Assessment of the European Central Bank’s Supervisory Review and Evaluation Process

Report by the Expert Group to the

Chair of the Supervisory Board of the ECB

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List of acronyms

EBA	European Banking Authority
ECB	European Central Bank
DG	Directorate General
IMAS	Information Management System
IMI	Internal Model Investigation
JST	Joint Supervisory Team
MYA	Multi-year Assessment
NCA	National Competent Authority
OSI	On-site Inspection
P2G	Pillar 2 Guidance
P2R	Pillar 2 Requirement
RTF	Risk Tolerance Framework
SI	Significant Institution
SEP	Supervisory Examination Process
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism

I. Executive summary

ECB Banking Supervision has successfully established itself as an effective and respected supervisory authority. It has built a strong and prudent methodology to ensure risk-based and consistent supervision. It has developed a harmonised Supervisory Review and Evaluation Process (SREP), which has significantly helped to increase the resilience of the European banking sector and to promote a level playing field for all significant institutions. Building on these achievements, the Expert Group believes that the ECB can further improve the efficiency and effectiveness of its existing supervision processes by making them more integrated and risk sensitive. That can be achieved by considering some adjustments to current procedures:

- **Further enhancing risk-based supervision and empowering supervisory judgement:** The Expert Group welcomes recent initiatives by the ECB such as the multi-year assessment (MYA) and risk tolerance framework (RTF), to become more risk-based in its supervisory approach. However, to reap their full benefits, these initiatives should be further developed, integrated into day-to-day supervision, and framed within a well-defined supervisory culture.

- **Promoting the better integration of the outcome of other supervisory assessments into the SREP:** In particular, SREP risk assessments should further leverage all available supervisory information. SREP-specific analysis should also be streamlined. Importantly, the SREP should leverage the outcome of other supervisory assessments. Measures addressing weaknesses identified in other supervisory processes may be issued as part of SREP decisions, according to a formalized escalation process. This would facilitate moving resources employed to conduct the bespoke mechanical tests currently required by the SREP to the actual monitoring of banks' main challenges and management actions.

- **Streamlining SREP processes and shortening their timeline:** The Single Supervisory Mechanism (SSM) as a system and its supervisory practices are now sufficiently robust and mature to allow the SREP to evolve towards a simpler and leaner process. In particular, the streamlining of SREP-specific modules should contribute to this goal. However, this would also require other changes, such as the further separation of SREP assessments from the determination of capital requirements, the parallel implementation of different steps in the process and the reduction of touch points with the Supervisory Board. In addition, the Information Management System (IMAS), as the backbone of the SSM's IT systems and central tool for the execution of the SREP, should become more flexible and allow for a better integration of other supervisory processes into the SREP.

- **Rebalancing capital and qualitative measures:** While the ECB has made impressive progress in ensuring an adequate level of capitalisation and supporting the clean-up of banks' balance sheets, the ECB's supervisory approach appears to be too capital centric. Capital alone cannot address all risks: weak business models and internal governance practices, as well as climate-related and environmental risks or IT/cyber risk, require the whole range of measures available in the supervisory toolkit to be tackled effectively. Thus, the ECB should refocus its supervisory approach by strengthening the link between SREP scores and qualitative measures. Instead of being a tool for risk quantification and numerical ranking, the objective of SREP scores should be to promote managerial actions to reduce and control risks. Having a clear link between expected management actions and SREP scores should create a strong incentive for banks to remediate their weaknesses in a timely and effective manner. In addition, more effort should be made to prioritise qualitative measures included in the SREP. Supervisors should strive to design and deploy qualitative measures in a targeted manner, with clear requirements focused on addressing banks' key vulnerabilities. To ensure full alignment with the supervisory priorities, European banking supervision should consider establishing an annual stock-take of the current state of all outstanding supervisory measures.
- **Reforming the process for determining Pillar 2 capital requirements:** The ECB's current process for the determination of Pillar 2 requirements combines a holistic approach based on an overall risk assessment with some elements of a risk-by-risk approach derived from banks' internal capital adequacy assessment processes (ICAAPs). This combination is conceptually weak as it mixes two mutually incompatible approaches and makes the process operationally complex. The Expert Group encourages the ECB to consider whether the current compromise adds any net value compared with a purely holistic approach. At the same time, the ECB should consider developing the methodology so that it focuses more directly on risks that are not sufficiently covered by Pillar 1 but with only limited ICAAP intervention. Combined with the discussion on supervisory priorities, the ECB should have a thorough annual discussion on the average capital needs of its supervised banks. This should aim at formulating preliminary expectations on the aggregated Pillar 2 requirement (P2R) and the desired severity for the adverse scenario in the stress test used for the determination of Pillar 2 guidance (P2G).

Summary of Recommendations:

1. Supervisory culture, process and systems

Recommendation 1.1: Further develop the target supervisory culture and the risk tolerance framework

Recommendation 1.2: Embed the risk-tolerance framework in day-to-day supervision.

Recommendation 1.3: Better integrate the outcomes of other supervisory activities into the SREP assessments and measures.

Recommendation 1.4: Shorten and make the SREP timeline more efficient.

Recommendation 1.5: Improve IMAS or the systems that the JSTs use to make them more flexible, correct the lack of sufficient integration across processes, and increase their adaptability to methodological enhancements.

Recommendation 1.6: Make SREP letters more effective to promote sound and timely management actions by banks.

Recommendation 1.7: Further develop data analytics

2. SREP scores and capital requirements

Recommendation 2.1: Redefine risk scores to strengthen the role of management actions, enhance the dispersion of ratings across banks and reduce their stickiness.

Recommendation 2.2: Better communicate the rationale behind scores.

Recommendation 2.3: Develop the P2R methodology to make it more operationally efficient and focused on specific risks requiring additional capital coverage, while significantly limiting the use of ICAAPs.

Recommendation 2.4: Schedule a thorough annual discussion within the Supervisory Board on the capital needs of the euro area banking sector.

3. Qualitative measures

Recommendation 3.1: Strengthen the link between qualitative measures and scores to promote better risk management and control.

Recommendation 3.2: Strengthen prioritisation of qualitative measures and the role of the escalation process.

Recommendation 3.3 Consider channelling all communication with banks in relation to supervisory processes through JSTs.

Recommendation 3.4: Further strive to design and deploy qualitative measures in a targeted manner, with clear requirements focused on addressing banks' key vulnerabilities.

Recommendation 3.5: Perform and deliver as part of the SREP a stocktake of outstanding measures, as well as form a view about the implications to structure necessary remedial actions.

Recommendation 3.6: Enhance technology already deployed to facilitate exchange of information with banks about remediation progress on outstanding measures.

II. Introduction

Strong bank supervision is key to safeguarding trust in the banking system, fostering the financial system's stability and resilience and ultimately laying the ground for economic growth. While regulation must be based on clear rules, effective supervision relies on a well-trained and qualified set of resources that can properly leverage supervisors' judgement and experience**.** Banking supervision has the task to oversee the implementation of banking rules, to set incentives that prevent excessive risk-taking, and to identify impending or emerging risks and monitor their evolution. Technical knowledge, analytical skills, and experience in identifying and managing risks are key to ensuring effective supervision.

Since such a supervisory resource base is not infinite, the efficiency of supervision is also of paramount importance. Tools and procedures must be designed to ensure that resources are properly assigned with maximum risk sensitivity. This entails the accurate identification of the main risks faced by individual institutions and the system as a whole, appropriate flexibility to reallocate resources when needed and sufficient investment in technology to enhance the productivity of supervisory activities.

The growing complexity of the financial landscape makes the preservation of the effectiveness and efficiency of supervisory tasks increasingly challenging. Today, the focus of supervision goes beyond the traditional risks on balance sheets emanating from the composition of credit and trading books and the quality and level of liquidity and incorporates the impact on banks' safety and soundness of structural changes in the environment in which they operate. Among other developments, such changes are generated by technological disruption, including the entrance of new players into the market for financial services, i.e., fintech and larger global technology companies (big techs). Moreover, the growth in the non-bank financial institution sector[1] internationally and in Europe generates new risks for financial stability, which interacts with those associated with the activity of traditional financial intermediaries. Importantly, there are also new operational risks for financial institutions, such as those arising from cyber threats, greater reliance on critical third-party providers (e.g. for cloud computing) and expanded digitalisation programs. Finally, banks are significantly exposed to the effects of physical and transition risks associated with climate change.

By holding itself to the highest standards of efficiency and effectiveness, European banking supervision will enhance its preparedness to tackle risks, such as those stemming from

1 See "Newsletter on bank exposures to non-bank financial intermediaries" and "EU Non-bank Financial Intermediation Risk Monitor 2022".

technological innovation and climate change. It will also strengthen its resilience and agility to adapt its supervisory approaches and policy to unforeseen shocks, such as those experienced in recent times.

Against this background, the Expert Group commends the ECB's initiative to commission an independent review of the extent to which the current SREP fully addresses existing needs and priorities and whether there are possibilities to improve and streamline the process. The SREP is the most important supervisory process performed by the ECB to gain a comprehensive view of the risk profile of the significant Institutions[2] it supervises. The ECB entrusted the Expert Group to review the functioning of the SREP and to assess how the SREP is situated and operates with respect to European banking supervision's overall supervisory activities such as on-site inspections, internal model investigations, fit and proper assessments, thematic horizontal reviews, deep dives and sanctions[3], and to make recommendations to improve the efficiency and effectiveness of SSM supervision. The Expert Group was tasked with issuing a report to the Chair of the ECB's Supervisory Board detailing its work performed over the last seven months.

Historical context and background of the SREP

The SSM is a rather new supervisory construct on the international stage, having been created by an EU regulation in 2013[4] and launched a year after. In the aftermath of the Great Financial Crisis and the following sovereign debt crisis, the European Union undertook an ambitious project of institutional reforms to its banking regulation and supervision to increase the financial sector's resilience, reduce financial fragmentation and reinforce the monetary union. As part of this project, the ECB was assigned the task of setting up the SSM in the euro area, with the aim of ensuring the consistent application of supervisory standards and best practices across the euro area and restoring trust in the euro-area's banking system. The SSM is comprised of NCAs from 21 countries and ECB Banking Supervision. The ECB's Supervisory Board includes representatives of the ECB and of all national supervisors across all participating Member States.

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2 The criteria for determining whether banks are considered significant are set out in the SSM Regulation and in the SSM Framework Regulation and are based on banks' size, economic importance, cross-border activities, and direct public financial assistance.

3 See Annex 1 and ECB (2022), "ECB appoints five experts to re-evaluate annual supervisory review process".

4 Council Regulation (EU) No 1024/2013 of 15 October 2013.

Less than ten years later, European banking supervision has become one of the world's largest supervisors, directly supervising 111 banks[5] and overseeing the supervision of more than 2000 smaller banks in 21 EU countries. Banks directly supervised by European banking supervision ("significant institutions") span different business models, sizes, and complexities. The EU legislative framework provides European banking supervision with a set of supervisory powers, which are exercised by applying both EU and national law. In 2022 alone, the ECB issued more than 2,000 supervisory decisions and performed more than 200 on-site and internal model investigations.

The ECB has, since 2014, recruited a cadre of experienced supervisors with the requisite skillset needed to enable it to undertake and deliver on the task of supervision. It on-boarded roughly 1000[6] staff beginning in 2014, recruiting primarily from the National Competent Authorities as well as from the Monetary Policy arm of the ECB to fill positions. Today ECB Banking Supervision has a staff of over 1200 full-time employees[7] operating in 7 business areas[8]. Extensive training has been consistently delivered as detailed methodologies for performing specific and comprehensive supervisory tasks were developed.

Through the SREP, European banking supervision assesses – on an annual basis - banks' viability, sets capital and liquidity requirements that banks must meet to cover the risks they are exposed to[9] and establishes measures that banks must execute to improve their internal controls and risk management practices. The SREP methodology is shaped by the European legislative framework: namely, the relevant provisions of the Capital Requirements Directive as transposed into national laws and the EBA guidelines on the SREP (EBA/GL/2014/13).

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5 As of 1 January 2023.The criteria for determining whether banks are considered significant are set out in the SSM Regulation and in the SSM Framework Regulation and are based on banks' size, economic importance, cross-border activities, and direct public financial assistance.

6 By the beginning of January 2015 more than 960 staff, representing all EU nationalities, had been recruited out of the roughly 1,000 total budgeted positions in ECB Banking Supervision and the related shared services [https://www.bankingsupervision.europa.eu/press/publications/annual-report/pdf/ssm.ar2014.mt.pdf].

7 There are 1206 FTEs working on ECB banking supervision Business Areas. There are also 510 FTEs dedicated to SSM from internal service providers working on e.g., HR, communications, statistics, or legal department. This number doesn't include the NCA staff in the JSTs, ca. 850 FTEs.

8 DG-SIB Systematic & international Banks | DG-UDI Universal & diversified institutions | DG-SPL specialised Institutions & LSIs | DG-HOL Horizontal Line supervision | DG-OMI on-site & internal Model Inspections | D-SSR Supervisory Strategy & Risk | DG-SGO SSM Governance & Operations.

9 Quantitative measures include (i) binding requirements (Pillar 2 Requirements, binding liquidity requirements); such requirements aim at covering risks that are not adequately covered by Pillar 1 requirements; and (ii) non-binding requirements (Pillar 2 Guidance), which aim at covering capital needs under stressed conditions, as determined in the adverse scenario of a stress test.

The SREP is conducted across four elements: (1) business model, (2) internal governance and risk management, (3) risks to capital, and (4) risks to liquidity. The process produces a risk assessment score (RAS) for each element that incorporates a review of both risk levels (for elements 1, 3 and 4) and risk controls (for elements 2, 3 and 4), reflecting supervisors' holistic view of each banks' risk, as well as an overall SREP score (OSS) reflecting supervisors' holistic view of each bank's viability. The risk assessment process is based on three phases, including (1) data gathering, (2) an automated anchoring score based on a pre-defined list of indicators, and (3) adjustments to the anchoring scores based on the supervisory view of each specific bank.

The SREP interacts with other important supervisory processes, including:

- On-site inspections and internal model validations which are coordinated and performed by the Directorate General Onsite & Internal Model Inspections.
- Fit and proper assessments and authorization procedures, coordinated and performed by the Directorate General SSM Governance & Operations.
- Enforcement actions, including periodic penalty payments and other enforcement measures available in the national implementing legislation in the relevant participating Member States, and sanctions.
- Stress tests, including the one performed by the EBA (in cooperation with the European Systemic Risk Board (ESRB), the NCAs and the ECB) every two years on the largest significant banks supervised directly by the ECB[10]; the stress test exercise performed by the Directorate General Horizontal Line Supervision for all significant institutions; the comprehensive assessments for new entities under the ECB remit; thematic scenario analyses such as the climate risk stress test; or the top down stress test performed by the ECB Directorate General Macroprudential Policy & Financial Stability.

The SREP is a dynamic process and has significantly evolved in the last decade to reflect the emergence of new risks and regulatory developments. It has also proven to be a flexible tool, able to adapt to extraordinary circumstances such as the coronavirus (COVID-19) crisis, when it delivered a "pragmatic SREP" that significantly streamlined the process of evaluating the risk profile of institutions. The pragmatic SREP serves as a useful test for possible enhancements to make the supervisory process more efficient in the future. Moreover, the ECB has introduced a series of reforms in recent

10 In years when the EBA conducts its EU-wide stress test, the ECB conducts its own stress test for those banks that are under its direct supervision and not part of the EU-wide EBA stress test. This parallel test is part of the annual SREP process and uses EBA methodology, with necessary adjustments for smaller banks to allow for proportionate treatment.

years such as the MYA and the RTF[11] to make the SREP more streamlined, risk-based, flexible, judgement-oriented, agile, timely, and forward-looking.

Through the implementation of a common SREP, the ECB has promoted risk-based, consistent, and effective supervision and capital adequacy. In turn, this has helped build trust and enhance the resilience of banks in its participating countries. In its first years, European banking supervision devoted significant resources to the development of rather detailed methodologies and processes to ensure coordination among its staff located in participating countries and a consistent supervisory approach that promoted a level playing field for all significant institutions. European banking supervision also created a robust organisational and IT infrastructure that allows hundreds of supervisors across the EU to interact and cooperate every day.

Importantly, the SREP and other supervisory processes at the ECB were designed at a time when Europe's banking system needed significant increases in capital to avert a full-scale banking crisis. By design, the SREP, from its inception, focused primarily on ensuring the availability of sufficient own resources for all institutions under its remit as a function of their risk profile.

Today's environment calls for a careful recalibration of the SREP and other supervisory processes. This calibration must ensure that the quest for consistency and the preservation of a level-playing field does not compromise efficiency, transparency, and the need for sufficient risk sensitivity. Moreover, supervisory processes should provide a sound basis for the calculation of appropriate levels of capital for each institution and, at the same time, directly promote stronger governance and risk management and sustainable business models. Managing risks stemming from the present challenges faced by the financial industry (e.g. the technological disruption and climate-related and environmental financial risks) primarily requires robust internal management actions. Capital alone is not enough to ensure banks' safety and soundness.

