information security and business continuity management[2];
- profitability and the wider business model framework, with a link to
- governance arrangements, namely whether those allow for the swift alignment of strategies and related procedures and the management's ability to ensure prompt implementation.

Overall SREP assessment and scoring

5. The overall SREP assessment of the viability of an institution should reflect the conclusions of the supervisory review conducted according to this annex with the exercise of supervisory judgement.

6. Within the focused and pragmatic 2020 SREP risk and viability scores assigned in the previous SREP cycle may remain unchanged.

SREP timeline in 2020

7. Competent authorities should adjust and extend as appropriate the pragmatic 2020 SREP cycle in order to facilitate the understanding of the implications of the crisis and in order to ensure a more robust assessment.

Supervisory measures

Pillar 2 requirements (P2R)

8. Following the 2020 SREP, the determination of additional own funds requirements (P2R) to cover the risk of unexpected losses or expected losses insufficiently covered should aim to address risks and vulnerabilities that are most material for the institution in the context of the crisis.

9. Where setting the additional own funds requirements (P2R), the requirements already imposed following the previous SREP cycle may remain unchanged, where this is deemed appropriate. Competent authorities should ensure that institutions comply with these requirements at all times.

10. Competent authorities should apply flexibility in adapting the quality of capital that institutions are allowed to use to meet the P2R, while ensuring a sound coverage of risk and the minimum composition laid down in the SREP Guidelines.

[2] In accordance with the focus described in the *EBA statement on digital operational resilience in the COVID-19 pandemic*.

11. Supervisory concerns stemming from the pragmatic 2020 SREP cycle should primarily be addressed with qualitative measures.

Pillar 2 Guidance

12. When determining and setting P2G, competent authorities should act in accordance with the minimum engagement model. Where this is justified by uncertainties over the institution's sensitivity to adverse scenarios, competent authorities may maintain the P2G determined and set during the previous SREP cycle.

13. Where, in the context of the pragmatic 2020 SREP cycle, the institution's own funds drop, or are likely to drop, below the level determined by P2G, competent authorities may tolerate that institution's operating temporarily below that level but they should request the institution to report this without undue delay. They should engage in enhanced supervisory dialogue with that institution, endeavouring to understand the timeframe for the eventual restoration of its P2G capital, which may extend beyond 2020.

SREP in cross-border context in 2020

14. The consolidating supervisor and the relevant competent authorities should endeavour to agree on a common determination of whether the supervisory review and evaluation process for the 2020 SREP cycle will be performed with or without the application of this annex for all group entities. Nevertheless, the consolidating supervisor should be able to decide whether the supervisory review and evaluation process for the 2020 SREP cycle will be performed with or without the application of this annex for the EU parent undertaking, and the relevant competent authorities should do the same for the group entities under their supervisory remit.

15. Notwithstanding paragraph 14, for the purposes of application of paragraph 7 in cross-border groups, the consolidating supervisor and the relevant competent authorities should discuss and update where needed the joint decision timetable set out in Article 3 of Commission Implementing Regulation (EU) No 710/2014.[3]

16. Notwithstanding paragraph 14, the consolidating supervisor and the relevant competent authorities should discuss in the supervisory college the focus of the capital and liquidity risk assessment taking into account the main risks and vulnerabilities as set out in paragraph 4 and they should have regard to institution-specific considerations as set out in paragraph 3.

[3] Commission Implementing Regulation (EU) No 710/2014 of 23 June 2014 laying down implementing technical standards with regard to conditions of application of the joint decision process for institution-specific prudential requirements according to Directive 2013/36/EU of the European Parliament and of the Council (OJ L 188/19 of 27.06.2014).

17. While applying Articles 10 and 11 of Commission Implementing Regulation (EU) No 710/2014 during the pragmatic 2020 SREP cycle, the consolidating supervisor and the competent authorities should endeavour to ensure that the mandatory content of the joint decisions is maintained but within the context of the pragmatic SREP as set out in these Guidelines, where relevant."