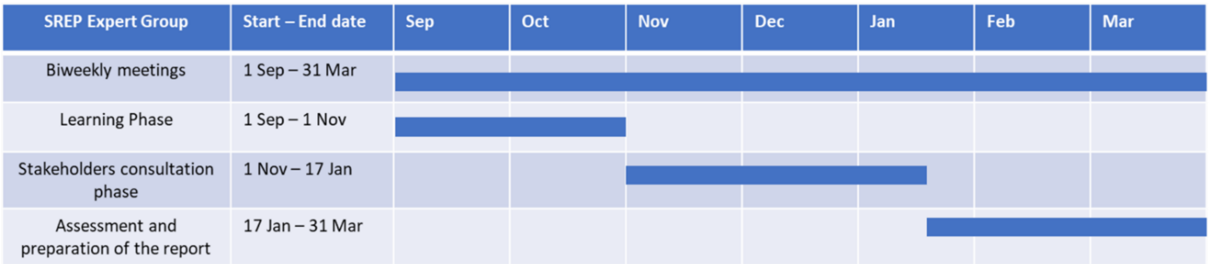
Building on the outstanding achievements of the last decade, European banking supervision can now reflect on how to develop the SREP and its other supervisory processes further. Leveraging the knowledge, technology, and the trust it has built in the last decade, processes and procedures may be streamlined, risk prioritisation may be further enhanced and the balance between quantitative and qualitative tools to address banks' risk may be reconsidered.

11 See Annex 2: Selected SSM supervisory processes and initiatives.

Organisation of the work

The mandate of the Expert Group spanned a seven-month period, starting on 1 September 2022 and ending on 31 March 2023. The work of the group was sponsored by Elizabeth McCaul, ECB Representative to the Supervisory Board of the ECB. The Expert Group organised its work into three phases: (i) a learning phase; (ii) an interview phase, and (iii) a report-drafting phase. The group met on a biweekly basis between 1 September and 23 March 2023 (see Exhibit 1).

Exhibit 1: Timeline of the work of the Expert Group



The Expert Group benefitted from unrestricted access to extensive documentation about the SREP and other supervisory processes at the ECB. It reviewed confidential supervisory material on an anonymised basis. In all, the Expert Group had access to over 85 documents covering methodologies, descriptions and statistics concerning SSM processes and systems, training materials, Supervisory Board materials, samples of SREP letters, on-site inspection reports and JST risk assessments.

The Expert Group performed extensive outreach and discussions with numerous stakeholders, holding over 70 meetings. In particular, the Expert Group's work benefitted from discussions with staff from the ECB and NCAs, current and former members of the ECB's Supervisory Board, representatives from the European banking industry and with European and international senior policymakers in the field of banking supervision**.** In addition, the Expert Group has conducted a broad-based survey among directly supervised banks and staff from the ECB and NCAs. These survey findings were also discussed at one of the in-person meetings in Frankfurt where the Expert Group organised brainstorming sessions with ECB staff. In multiple breakout sessions, which were chaired by Expert Group members, staff from the various business areas of ECB Banking Supervision provided feedback, based on their practical experience, on process, supervisory culture, SREP scores/P2R and qualitative measures. These brainstorming sessions with experts were complemented by a thorough discussion with the entire senior management team of ECB Banking Supervision to identify areas for improvement.

Structure of the report

Apart from the executive summary (Chapter I) and this introduction (Chapter II), the report contains an analysis of the different components of the SREP and of its interaction with other supervisory processes (Chapter III). The report also includes five annexes containing the mandate and members of Expert Group (Annex 1), selected SSM supervisory processes and initiatives (Annex 2), the results of the survey conducted with a number of stakeholders (Annex 3), and a list of meetings conducted by the Expert Group (Annex 4).

Chapter III, which is the core of the report, contains the main observations and recommendations and is organised into three main sections:

- European banking supervision's culture, and the core processes and systems developed by European banking supervision to perform its supervisory reviews (Section 1).
- European banking supervision's risk assessment score methodology and the criteria to determine capital requirements (Section 2).
- The role of qualitative measures in European banking supervision's supervisory toolkit (Section 3).

III. Review of the SREP and its interaction with other supervisory processes

1. Supervisory culture, process, and systems

1.1 Background

The core principles of the annual SREP are consistency, synchronisation, and transparency. Consistency is achieved through the establishment of harmonised risk assessment rules gathered in a SREP manual and reflected in the SSM's IT systems; it is also achieved by virtue of structured quality assurance processes, including benchmarking analyses and reviews by European banking supervision's second line of defence. Synchronisation is achieved by establishing a common assessment and decision-making process, including internal milestones, and culminating in the review and approval of the SREP outcome by the ECB's Supervisory Board. Transparency is mainly achieved by disclosing the preliminary SREP outcomes to significant institutions in dedicated supervisory dialogues and by publishing the Pillar 2 capital requirements.

Adhering to these principles while supervising a large number of banks across various countries inevitably results in complex processes and systems. At the inception of the SSM, when there was a need to knit together a wide variety of cultures and supervisory philosophies and supervisory processes, consistency required extremely detailed methodologies. In fact, thanks to the processes and systems it has established, European banking supervision has succeeded in less than a decade in promoting cooperation and collaboration among its stakeholders, developing a robust methodology, achieving consistency in the supervisory process timeline, and ultimately delivering effective supervision.

EU legislation and guidelines do not require the level of uniformity or synchronisation of SREP activities as currently adopted by the ECB. The introduction to the EBA guidelines explains that the SREP is "an ongoing supervisory process bringing together findings from all supervisory activities into a comprehensive supervisory overview of an institution"[12]. It also comments that the aim of the guidelines is not to impose "restrictive granular SREP procedures and methodologies"[13] and that assessment "scores should be assigned based on supervisory judgement."[14] The EBA guidelines

12 EBA GL 2022/03 Executive Summary page 6.
13 EBA GL 2022/03 Executive Summary Page 8.
14 EBA GL 2022/03 Executive Summary Page 12.

explain that there should be an annual assessment and summary with a score for large Category 1 institutions[15]. The SREP should, however, be a continuous assessment[16], and setting capital is a separate but related periodic assessment.[17]

European banking supervision's supervisory practices are now sufficiently robust and mature to allow the organization to evolve towards simpler processes and leaner systems. By reducing the length and complexity of some internal processes and developing streamlined and more integrated systems, European banking supervision would be able to reallocate resources from procedural tasks to more risk-based, in-depth supervisory assessments, which can contribute more effectively to promote banks' resilience.

The evolution of European banking supervision's supervisory processes and approaches should be supported by a well-established supervisory culture. The SSM has a clearly articulated mission statement, with well-defined strategic objectives that promote the equal treatment of all supervised institutions. Moreover, supervisors at the ECB demonstrate great pride to contribute to the European Project through their role in protecting the safety and soundness of the European banking system. The SSM also has a risk appetite statement that serves to define its core principles and determine its strategic objectives. These elements have played a significant role in shaping the SSM's supervisory practices to date and have helped European banking supervision mature as a supervisory organisation. In the current context and based on discussions held by the Expert Group, it appears that there is a widely accepted notion of supervisory culture in the SSM that relates to the shared values and behaviours characterising the way in which supervisors interact and perform their roles and responsibilities. However, to prepare the SSM adequately for the years ahead, a more structured definition of supervisory culture – accompanied by an effective risk tolerance framework – is necessary even if the overarching mission provides a strong fabric for the organisation.

1.2 Supervisory process

The annual SREP process relies on a prescriptive methodology, establishing specific criteria and controls supervisors must examine each year to determine significant institutions' scores. A common, prescriptive methodology is important to ensure consistent supervisory outcomes and was

15 EBA GL 2022/03 2.4.1 para 50.
16 EBA GL 2022/03 2.1.2 para 22.
17 EBA GL 2022/03 2.1.3 para 23.

key to building up the knowledge of significant institutions’ overall risk profiles when the SSM was introduced. However, repeating a full-fledged assessment of all banks’ risk profiles on a yearly basis maintains a vast breadth of the supervisory assessments, but may decrease their depth. Allocating resources without a sufficiently strong risk-based prioritisation, may prevent supervisors from detecting key weaknesses related to each significant institutions’ profiles.

In addition to the annual SREP, **European banking supervision conducts other supervisory activities**, **the outcome of which is not always reflected in the content of the SREP assessment but is typically communicated by the JSTs.** In fact, the SREP is the main, but not the only supervisory activity performed by European banking supervision during the year. Other activities include on-site inspections, horizontal reviews, internal model investigations, fit and proper assessments, sanctioning processes, and authorisation procedures. The schedule of these supervisory activities is independent of the SREP schedule, but their outcome is key to achieve a well-rounded understanding of a significant institution’s risk profile. While these activities are performed by different organisational units in the SSM (see Chapter I), the remediation measures are typically communicated to the bank by the JSTs.

SREP timetable

The SREP engages staff from many of the SSM’s internal functions, and the JSTs act as nodal points gathering all supervisory information and conducting the supervisory assessment. The JSTs are composed of staff from the ECB and NCAs and, for some significant institutions, also interact and coordinate with third-country home and host authorities.

Coordinating a high number of stakeholders and achieving synchronised decision-making procedures for all significant institutions results in an extended SREP timeline spanning up to 14 months. The long and precise sequence of steps in the timetable has ensured the consistency and comprehensiveness of the process. However, it does not promote an agile supervisory process. Specifically, it does not facilitate the timely consideration of new developments during the process or timely supervisory actions. During the stakeholder interviews organised by the Expert Group, members of both the industry and NCAs argued in favour of shortening the timeline and reducing the delay between the reference date of the assessment, i.e. the end of the previous calendar year and the SREP decision finalisation.

The current process for finalising a SREP decision through the governance process of the SSM can be represented as follows:

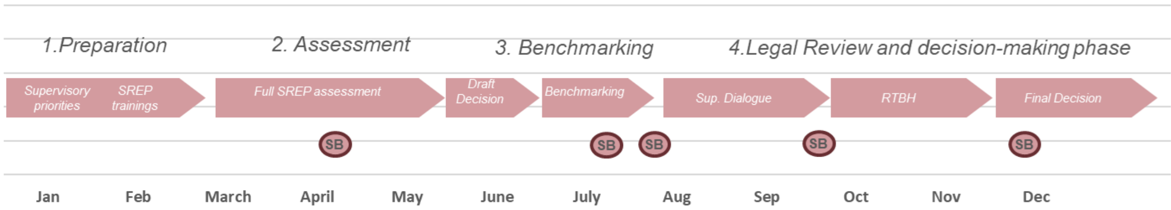
- First, general supervisory priorities are defined and assigned to each bank as appropriate. This helps to assign the intensity of their assessment work to each risk element. In parallel, supervisors may attend trainings to learn about changes in the processes, systems and methodologies occurred vis-à-vis the previous year. Such changes have been frequent in recent years as the SSM continues to build and refine its supervisory practices.

- Second, supervisors conduct the risk assessment, assign scores to each risk element, and define preliminary quantitative and qualitative measures. The scoring system of individual risk elements relies on a thorough methodology, developed by the ECB and the NCAs, which is regularly updated and enhanced.

- Third, the outcome of the risk assessment and the preliminary quantitative and qualitative measures are reviewed for consistency. Consistency is achieved through benchmarking analyses conducted by European banking supervision's second line of defence. Benchmarking is conducted considering significant institutions' business models and complexity to ensure adequate levels of comparability. The JSTs initiate the supervisory dialogue to share with the bank the preliminary outcome of their assessment and the qualitative and quantitative measures they plan to take. The supervisory dialogue is key to ensuring the transparency and predictability of supervisory actions, as well as allowing significant institutions to provide feedback before the conclusion of the SREP. Currently, most of the supervisory dialogue phases are held in September, which constrains the annual calendar for supervisory activities and banks' ability to execute remediation measures in a timely manner.

- Finally, the legal review, the right-to-be-heard process and the decision-making process takes place. Supervisory decisions are taken by the ECB's Supervisory Board. Current practice requires the Supervisory Board to repeatedly review and approve SREP outcomes for all significant institutions simultaneously. This practice helps the Supervisory Board and its members to be informed of the interim results from the SREP assessment, benchmarking, and supervisory dialogue phases, while still giving the Supervisory Board the possibility to react in a timely manner. At the same time, however, this practice occupies time and attention.

Exhibit 2: Overview of the SREP timetable



The Expert Group welcomes the ECB's decision to strengthen the supervisory prioritisation of risks and deploy a MYA in the context of a well-defined RTF. Faced with today's highly complex and dynamic risk environment, a key task of supervisors is to identify key risks and prioritise their assessment. Through the MYA, supervisors will be able to choose which risk areas to assess each year. This will allow them to avoid performing yearly assessments for less material risk areas or for areas where the supervisory assessment has not changed and dedicate more resources to in-depth reviews.

SREP outcome

The outcome of the SREP is then addressed by the ECB to significant institutions. The SREP decision includes the list of binding requirements stemming from the supervisory assessment and detailed summaries of risk assessments and findings for each SREP element. The SREP decision is a legal act adopted by the ECB Governing Council. The decision can also include non-legally binding recommendations.

The Expert Group notes that SREP decisions are generally technical and often long documents, which do not always point clearly to the key weaknesses that significant institutions must address to improve their risk profiles. In some cases, the risk assessment summaries are marginally updated each year and resubmitted to significant institutions, even if supervisors have not identified new material developments in banks' risk profiles. In other cases, the risk assessment summaries include compilations of indicators and descriptions for each risk area, regardless of its materiality to the significant institution's overall risk profile, without expressing clear views of the supervisory priorities.

In 2021 European banking supervision introduced an Executive Letter, with the aim of highlighting the main points that supervisors expect banks' leadership to focus on and the key drivers of Pillar 2 capital requirements. The Executive Letter has proven an effective tool to facilitate and structure the supervisory dialogue, as recognised by supervisors and by the industry. However, the Executive Letter still falls short, in general, of providing a sufficiently coherent and comprehensive portrait of the bank. Moreover, it often does not contain a clear description of the main expected management actions that would remedy the identified shortcomings.

1.3 Systems

Information Management System (IMAS)

While European banking supervision relies on multiple IT systems to perform its supervisory tasks[18] the Expert Group focused its attention on IMAS which forms the backbone of the SSM supervision systems. It is both a repository of supervisory information and a workflow process system and is the common IT-platform used by the SSM supervisors to store information and initiate and execute the primary workflows for supervision. All SSM supervisory processes are documented in IMAS, including the SREP, on-site inspections, internal model investigations, operational and strategic planning, enforcement and sanctions procedures, fit and proper assessments, and authorisation procedures. Through IMAS, SSM supervisors have direct, online access to much information related to the supervised institutions, allowing them to share information with the ECB or an NCA, regardless of their place of work, either as part of a JST or a specialised function.

IMAS has not kept pace with the material changes European banking supervision is making to enhance its methodologies and thus the efficiency and effectiveness of its supervision. As part of the SREP, JSTs include in specific text boxes their risk assessments, choice of scores, findings, measures issued and relevant data and supporting documentation**.** The design of the system dictates how the SREP is executed in the field and any flexibility introduced to the process cannot become operational unless corresponding changes are made to IMAS. As supervisors spend a significant part of their time working with IMAS, its design directly affects the structure of SSM processes and may ultimately affect the SSM's supervisory culture.

Moreover, IMAS still does not sufficiently integrate all of the relevant supervisory processes that are dictated by the SREP methodology. For example, the process of follow-up to the remediation of measures issued to banks relies on separate documents whose content must be pasted manually into IMAS by the JST. As a result, supervisors are required to include similar input for different purposes in different IMAS modules and to compile mandatory questionnaires covering all risk areas.

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18 Among the others, the document management and exchange platforms ASTRA and DARWIN, the Stress Tests Accounts Reporting (STAR), the portal for the submission of authorisation requests (IMAS Portal).

Data analytics

The SSM's data analytics infrastructure has not kept pace with the increased volume and complexity of data that European banking supervision collects. In the last few years, **European banking supervision** has successfully developed various supervisory technology tools to support textual analysis, data analytics and data visualization.[19] However, to date, most supervisory teams rely on manual processes to extract and analyse data, as the available tools do not allow supervisors to easily extract customised datasets from the data warehouse. In addition, the governance of data analytics tools is not fully or efficiently developed, since different organisational functions produce similar visualisation tools, some of which are not regularly updated and quality assured.

1.4 Observations and recommendations

Observation 1.1

Despite the efforts European banking supervision has undertaken to align the SSM and drive the accomplishment of its objectives, including a strong "tone from the top," it was observed during the feedback sessions with European banking supervision staff that a supervisory culture for the SSM is not yet sufficiently formalised. Without an indication of the willingness of European banking supervision to take some level of legal risk, further opportunities to evolve the SREP to become more risk-based are limited because of the concerns around legal challenges or personal liability.

Recommendation 1.1: Further develop the target supervisory culture and the risk tolerance framework

The Expert Group recommends that the European banking supervision establishes a formal document defining its supervisory culture and makes this publicly available. Both the ECB and NCAs should be directly involved in the process of defining and embracing the supervisory culture. In addition, to reinforce and further support the tone from the top, additional trainings should be implemented that highlight, for example, case studies demonstrating support for and acceptance of outcomes based on risk prioritization. Role models should also be identified as exemplars for staff to understand how best to implement the go-forward changes to the SREP.

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19 These include specific tools to support fit and proper assessments ("Heimdall") or internal model investigations ("Medusa"). It has also embarked on a project ("Agora") to gather all prudentially relevant information as a one-stop shop for prudential analytics. More information here.

Observation 1.2

Pending the full deployment of the MYA, the current SREP still aims each year to assess many risk areas in detail, without a clear prioritisation. Coupled with the long SREP timeline and the rigidity of some of the SSM's IT systems, this may divert supervisory resources away from the key risk drivers for each bank.

Recommendation 1.2: Embed the risk-tolerance framework in day-to-day supervision.

Leveraging the extensive knowledge built in the past decade, European banking supervision should continue its course to shift the focus of its supervisory processes away from all-encompassing reviews that lack proper risk-based prioritisation, towards targeted assessments of key risks.

The JSTs could be encouraged to perform deep-dive exercises less motivated by fault finding and more by the desire to understand the bank's risk profile and drive the bank toward strengthening its processes to manage that risk. Risk-prioritization should be informed by a bank's business, market and competition environment, strategy, history, and culture.

Observation 1.3:

The SREP process is conducted as an all-encompassing review of significant institutions' risk profiles, but it does not sufficiently leverage all findings and outcomes from other supervisory processes.

Recommendation 1.3: Better integrate the outcomes of other supervisory activities into the SREP assessments and measures.

The SREP should be a point-in-time stocktake of each significant institution's risk profile based on supervisory information available to that point in time, rather than a yearly omni-comprehensive review of banks' risk profiles through numerous modules. European banking supervision conducts several supervisory activities beyond the SREP and should ensure that insights stemming from those activities flow into and inform the SREP assessments and measures. Moreover, when relevant, recommendations and requirements issued as part of the SREP may refer to previous supervisory actions to reinforce them or escalate them as appropriate.

Observation 1.4

The annual SREP cycle is a lengthy process involving numerous iterations and spanning a period of up to 14 months. Given the maturity of the SREP process, there should now be greater room to streamline the review and approval by the Supervisory Board.

Recommendation 1.4: Shorten and make the SREP timeline more efficient.

The Expert Group recommends that European banking supervision consider what activities of the current SREP should stay within the common synchronised timeline and what should better be scheduled bank-by-bank or throughout the year. A point-in-time summary of the latter types of activities could be included in the SREP letter, but the JSTs could communicate some of the outcomes to banks on an ad hoc basis as soon as available.

At present, the period between the reference date and the yearly decision could be shortened by three to four months by fully implementing the MYA in the SSM's processes and systems, by streamlining the be-spoke SREP analysis (Recommendation 1.2), and by decoupling the calculation of P2R from the risk assessment (Recommendation 2.3). In doing so, the review of some elements of the risk assessment (such as risk controls, governance, and business model), which do not require financial data, could be anticipated, and based on all available supervisory information.

Moreover, a selective approach should be followed when deciding on the development of new complex methodologies: methodologies should be developed or updated only when properly justified on the grounds of effectiveness. The complexity of the SREP methodology is widely recognized, and as a result, there is a significant increase in the time required to conduct trainings when changes are made. Pursuing a more selective approach to methodology developments would result in a shorter SREP timeline, as supervisors would need less time to familiarize with new methodologies at the beginning of each SREP cycle. At the same, this would allow supervisors to employ a higher share of their training time to develop of state-of-the-art skills at a time where complex emerging risks are prevalent. Finally, further time savings could be achieved by conducting, when possible, parallel runs of multiple processes including supervisory dialogue, the right to be heard and legal reviews, and by streamlining Supervisory Board reviews and approvals.

On the latter, the processes could be made more effective and efficient by focusing the participation of the Supervisory Board on issues involving policy implications and on controversial or outlier cases. An illustrative composition of the new practice could include the following:

- In December approval of the yearly SSM priorities and the SREP strategy which considers the supervisory priorities in March; as well as discussion on the overall capital needs (see Recommendation 2.4).
- In September approval of the final SREP decisions; any individual issues which deserve the Supervisory Board's attention (e.g. limited number of controversial cases) can be brought to it on an ad hoc basis.

Observation 1.5:

As supervisors spend a significant part of their time working with IMAS, its design directly affects the structure of SSM processes and may ultimately affect the SSM's supervisory culture.

Currently, different processes are reflected in separate IMAS workflows, which do not interact, resulting in the need to replicate work in a variety of workflow steps. For example, the process for on-site inspections or authorisation is separate from the SREP, although JSTs often rely on findings from those activities to inform their SREP assessments.

Moreover, IMAS does not yet reflect the MYA, and still requires supervisors to fill in several templates, regardless of the risk-based prioritisation of tasks and assessments. In addition, the SSM's data analytics infrastructure relies heavily on manual processes and is not integrated in IMAS.

Recommendation 1.5: Improve IMAS or the systems that the JSTs use to make them more flexible, correct the lack of sufficient integration across processes and increase their adaptability to methodological enhancements.

The Expert Group recommends that European banking supervision review potential strategies to increase the flexibility of IMAS with a view to better integrating supervisory processes and better adapting to, rather than driving, the needs of supervisors.

Findings stemming from different supervisory processes but pertaining to the same risk area should be integrated in a single location in IMAS. This would ensure that such findings are all considered by JSTs when conducting their risk assessment and determining the applicable qualitative and quantitative measures.

In addition, for the MYA to deliver change and increase the effectiveness of supervisory action, the MYA should be fully reflected in IMAS. Streamlining IMAS, avoiding the duplication of information, in line with the multi-year risk prioritisation would reduce the time spent by JSTs on performing routine tasks and facilitate in-depth supervisory assessment of higher-risk areas, in line with their supervisory planning.

Observation 1.6:

SREP decisions and, in some cases, executive letters are composed as a compendium and do not always provide a holistic perspective on banks' strategic and risk profiles, also in the context of the specific environment in which they operate. Moreover, they often do not clearly identify and prioritise the actions banks must take to remediate their weaknesses.

Recommendation 1.6: Make SREP letters more effective to promote sound and timely management actions by banks.

The SREP letter should not be an inventory of findings but should provide a clear overview of (i) the key strategic risk drivers identified by supervisors, taking into account the external environment in which each bank operates; (ii) the key supervisory concerns and challenges faced by each bank; and (iii) the actions that banks are expected to undertake to mitigate and address these challenges and concerns.

The SREP decision and / or the executive letter should include narrative sections which describe what the JSTs consider to be distinct characteristics of the bank. This would frame the individual supervisory findings and measures into context taking into account each bank's business model, strategy history and culture as well as the market and competitive environment in which it operates, and it would help put requirements and recommendations into context. The section should be written to foster a forward-looking and interactive dialogue between the SSM management and the bank's CEO and board.

Importantly, the SREP letter should create mutual accountability for banks and supervisors to follow-up on open measures, and the SREP decision could also include an annex with a full list of measures issued under other supervisory processes (e.g. on-site inspections, internal model investigations and authorisation procedures) that are still pending.

Observation 1.7

While European banking supervision has invested significantly in the development of data visualisation tools in recent years, the SSM's data analytics infrastructure relies excessively on manual extractions, and data sources are not yet fully integrated. In addition, IMAS – the system in which risk assessments are conducted and documented - has no embedded data analytics function and is only a data repository.

Recommendation 1.7: Further develop data analytics.

European banking supervision should enhance the tools used by supervisors to extract, aggregate and analyse data. More efficient and robust data management and analysis tools would allow supervisory teams to fully leverage the high volume of data already available to them in a coordinated and integrated manner. It would also allow supervisors to allocate less time to data management tasks and more time to data-driven, risk-based supervisory assessments. European banking supervision may also assess the feasibility of introducing data analysis features in IMAS.

2. SREP scores and capital requirements

2.1 Background

The SREP's scoring system implemented by European banking supervision ranks banks from 1 (low risks) to 4 (high risk). For the overall SREP score and the scores of the four main elements (business model, governance, capital and liquidity),[20] the framework includes the possibility of applying +/- qualifiers to scores 2 and 3. Scores assigned to each SREP element are subsequently aggregated into two comprehensive indicators: (i) the overall SREP score and (ii) the overall risk score. The overall risk score is the key determinant of Pillar 2 capital requirements**.** It is a weighted average of the scores given to Element 1 (Business Model), Element 2 (Governance) and the four risks (Credit, Market, Operational and Interest Rate Risk in the Banking Book) assessed as part of Element 3 (Capital).

The leading role played by the overall risk assessment for determining capital requirements is a unique characteristic of the ECB's approach. It is uncommon to directly link overall risk scores and capital requirements in other jurisdictions. For instance, in both the United States and United Kingdom, qualitative measures directly aim at addressing the shortcomings identified through risk assessments. In both jurisdictions, Pillar 2 capital requirements are determined through separate exercises[21]. The approaches followed in those jurisdictions seem to be based on the principle that factors affecting the risk profile of a bank are not all necessarily best addressed by capital or liquidity add-ons (see Section 3 on qualitative measures)[22].

Arguably, the ECB's SREP is geared primarily toward quantitative measures without leveraging to the extent possible other supervisory tools to enhance banks' identified weaknesses. This characterisation is supported by the link established between risk scores and capital requirements, the limited role currently played by qualitative measures in the SREP decisions (the vast majority of qualitative measures are taken outside the SREP) and some imperfections in the way those measures are formulated, prioritised, and escalated (See Section 3).[23]

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20 Qualifiers for the 2 and 3 notches are also used for the main subcomponents of the third element (capital) of the SREP score.

21 In the United States, capital add-ons are determined exclusively by stress-test. In the United Kingdom, Pillar 2 Requirements are derived from a quantitative analysis of the potential losses associated with specific risks that are not sufficiently covered by Pillar 1.

22 This element is recognised in the ECBs SREP manual: "…factors that feed into the overall supervisory assessment of a bank do not all have the same impact on its additional capital requirements".

23 As indicated in the first page of the ECB's SREP manual: "*The SREP assesses the way a bank deals with its risks and the elements that could adversely affect its capital or liquidity, now or in the future*". This objective is arguably narrower than the EBA's understanding of the purpose of SREP: "The key purpose of SREP is to ensure that institutions have adequate arrangements, strategies, processes and mechanisms as well as capital and liquidity to ensure a sound management and coverage of their risks, to which they are or might be exposed".

2.2 Scores

The Expert Group finds that the current scoring system has served the ECB rather well. In particular, the Expert Group has found no evidence of favourable scores having been assigned to banks that subsequently failed. Moreover, the ECB is progressively improving the methodology and the tools used for the assessment of the different risk categories. Finally, the ECB's SREP includes elements that are not present in other jurisdictions, such as a dedicated assessment of business model risks, which is a strength.

A number of consulted stakeholders have made a series of observations on the process followed to determine scores:

- **The process is viewed as excessively mechanistic**. Supervisors are seen as mainly focusing on complying closely with the detailed methodology and ticking all the boxes. This work leaves little time and few incentives for them to invest in other analyses that could be helpful to form a comprehensive view on the overall risk profile and the main challenges of the institution. Indeed, the list of checks and analyses that need to be performed to derive scores in each SREP cycle appears excessive. This does not facilitate the objectives of empowering JSTs to decide on the priorities for supervisory analysis and of making the SREP assessment less dependent on ad hoc checks and more on regular supervisory activities (see Section 1).
- **Scores would not sufficiently discriminate across entities and are quite sticky.** Indeed, scores tend to concentrate around grades 2 and 3, and to change little over time despite changes in risk levels and in the quality of risk controls. This can reduce the incentives for banks to take remedial actions to improve their risk profile, as the implementation of those actions may not be reflected in the overall scores. The excessive codification of risk assessment criteria based on quasi-structural indicators that do not change much over time may partially explain this outcome.
- **Transparency on the process could be further enhanced.** Banks express difficulty understanding what needs to be done to improve their scores. The information they receive on the rationale behind the scores for the different elements of the overall SREP scores and their components could be expanded to allow banks to understand the shortcomings identified and to satisfactorily address them.

The Expert Group does not fully endorse those observations. In fact, the ECB has already made clear progress in introducing flexibility to the SREP processes, in relying more on supervisory judgement (see Section 1), in increasing the granularity by adding qualifiers to the main four-notch scale and in enhancing transparency by drafting SREP Executive letters accompanying the SREP decisions and enriching the supervisory dialogue. Nevertheless, the Expert Group believes that several issues raised by stakeholders could be further addressed by considering some additional adjustments to the existing procedures.

One general consideration is whether integer scores based on an assessment of risks to viability are the most effective approach. The Federal Reserve System has recently put in place a new scoring regime for large banks that assigns ratings based on the severity of the identified weaknesses but also, crucially, on the ability of banks to remedy these weaknesses without radical actions affecting their business models. Ratings are therefore directly linked to the timely adoption of management actions. While the scoring scale is not very granular, ratings are helpfully connected to banks' measures. This facilitates mobility across ratings and enhances transparency vis-à-vis banks[24].

2.3 Quantitative capital measures

The EBA guidelines establish that competent authorities should determine the quantity of additional own funds required to cover risks not covered by Pillar 1 (P2R). In addition, the EBA guidelines ask competent authorities to issue a non-binding request for banks to hold own resources above their capital requirements to ensure that institutions remain adequately capitalised in stress conditions (P2G). European banking supervision sets P2G as a function of the capital depletion estimated for each institution in the adverse scenario of a stress test.

The ECB establishes P2R using a four-step procedure (called TOM 2.0) based primarily on its risk assessment for each bank but also taking into account banks' ICAAPs.

- In step 1, the overall risk score is automatically calculated, but it can be adjusted (based on a constrained judgement principle) by the JSTs to determine an initial P2R. Through the adjustments they make, JSTs ensure that the year-to-year evolution of the risk profiles is fully reflected in the assessment and can give better incentives to the bank to remediate critical findings.
- In step 2, the first estimate of P2R is allocated to the different risk components using the (re-scaled) contributions of each of them to capital needs beyond Pillar 1 as derived from the banks' ICAAPs. The proportions of P2R allocated to business model and governance, which are not

24 The Federal Reserve System uses four ratings: i) Broadly meets supervisory expectations, ii) Conditionally meets supervisory expectations; iii) Deficient-1, and iv) Deficient-2. This scale is applied to the three main components of the supervisory evaluation: capital, liquidity, and governance and controls. The components are scored separately but the firm will only be considered "well managed" if all three components are rated at least as "conditionally meets supervisory expectations". When a firm is not considered "well managed" other supervisory actions kick-in. See Board of Governors (2019): SR 19-3 / CA 19-2: Large Financial Institution (LFI) Rating System, February 2019.

part of ICAAPs, are determined based on the supervisory risk scores for the elements 1 and 2 of the SREP.

- In step 3, the risk-by-risk decomposition of the initial P2R estimate is challenged by supervisors considering different sources of information and through benchmarking.
- In step 4, the final risk-by-risk components are determined and the final P2R is derived from the sum of those components. Importantly, risk-by-risk decompositions are not formally communicated to banks (see Exhibit 3).

The approach followed appears to be an attempt to combine two different conceptual frameworks in the determination of P2R, namely the risk-by-risk approach and the holistic approach. The former considers that P2Rs have a clear purpose of covering potential future losses (from risks not covered by Pillar 1) and should therefore be derived from a clear and individualised assessment of those risks. The latter, namely the holistic approach, considers that the determination of capital requirements should be based on the overall risk score of the institution and that any attempt to derive those requirements by adding estimates of capital required for individual risks is operationally challenging as risks may be significantly interrelated.

Exhibit 3: Infographic on TOM 2.0

In practice, the current procedure has already proven helpful to deliver an effective application of Pillar 2 and has contributed to an adequate capitalisation of the European banking sector. The strong role played by the overall risk scores when determining P2Rs strengthens the incentives for banks to improve their risk profile. Moreover, it has proven sufficiently flexible to allow the ECB to impose surcharges of capital to cover specific risks (like insufficient loan-loss provisions on non-performing loans[25] or exposures to leveraged finance). Finally, the elements of constrained judgement which the procedure contains (e.g. in the determination of the overall risk score, its translation to P2R, the assessments of ICAAP's) are effectively used by JSTs. As a result of all this, the current level of capital requirements for SSM banks looks broadly adequate.

Nonetheless, there is room to improve the conceptual underpinnings of the current approach and to address the implementation challenges it poses.

- **Using risk scores from all the categories of risks for determining capital add-ons may be suboptimal**. Some of the banks' weaknesses that are reflected in risk-scores are only indirectly linked to a specific need for capital, at least on the horizons relevant for the determination of capital requirements (typically one year). This is the case, for example, for governance risks. Furthermore, there are other cases where increases in capital requirements seem ill-suited to address deficiencies identified in the risk assessment. For example, whenever the business model analysis (Element 1 of the SREP risk assessment) finds that a bank is unable to deliver sufficient return to its equity holders, there should be little hope that additional equity would, alone and by itself, improve a bank's viability.
- **Moreover, P2R should mainly aim at absorbing potential losses which are not covered or are covered insufficiently by Pillar 1.** Understandably, the way overall risk scores are calculated goes beyond this narrow logic as they are designed to provide a broad characterisation of banks' risk profiles. Pillar 2 requirements should address issues such as sectoral concentration risks, IRRBB or pension risks which in the ECB's current P2R determination process do not necessarily receive a high weighting in the overall risk score. Although P2Rs can also be used to address weaknesses in internal controls when such issues become particularly persistent or severe as to translate in the near term into financial losses, other supervisory tools such as qualitative measures should be used in the first instance to address those weaknesses.
- **Using banks' ICAAPs to decompose the P2R into different risk-by-risk components can create additional distortions.** First, such an approach requires ad hoc interventions to introduce P2R components for elements (like governance and business model) that are not

25 The ECB imposed a P2R component on banks that did not book enough provisions to cover credit risk on the non-performing loans they granted before 26 April 2019, as well as an NPL backstop, a tool for the prevention of excessive build-up of new NPLs (after 26 April 2019) on bank balance sheets by creating buffers that allow banks to promptly tackle NPLs through sales or write-offs.

covered by banks' ICAAPs. More importantly, banks' self-evaluations are often subject to biases that may become even more significant when ICAAPs play a prominent role in the determination of P2R.

On the operational side, the use of ICAAPs to obtain a risk-by-risk decomposition is also quite challenging. In principle, ICAAPs' risk-by-risk decomposition is only accepted once it has been challenged by supervisors. However, given the heterogeneity of procedures used by banks, supervisors may struggle to understand the assumptions and methodologies underpinning banks' estimates and to provide alternative ones, even when they perceive that ICAAPs are generally unreliable. Supervisors exhibit high variability in how they justify deviations from the ICAAP numbers in the risk assessment narratives, and this practice triggers numerous touchpoints during the consistency reviews, which also devotes a large part of its efforts to this matter. Indeed, more than two-thirds of all findings of the second line of defence correspond to risk-by-risk-decompositions.

The end result seems to be that the final determination of P2R remains in general at or close to the initial calibration based on the overall risk score, while its risk-by-risk decomposition follows the non-fully reliable ICAAP calculations. As the risk by-risk decomposition of P2R is not published and is not communicated to the bank, the internal inconsistencies of the approach have little practical relevance. Yet, for the same reasons, the whole exercise may be excessively be costly with limited added value.

The current procedure followed by the ECB to determine P2R, which combines a predominantly holistic approach with some elements of the risk-by-risk approach derived from banks' ICAAPs may not outperform any of those two approaches. A purely holistic approach relies on the role of capital to address banks' weaknesses, may imply double-counting of risk factors for the calculation of capital requirements under Pillar 1 and Pillar 2 and follows a logic different from the one followed by banks to identify their needs of economic capital. This approach, however, is simple, relatively transparent and provides sufficient incentives for banks to address all their deficiencies, regardless of whether they pose direct risks for solvency in the short-term. The purely risk-by-risk approach is conceptually sounder as it focuses on specific risks to solvency that are not well covered by Pillar 1 and thus facilitates a fruitful dialogue with banks on their internal tools for capital planning. However, it is operationally more complex as it requires methodologies that could permit an estimation of potential losses associated with specific risks, that would inform the determination of P2R components with the required granularity. The ECB procedure may achieve neither the conceptual rigour of the risk-by-risk approach nor the operational simplicity of the holistic approach. First, it introduces additional inconsistencies by trying to mix two forms of computing P2R estimates that follow different logical paths. And second, the attempt by the JSTs and the horizontal function to reconcile the outcomes of banks' heterogeneous risk-by-risk ICAAPs with the holistic view of banks' risk profiles has become a tortuous task.

Other jurisdictions (such as the United Kingdom) have adopted a risk-by-risk approach that does not predominantly rely on ICAAPs, but instead on internal methodologies. Such an approach requires the development of tools and judgement criteria able to estimate potential losses that are not sufficiently covered by Pillar 1 for each risk category. These methodologies can then be used to estimate additional capital needs in a risk-by-risk manner, and lead to a derivation of the P2R (P2A in the United Kingdom case) for each bank, after properly applying supervisory judgement. Where relevant, those internal procedures may make use of ICAAPs but only as an ancillary information to estimate capital needs to cover specific risks. Moreover, risk assessments can be used as a judgemental factor affecting the final determination of the Pillar 2 requirements[26].

An adequate determination of P2R and P2G would benefit from an overall assessment of the capital needs of SSM banks. The current approach to determine P2R **-** based on the overall risk score – requires the development of an ad hoc transformation of risk profiles into specific quantitative capital requirements. There is obviously no hard science that can be used to develop universally valid metrics for this purpose.[27] A pragmatic approach to derive the correspondence between scores and P2R is to establish a general reference for the expected average level of P2R for SSM banks and that could help determining P2R for each entity. More generally, it may be useful to hold a structured discussion on the aggregate capital needs from a micro-prudential perspective and on the contributions of P2R and P2G to meet those needs. For this discussion, information on banks' risk scores could be combined with an analysis of the relevant aspects of the external environment (e.g., macroeconomic, geo-political, technological). Such information could largely coincide with that used for the annual determination of supervisory priorities each year. The assessment of overall capital needs may also facilitate dialogue with European and national macroprudential authorities which also establish capital buffers that may potentially interfere with the determination of P2R and P2G.

Among other factors, estimated capital needs depend on the severity assumed for the adverse scenario of the stress test. Neither the ECB nor other authorities involved in the organisation of stress tests (i.e., the EBA and the ESRB) have so far developed stable criteria to determine that degree of severity. Following the practice in some jurisdictions it could be considered introducing some anti-cyclical considerations. For instance, under buoyant (weak) current and expected economic conditions

26 See The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) and The PRA's methodologies for setting Pillar 2 capital.

27 In fact, over the last few years, the average P2R have remained broadly stable (at around 2,2 % of risk weighted assets27). The average P2G has also remained stable (at around 1.5%).

it may make sense to consider more (less) severe adverse scenarios than when the baseline scenario is already weak (buoyant). An alternative approach with the same objective could be that the ECB adjusts in the desired way the factor it currently applies to transform estimated banks' capital depletions in the adverse scenario of the stress tests into P2G.

It is more effective to rely on other supervisory instruments to enhance identified weaknesses in governance and business models rather than including them in the first instance in the evaluation of P2R together with credit, market, operational and IRRBB risks. The current approach is to embed those risks in the overall risk score that informs the determination of P2R. In principle, such weaknesses should only contribute to the determination of P2R to the extent qualitative measures are not expected, or have not proven to be, sufficient. An alternative approach could be to include them as a new and separate component in the determination of P2G when the supervisor wishes to introduce an additional measure as part of the escalation process. This would help focus P2R on risks that would directly require capital coverage in addition to the Pillar 1 requirements. As risks to governance or business model, in principle, will eventually affect solvency mainly over longer horizons, they would fit better with the risks identified in the forward-looking stress-test analysis[28]. While this would add rigor to the capital setting process, making this change does not imply that capital levels for banks would be lowered but only that its distribution between P2R and P2G might change. [29]

2.4 Observations and Recommendations

<u>Observation 2.1:</u>

The SREP process appears to be focussed on quantitative measures. The determination of capital add-ons - directly linked to risk scores - is perceived as the key output of the exercise**.** Qualitative measures do not have a comparable relevance. Compared with quantitative capital measures, qualitative measures included in the SREP do not appear to be a key output of the exercise (see related

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28 The reallocation of the capital coverage of risks related to governance and business model from P2R to P2G would logically imply a reduction of the average size of P2R in relation to P2G. Such a rebalancing may provide additional flexibility for the ECB as, unlike P2R, P2G is not published. In addition, if needed, P2G could be released to address unexpected shocks. However, although in practice P2R and P2G are both perceived as binding constraints for the institutions, they have different normative implications. Both breaches of P2R and P2G can trigger the request for a capital plan to address the shortfalls. However, unlike for P2R, breaches of P2G cannot by themselves trigger the declaration that the bank is failing or likely to fail.

29 The reallocation of the capital coverage of risks related to governance and business model from P2R to P2G would logically imply a reduction of the average size of P2R in relation to P2G. Such a rebalancing may provide additional flexibility for the ECB as, unlike P2R, P2G is not published. In addition, if needed, P2G could be released to address unexpected shocks. However, although in practice P2R and P2G are both perceived as binding constraints for the institutions, they have different normative implications. Both breaches of P2R and P2G can trigger the request for a capital plan to address the shortfalls. However, unlike for P2R, breaches of P2G cannot by themselves trigger the declaration that the bank is failing or likely to fail.

Recommendation 3.1). Moreover, scores do not show much variability across banks and appear to be quite sticky overtime**.**

<u>Recommendation 2.1</u>: Redefine risk scores to strengthen the role of management actions, enhance the dispersion of ratings across banks and reduce their stickiness.

To achieve these objectives, scores could be better connected with banks' progress in addressing the weaknesses identified in the assessment process. Rather than being a function of risks to viability, scores could be a function of banks' perceived ability to take specific actions to address supervisory concerns. Scores should change (increase / decrease) based on the actual performance of banks in addressing their deficiencies and delivering the expected actions, generating variability over time. This approach would also promote more dispersion across banks by facilitating the use of score 1, since, with the new definition, this would carry less reputational risk for supervisors. Such use of scores would also strengthen the role of qualitative measures.

<u>Observation 2.2:</u>

The Expert Group agrees with banks' perception that the determination of SREP scores provides limited information on what banks can undertake to improve the scores.

<u>Recommendation 2.2</u>: Better communicate the rationale behind scores.

As part of the SREP communication, a clear explanation of the scores should be provided as a function of the risks and actions that the firm needs to put in place to address identified weaknesses.

<u>Observation 2.3:</u>

To determine P2R, the ECB aims to combine a holistic approach based on its overall risk assessment with some elements of a risk-by-risk approach derived from banks' ICAAPs. The former is operationally simpler but does not permit focusing on risks that are not covered or are insufficiently covered by Pillar 1. The latter is arguably more consistent with the logic of Pillar 2 but entails potentially more operational complexity. The ECB's combined approach, however, does not seem to outperform those two approaches either in terms of simplicity or consistency. The reliance within the procedure on ICAAPs is highly problematic.

<u>Recommendation 2.3:</u> Develop the P2R methodology to make it more operationally efficient and focused on specific risks requiring additional capital coverage, while significantly limiting the use of ICAAPs.

The current P2R methodology could be reviewed as follows:

- Assess whether the combination of the holistic approach with the ICAAP-based risk-by-risk decomposition provides any benefit - considering also operational costs - as compared with the purely holistic approach.
- Consider transitioning away from a determination of P2R based on risk scores towards a more direct focus of the P2R on actual capital needs. In particular, consider developing internal tools and criteria to identify and assess firms' specific risks, for which Pillar 1 does not provide sufficient capital coverage[30]. Methodologies should be sufficiently flexible as to accommodate new capital needs under specific circumstances and leave sufficient space for supervisory judgement. This judgement could be used, for example, to impose capital requirements for banks that prove unable to timely deliver on qualitative measures that were previously imposed to address relevant weaknesses. ICAAPs should be used as ancillary information, rather than the basis for the analysis.
- When developing the new approach, assess whether the introduction of some proportionality may help to reduce operational costs. For example, it could be considered to apply when ready, the new non-ICAAP-based risk-by-risk approach only to larger banks (e.g., for clusters 1 and 2) and use a simpler approach (e.g. a refined holistic approach) for the remainder.
- Under this longer-term solution apply judgement to adjust P2R also to cover business model and governance risks whenever additional capital add-ons related to those risks are considered necessary to complement qualitative measures. Alternatively, and to the extent permitted by the legal framework, they could also be included as a new component of P2G in addition to the one based on the capital depletion in the adverse scenario of the stress test.

Transitioning away from a determination of P2R based on risk scores towards a more direct focus of the P2R on actual capital needs would also disentangle the process for the determination of capital requirements from the risk assessment process. This would provide the European banking supervision with more flexibility to shorten and streamline the SREP timeline (see Recommendation 1.4).

Observation 2.4:

The bank-by-bank calibration of P2R and P2G should take account of the estimated aggregated capital needs for SSM banks. There may be room to conduct an annual assessment of the required capital for

30 Several approaches could be explored. For example, the PRA has developed an-ad-hoc methodology for each relevant risk. Alternatively, stress tests could provide a helpful quantitative guidance on the main risk drivers affecting the capital position.

the sector that could inform the estimation of expected average P2R at the beginning of each SREP cycle as well as a discussion on the adverse scenario of the stress test leading to P2G determination.

Recommendation 2.4: Schedule a thorough annual discussion within the Supervisory Board on the capital needs of the euro area banking sector.

The discussion should aim to formulate preliminary expectations on the average P2R, the calibration factor for the P2G and the desired severity for the adverse scenario in the stress test used for the determination of P2G.[31] Such a discussion could be combined with the annual review of supervisory priorities.

31 For the EBA exercise the severity of the adverse scenario would not be determined directly by the ECB, but by the EBA and the ESRB. Yet, the ECB's (qualified) view on the matter could well be transmitted through its representation in both organisations.

3. Qualitative measures

3.1 Background

Qualitative measures are a key tool available to supervisors to address gaps in banks' internal controls, internal governance, and risk culture. Gaps between a bank's policies and practices in this area and regulatory requirements or supervisory expectations contribute to the build-up of risk and may hinder banks' viability, especially in the medium and long term.

As they aim to address risks that cannot be easily measured numerically, qualitative measures necessarily require a high degree of supervisory judgement. Most supervisors issue a range of qualitative measures using terms such as "observations" or "recommendations" through to "requirements" or "notices to comply". This range typically aligns with the severity of the finding, the intended outcome of the measure, and the legal framework and powers within which the supervisor operates.

The effectiveness of qualitative measures relies on the timely follow-through and consistent enforcement exercised by the supervisor. Because qualitative measures often aim at remediating structural weaknesses, remediation can take a long time and considerable effort by both the bank and the supervisor responsible for monitoring the measures and assessing their ultimate effectiveness.

In 2022, European banking supervision issued around 5,500 qualitative measures to its (at the time) 113 supervised banks.[32] The SREP accounted for a relatively small proportion of the total measures and typically those of a more severe nature. Most qualitative measures fall outside the SREP. Close to half (46%) of qualitative measures are issued in response to bank-initiated processes (internal model investigations and legislated requirements such as including licensing, qualifying holding authorisations and fit and proper assessments). On-site inspections account for 26% of qualitative measures, while the SREP accounts for just 12%. Of the qualitative measures included in the 2022 SREP, the vast majority (65%) stemmed from findings with high severity (ranked 3 of 4)[33]. Only half of the measures were legally binding, with the remaining half being issued as non-binding recommendations. Banks with larger balance sheets and more complex business models received, in absolute terms, a higher number of measures than smaller and less complex banks.

32 In 2020, the European banking supervision issued 5.767 qualitative measures. In 2021 it issued 8.702 measures due to the one-off flow of measures stemming from the Targeted Review of Internal Models.

33 The severity is assessed by the experts in charge of each supervisory activity according to a four-point scale, from 1 (low severity) to 4 (high severity).

Around 45,000 measures have been issued by European banking supervision since the inception of the SSM. Of those, 73% were closed following the implementation of the necessary remedial actions by supervised banks. Since 2020 the number of open measures outstanding at the end of each year has stabilised at around 12,000, half of which stem from findings with medium or high severity. Measures remain open until their deadline expires and JSTs confirm their adequate execution.

Data shows that the ECB uses qualitative measures extensively. However, the Expert Group believes there is scope to enhance the effectiveness of the ECB's qualitative measures. Supervisors can ensure that qualitative measures remain effective by being judicious about when they are used, by ensuring there is an effective follow-through process for all outstanding measures and by using enforcement powers, including sanctions, to ensure measures are complied with.

First, the process for formulating qualitative measures could be further streamlined to consolidate the role of the JSTs as a gateway between the ECB and banks. In the SSM, JSTs are responsible for communicating supervisory findings stemming from most supervisory activities, including the SREP, to banks and for issuing all qualitative measures. To conduct their supervisory work, JSTs rely on the support of horizontal experts specialized in specific risk areas or processes.[34] The central role played by JSTs aims at ensuring consistency in the supervisory approach and establishing a single communication channel between European banking supervision and banks. It also facilitates the monitoring of qualitative measures' implementation and ensures that their outcome is reflected in the assessment of each bank's risk profile. However, on-site inspections and internal model investigations, which are performed by the ECB's independent inspectors[35] and generate the highest volume of qualitative measures, follow a different process. Findings are reported to the bank directly by the on-site team at the end of the inspection period. The JSTs are then responsible for determining which findings warrant qualitative measures, formulating the measures and monitoring their implementation.

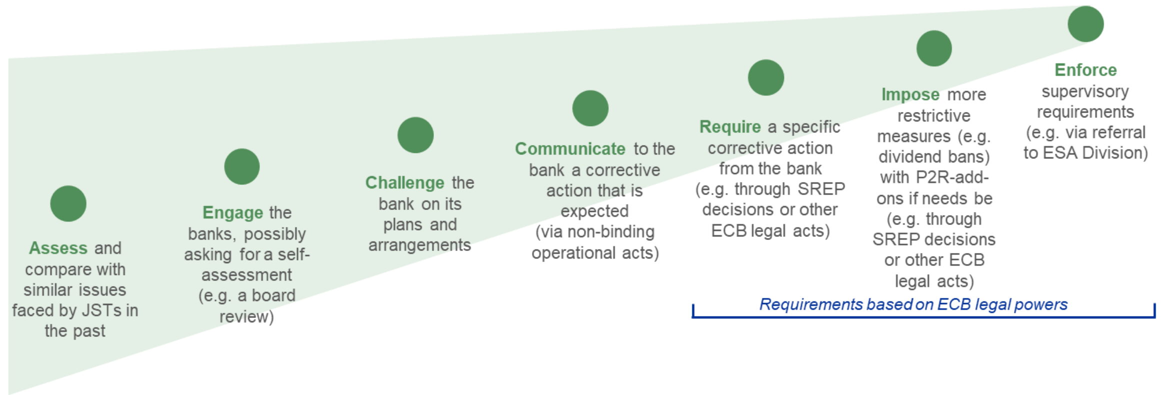
Second, the process for formulating qualitative measures could benefit from further integration with the SREP. Currently, pending the full implementation of the SREP MYA, the SREP outcome does not provide for a systematic review of the qualitative measures issued as part of all supervisory processes, of the state of play in the execution of those measures, and of the impact that those measures have on the bank's overall risk profile. As a result, the supervisory approach may appear fragmented, as measures are not all geared towards the same risk-based, supervisory objectives, but independently tackle different weaknesses.

35 The ECB has established a principle of independence between on-site and off-site supervision according to which on-site teams must act independently of, but in cooperation with, the JST.

Third, the formulation of qualitative measures across teams and supervisory activities is not always consistent. The Expert Group finds that the formulation of qualitative measures is heterogeneous, with some providing a clear overview of the specific supervisory concerns and desired remediation actions, and others outlining only high-level expectations. European banking supervision collects individual measures and fosters dialogue and the exchange of information among experts through dedicated expert groups, but it has not developed a standardised repository of qualitative measures blueprints that could be used by JSTs as a starting point to formulate measures addressing similar gaps.

Fourth, the follow-through process for qualitative measures does not embed a clear escalation ladder. While JSTs are responsible for monitoring the execution progress of qualitative measures and reflecting this in IMAS, the late or inadequate remediation of qualitative measures does not trigger any automatic escalation or reassessment. In some cases, the Expert Group has observed that JSTs use the SREP as an escalation tool, including binding requirements to address a certain weakness when non-binding qualitative measures have proven ineffective. However, in most cases the SREP is geared towards setting quantitative requirements, rather than on identifying the full set of qualitative and quantitative measures that banks need to execute to mitigate their key risk drivers. Defining a clearer escalation ladder that reminds JSTs of the tools at their disposal - to be selected in view of the specific circumstances - and that would range from non-binding qualitative measure to binding SREP measure up to enforcement and sanctions, for instance, would enhance consistency, set clearer incentives for banks, and ultimately increase the effectiveness of the qualitative measures process.

Exhibit 4: Escalation ladder



Finally, notwithstanding the significant progress done in the last years, there is still scope to streamline and standardise the follow-up process, including by developing specific modules to document and track progress on the implementation of qualitative measures in IMAS. Currently, banks and JSTs do not have a shared interface to exchange information and rely on non-standardised progress reports throughout the follow-up process. As a result, delays may occur between banks' execution of qualitative measures and the review and formal closure of those measures by JSTs.

3.2 Observations and Recommendations

Observation 3.1:

Compared with quantitative capital measures, qualitative measures included in the SREP do not appear to be a key output of the exercise. This contrasts with the situation in other jurisdictions, where qualitative measures are seen as the main output of the annual supervisory reviews (e.g. in the United States). This may partly be since most qualitative measures are imposed outside the SREP process. More importantly, it could also be due to the lack of clarity on the linkages between the overall risk assessment and the required management actions that banks are supposed to undertake.

Recommendation 3.1: Strengthen the link between qualitative measures and scores to promote better risk management and control.

Qualitative measures should complement quantitative capital and liquidity measures by addressing weaknesses in banks' internal controls and risk management practices. Such weaknesses contribute to the build-up of risk and may hinder banks' viability, especially in the medium and long term.

In Recommendation 2.1, we recommend that European banking supervision considers redefining the meaning of its SREP scores from measures of banks' risks to viability to measures of banks' ability and willingness (as judged by the supervisor) to execute actions to remediate their weaknesses. If such a new definition were adopted, it is key that, when they set SREP scores, supervisors also identify, for each risk area, the (qualitative) measures those banks need to execute to remediate their weaknesses and graduate to better SREP scores.

Achieving a stronger, clearer link between the outcome of the SREP assessment, summarised in the SREP scores, and the issuance of qualitative measures would:

- shift supervisors' focus from ranking and measuring risk to decisively promoting actions to reduce and control risk.
- provide clearer supervisory expectations to banks on the qualitative measures required to improve the outcome of the supervisory risk assessment.
- set strong incentives for banks to remediate to their weaknesses in a timely and effective manner.

Observation 3.2:

Currently, the number of findings is highly correlated with the number of measures. As a consequence, most qualitative measures are issued to address low-risk findings. Banks do not often understand how they should prioritise the management actions they should undertake. Moreover, there is often a lack of clarity on the consequences of not implementing the qualitative measures satisfactorily.

Recommendation 3.2: Strengthen prioritisation of qualitative measures and the role of the escalation process.

More effort should be made to prioritise qualitative measures across supervisory processes, including the SREP. This should lead to fewer measures aimed at strengthening key processes in the bank that need remediation. Narrowing down the scope of findings and measures communicated to the bank would be consistent with the risk-based supervision principle established by European banking supervision in other areas.

The four-point severity scale developed by European banking supervision, subject to the outcome of robust consistency checks, could act as a basis to identify the most severe findings that warrant binding qualitative measures in the SREP decision. Such binding measures should be followed-up without delay and, if banks' fulfilment of the measures is not satisfactory, JSTs should initiate enforcement actions. Less severe findings may still be addressed through other non-binding or binding measures outside of the SREP, enhancing the flexibility and timeliness of SSM supervisory action.

Focusing supervisors' and banks' resources on key risk drivers will, in the long term, contribute to consolidating the SSM's culture of risk-based prioritisation. Other findings would still be available to the JST, who could use them as basis for further assessments.

A more targeted approach would result in better efficiency in the SREP and would mark the inclusion of binding qualitative measures in the SREP decision as a clear milestone in the supervisory escalation ladder.

Observation 3.3:

On-site inspections and internal model investigations generate the highest volume of qualitative measures, most of which are rated as medium-low or low severity.

On-site inspections and internal model investigations are the only supervisory processes whose findings are communicated to banks by supervisory teams different from the JST and separately from the corresponding qualitative measures. This creates a time lag between the communication of findings to banks and the issuance of qualitative measures by the JST. In addition, given that qualitative measures are issued after banks have already become aware of all individual findings, JSTs tend to issue a qualitative measure to address each finding, without sufficient prioritisation. Therefore, channelling the communication of findings without JST intervention may weaken the perceived authority of JSTs, which are often seen as passive followers of the findings of other SSM staff.

Recommendation 3.3 Consider channelling all communication with banks in relation to supervisory processes through JSTs.

The Expert Group recommends that European banking supervision consider strengthening the existing principle of having the JST act as a nodal point of overall SSM supervisory activities. For example, on-site inspections reports may be handed over to the JST instead of the bank, allowing the JST and the on-site inspectors to jointly identify the material findings and the associated measures that are most important and require banks' immediate action.

Observation 3.4:

Examples of qualitative measures reviewed by the Expert Group were sometimes difficult to interpret. The narratives supporting the measures used a lot of subjective and very general descriptions and mixed supervisory observations with references to regulations and guidelines. Remediation requirements were often hard to interpret and, in many cases, measurable outcomes, including timelines, were absent. It was also rare to see qualitative measures with embedded enforcement.

Recommendation 3.4: Further strive to design and deploy qualitative measures in a targeted manner, with clear requirements focused on addressing banks' key vulnerabilities.

A possible framework to test the effectiveness of qualitative measures may require them to be:

- specific: qualitative measures should address specific problems and provide for clear, specific expectations.
- measurable: qualitative measures should be formulated in a way that allows both banks and supervisors to clearly assess the progress in their implementation.
- achievable: qualitative measures should be achievable and rely on best practices that supervisors observe in the market.
- relevant: qualitative measures should focus on key risk drivers, with a view to concentrating banks' and supervisors' attention on the most relevant sources of vulnerability for each bank.
- time-bound: qualitative measures should include clear expectations on the implementation timeline and should be regularly monitored and followed up by supervisors.

For similar situations, a repository of standardised templates for typical scenarios could be established and managed for the use of JSTs in comparable circumstances. The ECB should also make a practice of embedding enforcement actions to be activated if the measures are not implemented in a timely and adequate fashion. For example, restrictions on business or remuneration may be triggered if a bank fails to comply with a qualitative measure. The SSM risk appetite statement could be amended to clarify use of such measures if warranted. In combination with Recommendation 3.3, this Recommendation would establish a clear escalation ladder and focus the use of qualitative measure on the most severe findings.

Observation 3.5:

Efforts to establish procedure to regularly collect and organise the complete spectrum of qualitative measures for every bank are in the early stages of development. The JSTs are the originators of some of the qualitative measures and they also act as the channel for conveying qualitative measures from different sources. While the second line of defence collects data on the open inventory and status of measures, there is not a first-line process for the regular review of the open qualitative measure inventory. There is a lack of clarity as to when and how open measures affect the supervisory assessment and how linkages between remedial actions, risk assessment and supervisory planning are implemented.

Recommendation 3.5: Perform and deliver as part of the SREP a stocktake of outstanding measures, as well as form a view about the implications to structure necessary remedial actions.

To ensure full alignment among supervisory priorities, supervisory activities including but not limited to the SREP, and supervisory measures, European banking supervision should consider establishing a stocktake of all outstanding supervisory measures at the beginning of each SREP cycle. This stocktake and the resulting view about its implications would be the basis to produce an annex of the SREP communication and should be summarized in the executive letter (see Recommendation 1.6).

The stocktake should leverage information already available in IMAS, including (i) a review and prioritisation of pending supervisory measures, particularly qualitative ones, to identify potential delays or implementation gaps; and (ii) an assessment of the effectiveness of past measures.

The process should be facilitated by the second line of defence, building on the work already done by assessing the consistency of qualitative measures with supervisory objectives and the consistent follow-up and remediation of qualitative measures at the JST, peer group and aggregate level.

The results of the review may be shared with each bank together with the Supervisory Examination Programme to enhance transparency.

Observation 3.6:

In line with the observations of the Expert Group, both supervisors and banks have expressed frustration with the time and effort necessary to follow up on qualitative measures. In addition, banks have expressed dissatisfaction with the frequency and quality of feedback received on their remediation efforts. The ECB should leverage its robust IMAS system to enhance and streamline the tracking and feedback process.

Recommendation 3.6: Enhance technology already deployed to facilitate exchange of information with banks about remediation progress on outstanding measures.

IMAS allows supervisors to store findings and track the implementation of qualitative measures in an organized manner. However, there is no standardized process for banks to provide JSTs with updates on the progress in fulfilling qualitative measures.

European banking supervision has successfully developed innovative technology to exchange information with banks, such as the ASTRA repository and the IMAS portal. Leveraging on these best practices, the SSM could develop a common interface for qualitative measures, accessible to both supervisors and banks. Banks would be able to directly update supervisors on their progress and upload relevant documentation, without the need to draft ad hoc submissions. Supervisors in turn thus would have a regularly updated overview of banks' progress in fulfilling their qualitative measures and could then consider their own view about the progress.

This technology enhancement would not only increase efficiency, but it would also enhance transparency and ultimately boost the effectiveness of qualitative measures, ultimately resulting in remediation that strengthens the banks processes.

Annex 1: Mandate and members of Expert Group

1.1. Mandate of Expert Group

The objective of the project is to provide input to review the functioning of the Supervisory Review and Evaluation Process (SREP) as performed by European banking supervision and make recommendations for any enhancements to improve the effectiveness and efficiency of SSM supervision.

More specifically, the objectives of the SREP Expert Group are to:

- gather information and perspectives from:

  (i) major relevant stakeholders on the functioning and effectiveness of the SREP such as ECB Banking Supervision, national competent authorities (NCAs) of the SSM, EBA, industry; and

  (ii) other external international supervisory experts on supervisory best practices and forward-looking perspectives on the trajectory of supervision; and
- subsequently discuss and agree recommendations to improve the effectiveness and efficiency of the SSM's supervision.

To achieve these objectives, the Expert Group is composed of highly experienced individuals with diverse and international backgrounds in banking supervision, who report to the Chair of the Supervisory Board. Elizabeth McCaul, ECB Representative to the Supervisory Board, acts as sponsor of the project and contact point of the Supervisory Board for the SREP Expert Group.

The SREP Expert Group is invited to participate in relevant meetings to gather first-hand evidence on the functioning of the SREP. The SREP Expert Group is invited to consider the effectiveness and efficiency of the SREP, including how it is situated and operates with respect to the ECB's overall supervisory activities such as on-site inspections, internal model investigations, fit and proper assessments, thematic horizontal reviews, deep dives and sanctions.

1.2. Composition of Expert Group

Sarah Dahlgren is a Partner at McKinsey & Company. Ms. Dahlgren had a 25-year career at the Federal Reserve Bank of New York, where she started as an examiner and rose to become Executive Vice President and Head of Financial Institution Supervision. In that position, she was responsible for overseeing many of the largest banks operating in the United States and developing new supervisory policies and procedures. Additionally, Ms. Dahlgren was the Head of Regulatory Relations at Wells Fargo from 2018 to 2021.

Matthew Elderfield was a member of the expert group until 5 December 2022, when he decided to step down as he decided to pursue other professional opportunities. Mr. Elderfield was Deputy Governor and Head of Financial Regulation at the Central Bank of Ireland, Chief Risk Officer and Management Board member of Nordea and a senior executive at Lloyds Banking Group. He is also the former chief executive of the Bermuda Monetary Authority (BMA). Prior to joining the BMA, Mr. Elderfield spent eight years at the UK Financial Services Authority (FSA) as a head of several departments responsible for exchange and clearing-house supervision of secondary markets, listing policy and for banking supervision. Before joining the FSA, he established the European operation of the International Swaps and Derivatives Association (ISDA) and held position at the London Investment Banking Association and the British Bankers Association.

Ryozo Himino was the Chair of the Expert Group until he stepped down from the SREP Expert Group on 19 March 2023 to take over the position of deputy governor of Bank of Japan as of 20 March 2023. Mr. Himino served as the commissioner of the Financial Services Agency of Japan from 2020 to 2021 and chaired the Standing Committee on Supervisory and Regulatory Cooperation of the Financial Stability Board from 2019 to 2021. He was the secretary general of the Basel Committee on Banking Supervision from 2003 to 2006 and helped the Committee finalise Basel II.

Fernando Restoy has been the Chair of the Financial Stability Institute at the BIS since 2017. Previously, he had been Deputy Governor of the Bank of Spain since 2012. Prior to this he held other senior positions at the Bank of Spain, which he joined in 1991. From 1995 to 1997, he was Economic Advisor and Head of the Monetary Framework Section at the European Monetary Institute in Frankfurt. Mr. Restoy was Vice Chair of the Spanish Securities and Markets Commission (CNMV) from 2008 to 2012 and Vice Chair of the IOSCO Technical Committee. He was the Chairman of the Spanish Executive Resolution Authority from 2012 to 2015 and was a member of the Supervisory Board of the ECB from 2014 to the end of 2016.

Carolyn Rogers is the Senior Deputy Governor of the Bank of Canada, having been appointed at the end of 2021 for a term of seven years. She has 20 years of executive management experience in the financial services industry, having worked in both the public and the private sector. Ms. Rogers was the

Assistant Superintendent of Regulation at the Office of the Superintendent of Financial Institutions (OSFI) in Canada and OSFI's representative on the Basel Committee from 2016-2019. From 2019-2021, Ms. Rogers served as Secretary General of the Basel Committee.

Annex 2: Selected SSM supervisory processes and initiatives

A. Risk tolerance framework (RTF)

The RTF is meant to provide a strategic direction for supervisors. It combines top-down Supervisory Board guidance (provided via the SSM supervisory priorities) with a bottom-up assessment of individual risks (relevance). It empowers Joint Supervisory Teams (JSTs) to focus efforts on what is important and adapt their planning and day-to-day supervision accordingly.

The RTF is a simple principle-based framework providing strategic direction to focus on what matters. It is meant to empower supervisors to prioritise their work as opposed to follow a rule-based approach. This is intended to increase supervisory effectiveness within the Single Supervisory Mechanism (SSM) and focus on risk-based supervision.

The two main concepts of the RTF are:

Supervisory relevance: While there is no dedicated methodology on how relevance should be assessed, supervisors are empowered to take the available information into account in deciding what risks are important for their bank or supervisory tasks. The relevance assessment varies from high to low. It should reflect the level of concern that the JST has about a specific risk area.

Risk tolerance: The risk tolerance is determined via the risk tolerance matrix using the SSM supervisory priorities and the risk relevance as inputs. If a risk area is considered moderately relevant for a bank, then the risk tolerance will be moderate as well. However, for the sub-risks that are labelled as SSM supervisory priorities, the risk tolerance will be low.

B. SREP multi-year assessment (MYA)

The SREP MYA increases the flexibility for JSTs by providing the means to distribute the SREP assessment over multiple years. The revised SREP MYA is based on the newly defined concept of a minimum yearly mandatory assessment ("core" assessment), complemented by additional components to be carried out on a multi-year basis (these components are structured in "modules" and defined in the methodology of each risk area). This approach replaces the former concept of comprehensive assessment, under which a full risk area was assessed every three years.

The three main concepts of the MYA are:

Core assessment: The "core" component of the SREP assessment is the minimum set of information required to perform an annual SREP assessment.

It consists of providing an overall SREP score and summary narrative for the supervised institution with a clear identification of the key vulnerabilities and the supervisory actions; moreover it consists of an assessment (with a score and a summary narrative) of every SREP element (including all Element 3 and Element 4 sub-elements) with a summary indication of the risk level and/or risk control assessment and with a reference to every other relevant SEP activity conducted outside the SREP (e.g., conclusions stemming from a deep dive). Logically, it would also include a summary of the SREP modules assessed in a given year.

Modules are a subdivision of the areas to be assessed within a risk area. They are granular enough to allow its assessment in a multi-year planning, but not too granular to avoid excessive number and complexity. Modules have been defined at risk element level (e.g., for the Element 3 - credit risk), or at-risk control level (e.g., for the Element 2-governance) or at element level (e.g., for Element 3-risk of excessive leverage). Currently, modularity is being implemented in all risk areas. A transitional approach was introduced for those areas without modules in SREP 2023.[36]

To complete the “core” assessment of the SREP, JSTs can choose one or more modules to support the detailed element assessment from the modules within each risk area. Module assessment is only requested if the module is relevant/material for the supervised entity and the expectation is that such modules will be assessed over a maximum of four years’[37] (i.e., the JSTs will distribute the assessment of the relevant modules over four years). The selection of modules assessed each year should consider the risk tolerance level resulting from the RTF at the element level.

Prioritisation guidance (PG): This consists of a list of indications that translates the SSM supervisory priorities into a guidance on the optional components and modules to be assessed with higher priority in the context of the SREP assessment. This document aims to facilitate the mapping between priorities that may evolve over time.

C. Supervisory Examination Programme (SEP)

In accordance with Article 99 of Directive 2013/36/EU of the European Parliament and of the Council, the ECB must adopt at least annually a Supervisory Examination Programme (“SEP”) for significant institutions (SIs), including a plan for inspections (on-site inspections and internal model investigations) at the SIs’ premises. The SEP lists the legal entities concerned by an on-site inspection and the purpose

36 The evolution of the SREP methodology in the new multiyear dimension was fully implemented for all SREP elements starting from the 2023 cycle: the optional “modules” were introduced for E1, E2 and E3 (credit risk, market risk and risk of excessive leverage) and will be completed for the other SREP elements in the future SREP cycles.

37 The horizon of four years is extended to five years for uncontroversial small banks.

of the inspection. Based on the information contained in the SEP, a decision on the on-site inspections to be performed during the year is prepared, in line with the SSM supervisory strategy as defined by the Supervisory Board. Indeed, in accordance with Articles 11 and 12 of the SSM Regulation and Articles 142 and 143 of the SSM Framework Regulation, inspections at the banks' premises require a formal decision of the ECB (i.e. approval by the Supervisory Board and then the Governing Council via non-objection procedure).

D. On-site Inspections (OSIs)

OSIs are in-depth investigations of risks, risk controls and governance that follow specific procedures described in this part of the Supervisory Manual. The scope and frequency of OSIs considers the SSM supervisory strategy, the characteristics of the credit institution (size, nature of activities and risk profile) and the specific areas of the credit institution perceived as more vulnerable, where ongoing supervisory teams may need additional information, or where on-going supervisory techniques are not sufficient. The SSM OSIs are conducted in an independent manner, while remaining in close liaison with the JSTs based on a coordinated approach steered by the ECB. The OSIs are performed at the premises of the credit institution according to a pre-defined scope.

OSIs are point-in-time investigations, while, as the name denotes, on-going supervision is continuous with the objective to permanently monitor and assess the situation of the supervised credit institution. Both on-going supervision and OSIs are essential for effective supervision. They are complementary. Supervisors must have a permanent in-depth knowledge of the credit institution. This knowledge is obtained through ongoing supervision, which mainly relies on the information reported by the credit institution (regulatory, external, and internal reporting), complemented by OSIs to check inter alia the accurateness of the information used by the on-going supervision.

Accordingly, in the SSM organisational model, the OSI function is embedded and anchored in the overall SSM framework without jeopardising its independence. This principle of independent inspections is made operational through a separation in the performance of the two types of supervision: (i) the JST performs on-going supervision, and (ii) independent inspection teams conducting the OSIs. The close liaison between the JSTs and the OSIs is ensured by the possibility for JST members to participate in the inspections. However, they should not act as head of OSI teams.

Therefore, OSIs are:

- An integral part of the supervisory approach and a fundamental element of supervision.
- Conducted in an independent manner from the on-going supervision but connected to it on the basis of a coordinated SSM approach steered by the ECB.

- Essential to obtain an objective and comprehensive assessment of aspects of a credit institution, and to perform a focused investigation of risks, risk controls, processes, systems and personnel, which enable the verification of the functioning of the risk management framework in practice.
- Conducive to enrich and update the JST's knowledge of the credit institution.

E. Internal Model Investigations (IMIs)

Internally developed models form an important element in the capital requirements calculation of many credit institutions in the SSM. Their initial approval, as well as regular review, relies on intense investigations. The SSM internal guidelines set out the framework for these IMIs with a view to ensuring accurate capital quantification and a level playing field for institutions throughout the SSM. IMIs are either initiated by an application from the institution (e.g. in initial model approvals) or by the competent authority (e.g. in the follow-up of earlier IMIs). IMIs need to be incorporated in the SEP.

Internal model supervision in the SSM is driven by five guiding principles:

- **Risk sensitivity**, i.e. internal models reflect all material risks within their scope and appropriately react to changes in risk profiles, portfolios and processes.
- **Validation**, i.e. internal models are validated quantitatively and qualitatively in a sound manner and model uncertainties can be assessed by the bank.
- **Model risk management**, i.e. model risks of internal models are assessed rigorously.
- **Regular adaption**, i.e. internal models are regularly adapted to changing environments and risk profiles of the underlying portfolio.
- **Comparability**, i.e. internal models produce similar capital requirements for similar types and levels of risks across banks and any differences in required capital across banks and over time can be explained. An IMI is performed on-site, based on Article 12 of the SSM Regulation (OSIs), or off-site, by resources which are distinct from those of the JST and thus require the appointment of an inspection team led by a head of mission. It starts with a preparatory phase to assess the institution's readiness and facilitate a smooth investigation, continues with the investigation phase to collect the facts and findings, which are then, in the reporting phase, presented in a model assessment report and disclosed to the institution. The last two phases of an IMI comprise the drafting of a decision, and its adoption and notification to the institution.

IMIs are focused investigations of internal models, in particular regarding methodologies, economic appropriateness, risks, risk controls and governance. These investigations follow specific procedures described in this document.

Annex 3: Survey results

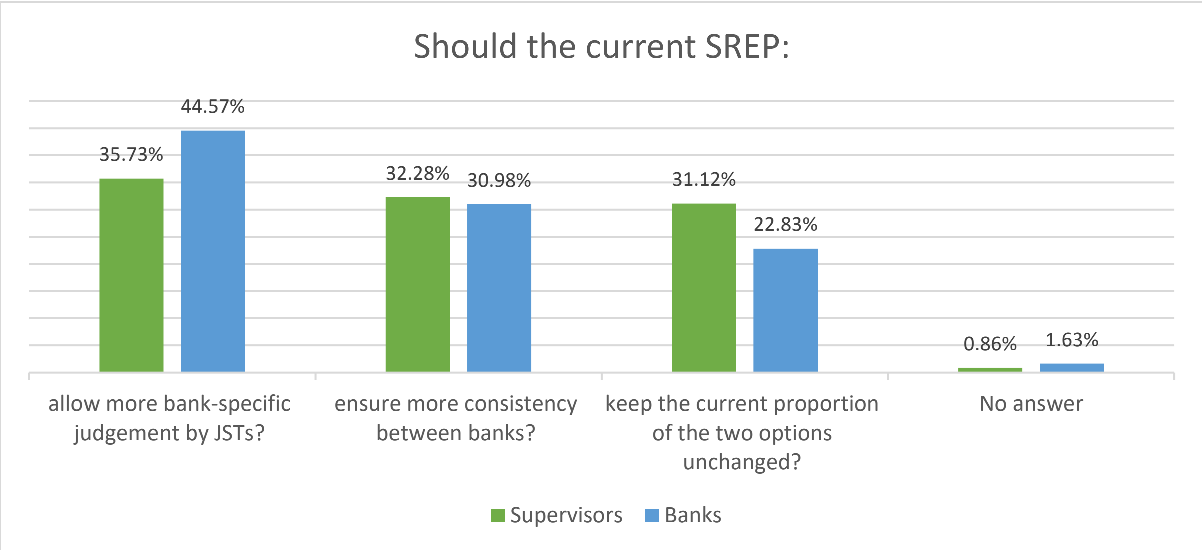
The Expert Group conducted a generic survey on the SREP from 22 November to 2 December 2022. The total number of respondents amounted to 780, with 320 answers from banks stakeholders and 460 from supervisors in the ECB and NCAs.

The responses to the survey were anonymised.

The survey also consisted of a free text format question regarding the submission of proposals for reform within the SREP context. The banks and supervisor stakeholders submitted over 700 individual proposals related to the SREP, such as communication, IT support, methodology, efficiency and effectiveness, transparency, quantitative and qualitative measures, scoring and prioritisation.

1. Consistency vs supervisory discretion - banks are advocating for more supervisory discretions, while supervisors' views are split

Exhibit 5: Consistency vs supervisory discretion



Many stakeholders interviewed by the Expert Group cited enhanced supervisory consistency as one of the key achievements of the SSM SREP. Some, however, argued that the repeated implementation of prescriptive processes may entail the risk of fostering a culture of box ticking and reluctance to exercise supervisory judgement.

Asked whether judgement or consistency should be emphasized going forward, half of the bankers responding to the survey wanted to see more bank-specific judgement by JSTs. Conversely, one-third of the bankers preferred to ensure more consistency between banks, and

23% wanted to keep the current proportion of the two options unchanged. It may be somewhat surprising that half of the responding bankers continue to emphasise consistency despite the high rigidities of the current SREP. Some interviewees argued that mechanical consistency in process does not guarantee consistency in substance and outcome, as it may lead to comparing apples and oranges.

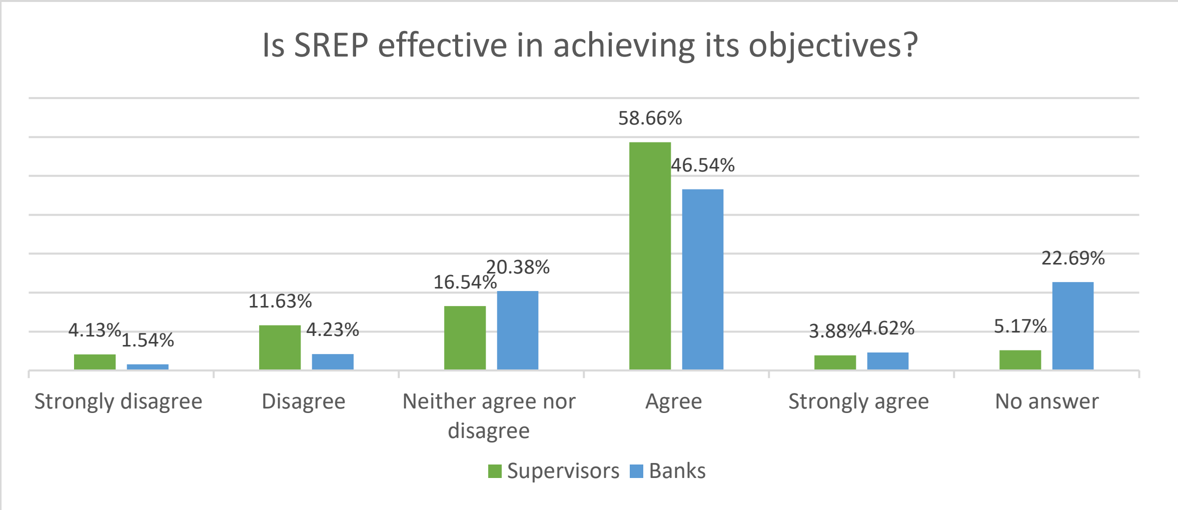
The supervisors' views were more tilted towards consistency and cautious about discretion: one-third of the respondents were for more discretion, one-third for more consistency, and the remaining one-third were happy with the status quo. Some interviewees mentioned that more use of discretion may entail the risk of putting excessive responsibility on the shoulders of line supervisors without adequate support or cover. Exercise of supervisory judgements is always accompanied by responsibilities and supervisors cannot and should not shy away from assuming responsibilities. Nevertheless, effective mechanism and culture to properly encourage, support and protect them would be indispensable.

The relationship between consistency and discretion is not necessarily a simple trade-off, and the aim should be to make consistency and discretion complement each other. A better guided judgement can enhance substantive consistency and proper safeguards on consistency may allow more use of judgement.

2. Effectiveness vs efficiency - respondents agree on the SREP's effectiveness, but more than half of them see scope to improve efficiency.

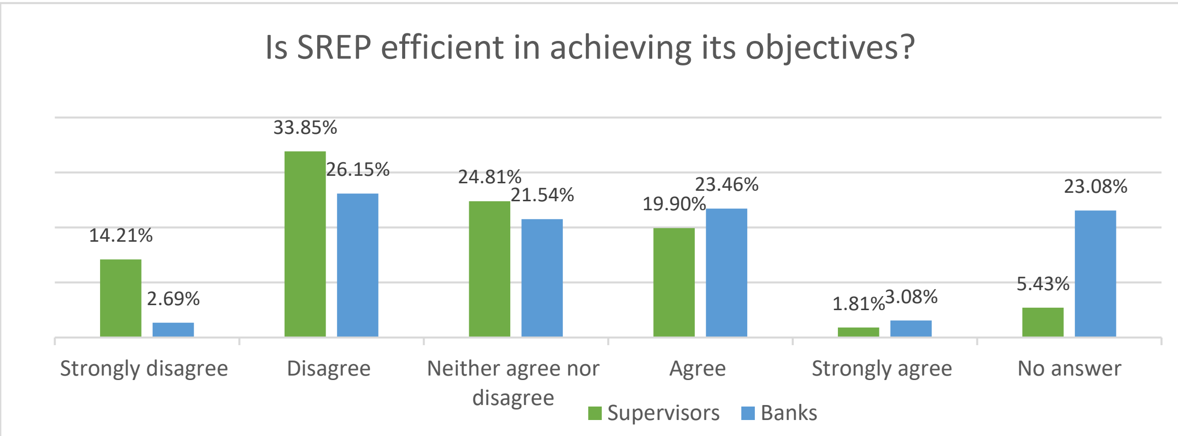
The SSM thus has made major progress in enhancing supervisory effectiveness. The majority of bankers and supervisors who responded to the survey conducted by the Expert Group agree that the SREP is effective in achieving its objectives.

Exhibit 6: SREP effectiveness in achieving its objectives



While the majority of supervisors and banks agree that the SREP is effective in achieving its objectives, most supervisors believe efficiency should be significantly enhanced. A high share of banks also see some room to enhance efficiency.

Exhibit 7: **SREP efficiency in achieving its objectives**

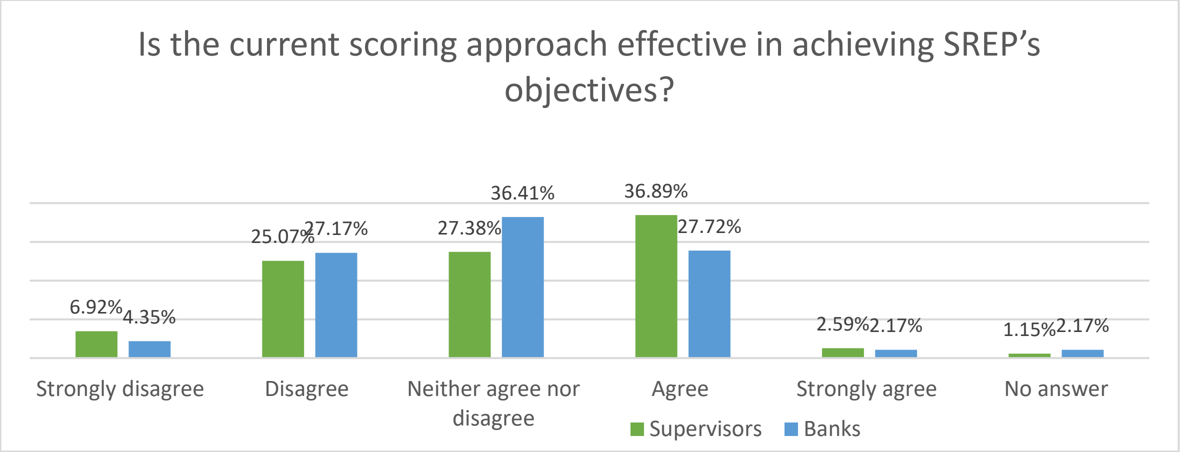


Some of the stakeholders interviewed by the Expert Group, however, pointed out that the repeated implementation of prescriptive and synchronised processes can frustrate supervisors' efforts to allocate limited resources more efficiently. The survey responses presented fewer positive views on efficiency than on effectiveness.

3. **Scoring vs capital requirements - when asked about the effectiveness of the P2R-setting approach, banks are more positive than supervisors.**

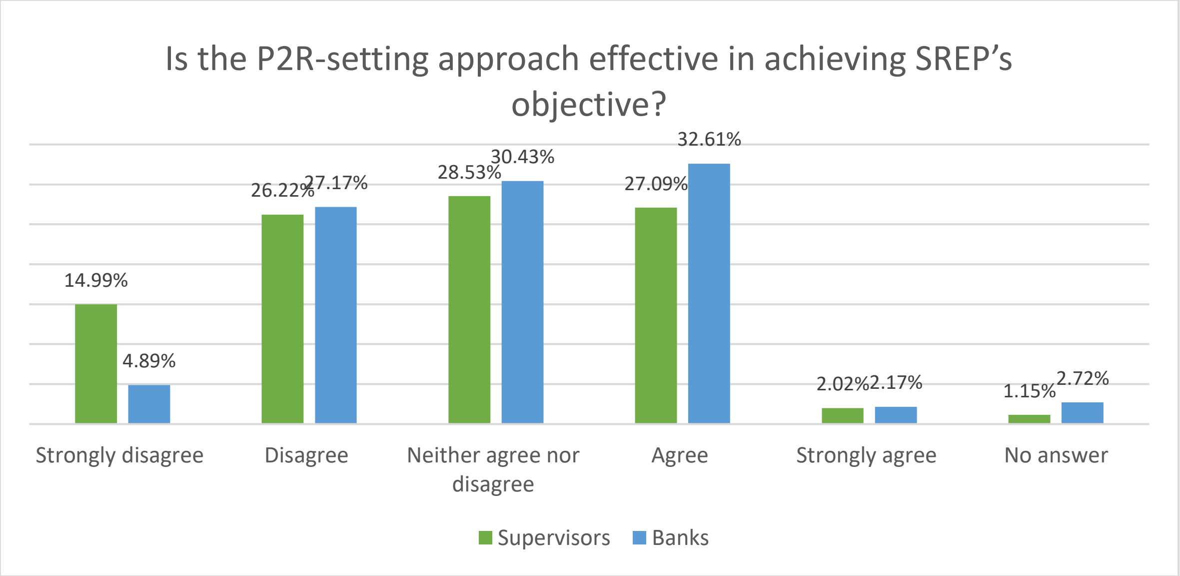
Both banks and supervisors have mixed view on the effectiveness of the SREP scoring approach.

Exhibit 7: Efficiency of the scoring approach



However, banks are more positive than supervisors on the effectiveness of the P2R-setting approach.

Exhibit 8: **Effectiveness of the P2R setting approach**

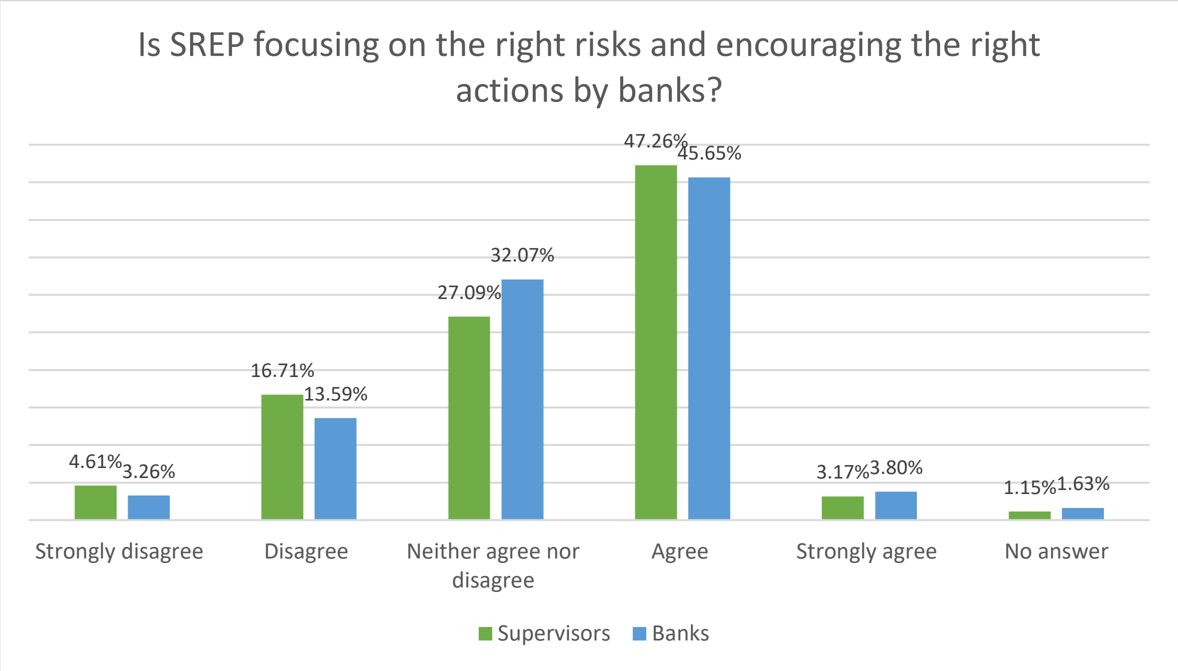


4. **SREP risks focus and communication to banks - respondents judge positively the SREP's ability to focus on the right risks.**

Most of the survey respondents were of the view that the SREP focuses on the right risks and encourages the right actions by banks. Some interviewed bankers, however, argued that the process is intrusive on all aspects of review regardless of their relevance, demands large inputs from banks with short notice, and tends to dump long lists of requirements and findings in an uncoordinated manner. The practice, in their view, hinders banks focusing on priority issues.

Most supervisors and banks agree that the SREP focuses on the relevant risks and encourages the right actions by banks.

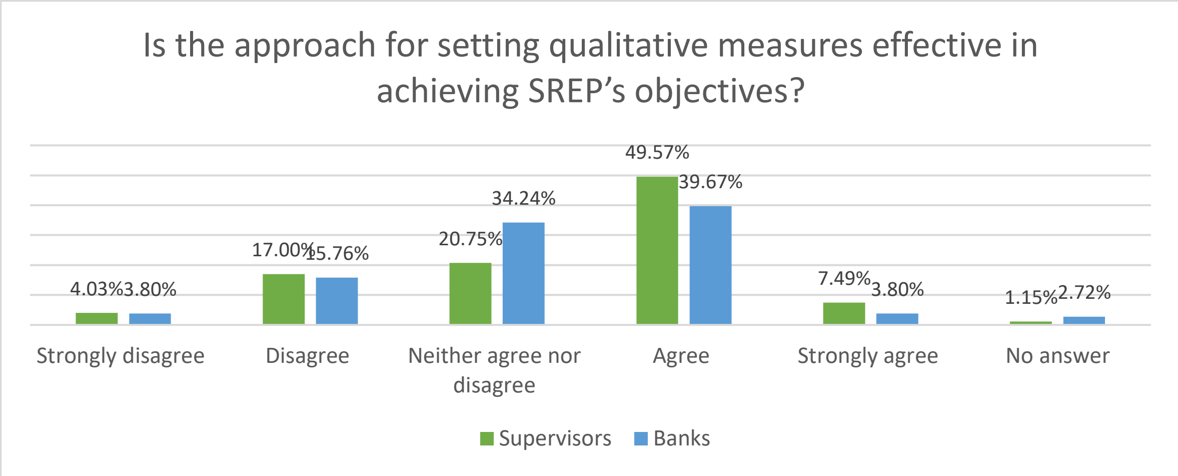
Exhibit 9: **Is SREP covering the right risks and setting the right incentives?**



5. **Qualitative measures - respondents judge positively the SREP's ability to focus on the right risks**

The majority of supervisors and banks agree that the approach for setting qualitative measures achieves the SREP's objectives.

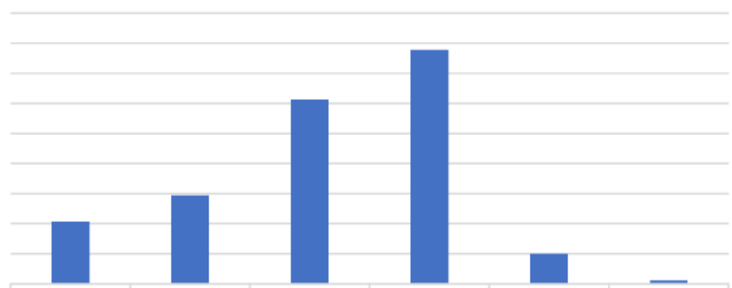
Exhibit 10: Is the approach for setting qualitative measures effective in achieving SREP's objectives?



6. Right supervisory culture

Despite the lack of a common definition of what supervisory culture means within the SSM, the SREP survey in the context of the SREP WPG revealed that just over 44% of SSM staff either agreed or strongly agreed with the following statement: "Does the SREP support the right supervisory culture at the ECB and NCAs?".

Exhibit 11: SREP and supervisory culture



	Strongly disagree (A1)	Disagree (A2)	Neither agree nor disagree (A3)	Agree (A4)	Strongly agree (A5)	No answer
Does SREP support the right supervisory culture at the ECB and NCAs? Percentage	10.29%	14.71%	30.59%	38.82%	5.00%	0.59%

Annex 4: Meetings conducted by the Expert Group

The Expert Advisory Group conducted interviews and discussions with ECB staff, national competent authorities (NCAs), members of the Supervisory Board of the Single Supervisory Mechanism, representatives from the European banking industry and with European and international senior policymakers in the field of banking supervision.

Area	Foundation meetings	Participants	Affiliation	Date
Overview/ Introduction	Overview of SSM Supervision and high-level overview of SREP fundamentals	Stefan Walter	ECB Director General Horizontal Line Supervision (DGHOL)	01-Sep-22
		Sofia Toscano Rico	ECB Deputy Director General Horizontal Line Supervision (DGHOL)	
		Isabel von Köppen-Mertes	ECB Deputy Director General Horizontal Line Supervision (DGHOL)	
	Short History on the SREP	Korbinian Ibel	ECB Director General Universal & Diversified Institutions (DGUDI)	13-Sep-22
	Deep dive into the four elements of the SREP	Jan Hendrik Schmidt	ECB Head of Supervisory Methodology Division (DGHOL/SMD)	13-Sep-22
		Federico Pierobon	ECB Head of Non-Financial Risk Methodologies Section (DGHOL/SMD/NM)	
		Nancy Masschelein	ECB Head of Financial Risk Methodologies Section (DGHOL/SMD/FM)	
		Eduardo del Molino	ECB Principal Supervisor in Financial Risk Methodologies (DGHOL/SMD/FM)	
		Emanuela Branca	ECB Team Lead in Non-Financial Risk Methodologies (DGHOL/SMD/NM)	
	Session with Andrea Enria, Chair of the Supervisory Board and Frank Elderson, Vice-Chair of the Supervisory Board (speaking points)	Andrea Enria	Chair of the Supervisory Board	13-Sep-22
		Frank Elderson	Vice-Chair of the Supervisory Board	
		Pedro Gustavo Teixeira	ECB Director General SSM Governance & Operations (DGSGO)	

Area	Foundation meetings	Participants	Affiliation	Date
		Laura Fabiani	ECB Head of Supervisory Decisions Section (DGSGO/SSE/DE)	
		Klaus Lackhoff	ECB Head of Banking Law section (DGL/SLA/BAL)	
	The role of IMAS in overall supervisory processes	Irene Rebollo	ECB Senior Adviser SSM Governance & Operations (DGSGO)	22-Sep-22
		Luis Esguevillas	ECB Head of Core Systems Section (DGSGO/TIN/CS)	
	Setting supervisory priorities and resource planning	Mario Quagliariello	ECB Director Supervisory Strategy & Risk (DSSR)	27-Oct-22
	Authorisations, focus on assessment of business plan an ongoing monitoring	Paolo Mecenero	ECB Team Lead in Common Procedures & Transactions 2 (DGSGO/AUT/P2)	22-Sep-22
		Erik Boudewijn	ECB Senior Team Lead in Common Procedures & Transactions 1 (DGSGO/AUT/P1)	
	Fit and Proper process, including reassessments	Paulus Johannes Disveld	ECB Head of Suitability Assessment 2 Section (DGSGO/FAP/S2))	22-Sep-22
	Sanctions and Enforcements	Ana Sofia Almeida	ECB Team Lead in Enforcement & Sanctions (DGSGO/ESA)	22-Sep-22
		Henrik Petersen	ECB Team Lead in Enforcement & Sanctions (DGSGO/ESA)	
	Walkthrough on the SREP cycle	Ramón Quintana Aguirre	ECB Director General Systemic & International Banks (DGSIB)	06-Oct-22
		Korbinian Ibel	ECB Director General Universal & Diversified Institutions (DGUDI)	
		Patrick Amis	ECB Director General Specialised Institutions & LSIs (DGSPL)	
	Hiring culture at the ECB	Eva Murciano	ECB Director General Human Resources (DGHR)	20-Oct-22
	Follow up discussion with DG-L	Roberto Ugena	ECB Deputy Director General Legal Services (DGL)	07-Nov-22
	Execution and role of JSTs for specialized institutions & LSIs (SPL)	Patrick Amis	ECB Director General Specialised Institutions & LSIs (DGSPL)	28-Sep-22

Area	Foundation meetings	Participants	Affiliation	Date
	Execution and role of JSTs for Universal & Diversified Institutions (UDI)	Maria Macedo	ECB Deputy Director General Universal & Diversified Institutions (DGUDI)	28-Sep-22
	Execution and role of JSTs for Systemic and International Banks (SIB)	Ramón Quintana Aguirre	ECB Director General Systemic & International Banks (DGSIB)	29-Sep-22
Methodology related	Session on Stress test	Christoffer Kok	ECB Head of Stress Test Experts Division (DGHOL/STE)	13-Sep-22
	Supervisory measures towards banks – focus on capital requirements	Nancy Masschelein	ECB Head of Financial Risk Methodologies Section (DGHOL/SMD/FM)	13-Sep-22
		Eduardo del Molino	ECB Principal Supervisor Financial Risk Methodologies (DGHOL/SMD/FM)	
	Supervisory measures towards banks – focus on qualitative requirements	Floriana Grimaldi	ECB Team Lead Non-Financial Risk Methodologies (DGHOL/SMD/NM)	13-Sep-22
		Federico Pierobon	ECB Head of Non-Financial Risk Methodologies Section (DGHOL/SMD/NM)	
	Tools of horizontal function to support line supervision – focus on thematic horizontal reviews and deep dives	Maria Jose Lopez Calvo	ECB Adviser Horizontal Line Supervision (DGHOL)	13-Sep-22
		Federico Pierobon	ECB Head of Non-Financial Risk Methodologies Section (DGHOL/SMD/NM)	
		Emanuela Branca	ECB Team Lead Non-Financial Risk Methodologies (DGHOL/SMD/NM)	
	TOM 2.0 High Level Group	Felix Hufeld	Former BaFin President	31-Oct-22
		Korbinian Ibel	ECB Director General Universal & Diversified Institutions (DGUDI)	
		Armin Leistenschneider	ECB Head of Capital Markets & Treasury Experts Division (DGHOL/CME)	
	Consistency/benchmarking/Quality assurance of SREP scores	Thomas Prehofer	ECB Head of Supervisory Risk-Financial Risk Section (DSSR/SRFR)	27-Oct-22
		Veerle De Vuyst	ECB Head of Supervisory Risk-Non-Financial Risk Section (DSSR/SRNF)	

Area	Foundation meetings	Participants	Affiliation	Date
		Klaus Düllmann	ECB Head of Strategic Risk & Analytics Division (DSSR/SRA)	
	Follow-up meeting – deep-dive SREP	Jan Hendrik Schmidt	ECB Head of Supervisory Methodology Division (DGHOL/SMD)	05-Oct-22
		Federico Pierobon	ECB Head of Non-Financial Risk Methodologies Section (DGHOL/SMD/NM)	
		Nancy Masschelein	ECB Head of Financial Risk Methodologies Section (DGHOL/SMD/FM)	
	Culture at the ECB Banking Supervision	Eva Murciano	ECB Director General Human Resources (DGHR)	20-Oct-22
	Follow-up meeting with SSR	Thomas Prehofer	ECB Head of Supervisory Risk-Financial Risk Section (DSSR/SRFR)	28-Nov-22
		Veerle De Vuyst	ECB Head of Supervisory Risk-Non-Financial Risk Section (DSSR/SRNF)	
		Klaus Düllmann	Strategic Risk & Analytics (DSSR/SRA)	
	On-site inspections and internal models	Linette Jane Field	ECB Director General On-site & Internal Model Inspections (DGOMI)	03-Nov-22
		Muriel Tiesset	ECB Deputy Director General On-site & Internal Model Inspections (DGOMI)	
	Case Study on SREP effectiveness	Ramón Quintana Aguirre	ECB Director General Systemic & International Banks (DGSIB)	08-Dec-22
		Korbinian Ibel	ECB Director General Universal & Diversified Institutions (DGUDI)	
		Juan Blanc	ECB Head of Universal & Diversified Inst. 4 Division (DGUDI/4)	
		Carlo Giorgis	ECB Head of Universal & Diversified Inst. 5c Section (DGUDI/5/5c)	
		Ignacio Pardo Cuerdo	ECB Head of Universal & Diversified Inst. 2d Section (DGUDI/2/2d)	
	Follow-up meeting with SSR	Thomas Prehofer	ECB Head of Supervisory Risk-Financial Risk Section (DSSR/SRFR)	20-Jan-23

Area	Foundation meetings	Participants	Affiliation	Date
		Veerle De Vuyst	ECB Head of Supervisory Risk-Non-Financial Risk Section (DSSR/SRNF)	

Follow-up Interviews with SSM DGs	Affiliation	Date
Stefan Walter	ECB Director General Horizontal Line Supervision (DGHOL)	09-Dec-22
Patrick Amis	ECB Director General Specialised Institutions & LSIs (DGSPL)	13-Dec-22
Mario Quagliariello	ECB Director Supervisory Strategy & Risk (DSSR)	20-Jan-22

Executive Meeting with SSM Senior Management	Affiliation	Date
Korbinian Ibel	ECB Director General Universal & Diversified Institutions (DGUDI)	15-12-2022
Stefan Walter	ECB Director General Horizontal Line Supervision (DGHOL)	
Ramón Quintana Aguirre	ECB Director General Systemic & International Banks (DGSIB)	
Patrick Amis	ECB Director General Specialised Institutions & LSIs (DGSPL)	
Pedro Gustavo Teixeira	ECB Director General SSM Governance & Operations (DGSGO)	
Maria Macedo	ECB Deputy Director General Universal & Diversified Institutions (DGUDI)	
Sofia Toscano Rico	ECB Deputy Director General Horizontal Line Supervision (DGHOL)	
Isabel von Köppen-Mertes	ECB Deputy Director General Horizontal Line Supervision (DGHOL)	
Muriel Tiesset	ECB Deputy Director General On-site & Internal Model Inspections (DGOMI)	
Anne Lécuyer	ECB Deputy Director General Specialised Institutions & LSIs (DGSPL)	

Brainstorming sessions with ECB Banking Supervision staff

A. How to further streamline the SREP process and enhance its timeliness?

ECB Participants	Affiliation	Date
Federico Pierobon	ECB Head of Non-Financial Risk Methodologies Section (DGHOL/SMD/NM)	15-Dec-22
Torsten Bremer	ECB Head of Universal & Diversified Inst. 4c Section (DGUDI/4/4c)	
Laura Baztán Gutiérrez	ECB Adviser of Universal & Diversified Institutions (DGUDI)	
Paul Wegener	ECB Head of Specialised Institutions & LSIs 5b Section (DGSPL/5/5b)	
Luca Giaccherini	ECB Head of Systemic & International Banks 2a Section (DGSIB/2/2a)	
Ciara O'Shea	ECB Head of Systemic & International Banks 2c Section (DGSIB/2/2c)	
Laura Fabiani	ECB Head of Supervisory Decisions Section (DGSGO/SSE/DE)	
Katharina Ihrig	ECB Senior Team Lead in Supervisory Risk-Non-Financial Risk (DSSR/SRNF)	

B. How to enhance the flexibility of the SREP process and continue developing an effective supervisory culture?

ECB Participants	Affiliation	Date
Klaus Düllmann	ECB Head of Strategic Risk & Analytics Division (DSSR/SRA)	15-Dec-22
Germar Knöchlein	ECB Head of Systemic & International Banks 3 Division (DGSIB/3)	
Mahmoud Menni	ECB Head of Specialised Institutions & LSIs 5a Section (DGSPL/5/5a)	
Rocío Ripoll Sánchez	ECB Head of Specialised Institutions & LSIs 1a Section (DGSPL/1/1a)	
Emanuela Branca	ECB Team Lead in Non-Financial Risk Methodologies (DGHOL/SMD/NM)	
Francesco Maria De Rossi	ECB Team Lead in Financial Risk Methodologies (DGHOL/SMD/NM)	
Manja Walther	ECB Team Lead in Universal & Diversified Inst. 6c (DGUDI/6/6c)	

C. How to enhance the use of SREP scores and P2R?

ECB Participants	Affiliation	Date
Jan Hendrik Schmidt	ECB Head of Supervisory Methodology Division (DGHOL/SMD)	15-Dec-22
Thomas Prehofer	ECB Head of Supervisory Risk-Financial Risk Section (DSSR/SRFR)	
Nancy Masschelein	ECB Head of Financial Risk Methodologies Section (DGHOL/SMD/FM)	
Klearchos Kylintireas	ECB Head of Specialised Institutions & LSIs 2c Section (DGSPL/2/2c)	
Miguel Fernandez Fidalgo	ECB Adviser in Universal & Diversified Institutions (DGUDI)	
Gregorio Moral Turiel	ECB Adviser in Systemic & International Banks (DGSIB)	
Paolo Mecenero	ECB Team Lead in Common Procedures & Transactions 2 (DGSGO/AUT/P2)	
Philipp Koziol	ECB Team Lead in Supervisory Risk-Non-Financial Risk (DSSR/SRNF)	

D. How to better prioritize and communicate qualitative measures?

ECB Participants	Affiliation	Date
José Vicente Martínez Lisalde	ECB Head of Systemic & International Banks 4 Division (DGSIB/4)	15-Dec-22
Maria Jose Romero Rico	ECB Head of Supervisory Risk-Non-Financial Risk Division (DSSR/SRNF)	
Carlos Miguel Hervas Arnaez	ECB Head of Universal & Diversified Inst. 3b Section (DGUDI/3/3b)	
Elodie Mathilde Suzanne Brunet	ECB Head of Specialised Institutions & LSIs 4b Section (DGSPL/4/4b)	
Floriana Grimaldi	ECB Team Lead in Non-Financial Risk Methodologies (DGHOL/SMD/NM)	
Aikaterini Georgiou	ECB Team Lead in Supervisory Risk-Non-Financial Risk (DSSR/SRNF)	
Katarzyna Ryczko	ECB Supervisor in Suitability Assessment 2 (DGSGO/FAP/S2)	

<table>
<tr><th colspan="2">Interviews with Current and Former SB members</th><th>Affiliation</th><th>Date</th></tr>
<tr><td colspan="2">Felix Hufeld</td><td>Former BaFin President</td><td>31-Oct-22</td></tr>
<tr><td colspan="2">Sabine Lautenschlager</td><td>Former ECB Vice-Chair of the Supervisory Board</td><td>04-Nov-22</td></tr>
<tr><td colspan="2">Sharon Donnery</td><td>Deputy Governor of the Central Bank of Ireland</td><td>07-Nov-22</td></tr>
<tr><td colspan="2">Margarita Delgado</td><td>Deputy Governor of Banco de España</td><td>21-Nov-22</td></tr>
<tr><td colspan="2">Steven Maijoor</td><td>Executive Director of De Nederlandsche Bank</td><td>06-Dec-22</td></tr>
<tr><td colspan="2">Joachim Wuermeling</td><td>Executive Board Member of the Deutsche Bundesbank</td><td rowspan="2">09-Dec-22</td></tr>
<tr><td colspan="2">Karlheinz Walch</td><td>Deutsche Bundesbank Director General Banking and Financial Supervision</td></tr>
<tr><td colspan="2">Tom Dechaene</td><td>Director of the National Bank of Belgium</td><td>19-Dec-23</td></tr>
<tr><td colspan="2">Mark Branson</td><td>President of BaFin</td><td>12-Jan-23</td></tr>
<tr><td rowspan="4">ECB Representatives</td><td>Elizabeth McCaul</td><td>ECB Member of the Supervisory Board</td><td rowspan="4">17-Jan-23</td></tr>
<tr><td>Édouard Fernandez-Bollo</td><td>ECB Member of the Supervisory Board</td></tr>
<tr><td>Anneli Tuominen</td><td>ECB Member of the Supervisory Board</td></tr>
<tr><td>Kerstin af Jochnick</td><td>ECB Member of the Supervisory Board</td></tr>
<tr><td colspan="2">Denis Beau</td><td>Deputy Governor of the Banque de France</td><td>10-Mar-23</td></tr>
<tr><td colspan="2">Alessandra Perrazzelli</td><td>Deputy Governor of the Bank of Italy</td><td>13-Mar-23</td></tr>
</table>

<table>
<tr><th colspan="2">Meetings with International Supervisors</th><th>Affiliation</th><th>Date</th></tr>
<tr><td rowspan="2">Meeting with PRA</td><td>Sam Woods</td><td>Deputy Governor for Prudential Regulation and CEO of the PRA and</td><td rowspan="2">31-Oct-22</td></tr>
<tr><td>Nathanaël (Nat) Benjamin</td><td>Executive Director for Authorisations, Regulatory Technology, and International Supervision</td></tr>
<tr><td rowspan="2">Meeting with APRA</td><td>Brandon Khoo</td><td>APRA Executive General Manager (SID)</td><td rowspan="2">23-Nov-22</td></tr>
<tr><td>Sue Davis</td><td>Managing Partner</td></tr>
<tr><td rowspan="2">Meeting with FRB</td><td>Michael Barr</td><td>FRB Vice Chair for Supervision</td><td rowspan="2">19-Dec-22</td></tr>
<tr><td>Michael Gibson</td><td>FRB Director Supervision & Regulation</td></tr>
</table>

<table>
<tr><th>Meeting with EBA</th><th>Affiliation</th><th>Date</th></tr>
<tr><td>Jose Manuel Campa</td><td>EBA Chairperson</td><td rowspan="2">08-Dec-22</td></tr>
<tr><td>Francois-Louis Michaud</td><td>EBA Executive Director</td></tr>
</table>

AFME Meeting	Affiliation	Date
Arved Kolle	AFME Associate Director	01-Dec-22
Caroline Liesegang	Head of Prudential Regulation & Research, AFME	
Benedetta Albano	Legal & European Affairs Specialist, AFME	
Jouni Aaltonen	Managing Director, AFME	
Alejandro Fernandez	Business Analyst, BBVA	
David Nicolas S. Brezmes	Chairman of the AFME Supervisory Committee	
Raphaela Schneider	Deutsche Bank	
Eva Mund	Morgan Stanley	
Hugues Colmant	BNP Paribas	
Pascal Ophorst	UBS	
Arbi Phelps	Executive Director, Goldman Sachs	
Gabriel Mauger	Société Générale	
Gert Luiting	ING	
Morales Cartagena Guillermo	Grupo Santander	

Meeting with EBF Members	Affiliation	Date
Gonzalo Gasós	EBF	09-Nov-22
Maria Ana Barata	EBF	
Lukas Bornemann	EBF	
Vasileia Tsirigkaki	EBF	
Simon Vervaet	EBF Febelfin Belgium	
Sami Pyykönen	EBF Nordea Finland	
Jukka Vesala	EBF Nordea Finland	
Hugues Colmant	EBF BNP Paribas France	
Anne Pouchous	EBF Crédit Agricole France	
Denis Devers	EBF Société Générale France	
Dirk Jäger	EBF Association of German Banks Germany	
Gerlinde Siebert	EBF Deutsche Bank Germany	
Zacharias Damianakis	EBF Eurobank Greece	
Christos Pergamalis	EBF Eurobank Greece	
Nikitas Bobotis	EBF Hellenic Bank Association Greece	
Walter Chiaradonna	EBF (SG Chair) Intesa Sanpaolo Italy	
Maria Angiulli	EBF Italian Banking Association Italy	
Antonietta Volgarino	EBF UniCredit Italy	
Gert Luiting	EBF ING Netherlands	

Meeting with EBF Members	Affiliation	Date
Neda Naderi	EBF Rabobank Netherlands	
Gonçalo Pascoal	EBF Millennium BCP Portugal	
Matej Bezak	EBF Tatra Banka Slovakia	
Eduardo Avila	EBF BBVA Spain	
Elsa Martínes Abeytua	EBF BBVA Spain	
Alberto Buffa Di Perrero	EBF Santander Spain	
Pedro Cadarso	EBF Spanish Banking Association Spain	

Meeting with ESBG	Affiliation	Date
Martin Switaiski	ESBG DGSV	21-Nov-22
Javier De Celis	ESBG Caixa Bank	
Monika Zahora-Szucsich	ESBG Erste Group	
Paul Methorst	ESBG De Volksbank	
Dominique Carriou	ESBG	
Roberto Timpano	ESBG	

Meetings with CRO Group	Affiliation	Date
Jaime Sáenz de Tejada	CRO BBVA	25-Nov-22
Frank Roncey	CRO BNP Paribas	
Marcus Chromik	CRO Commerzbank	
Alexandra Boleslawski	CRO Crédit Agricole	
Ljiljana Cortan	CRO ING	
Mark Kandborg	CRO Nordea	
Stéphane Landon	CRO Société Générale	
Tj Lim	CRO UniCredit	

Meeting with IIF	Affiliation	Date
Andrés Portilla	IIF Managing Director	07-Dec-22
Martin Boer	IIF Senior Director	
Eduardo Avila Zaragoza	IIF (BBVA)	
Angélique Chhuor	IIF (BNP Paribas)	
Barbara Frohn	IIF (Citi)	

Meeting with EACB	Affiliation	Date
Marco Mancino	EACB Partner	08-Dec-22
Nina Schindler	EACB CEO	
Volker Heegemann	EACB	

Meeting with EBF (C-Suite)	Affiliation	Date
Wim Mijs	EBF CEO	28-Feb-23
Hans De Munck	EBF CFO ING Belgium	
Mark Kandborg	EBF CRO Nordea Bank	
Tiia Tuovinen	EBF Chief Legal Counsel OP Group	
Jacques Beyssade	EBF General Secretary BPCE	
Perrine Kaltwasser	EBF Member of the executive Board La Banque Postale	
Gilles Briatta	General Secretary Société Générale	
Nina Babic	CRO Aareal Bank	
Marcus Chromik	CRO Commerzbank	
Sylvia Wilhelm	CRO member of the Board of Directors Deutsche Apotheker- und Ärztebank eG (apoBank)	
James von Moltke	CFO Deutsche Bank	
Ulrik Lackschewitz	CRO Hamburg Commercial Bank	
Martin Zenker	Vice President State Street Bank International (SSBI)	
Christian Löbke	CRO VW Bank	
Georgios Kouroumalos	CRO Attica Bank	
Christos Adam	CRO Eurobank	
Ioannis Vagionitis	CRO National Bank of Greece	
Sotirios Papakonstantinou	CRO Optima Bank	
Michael Frawley	CRO AIB	
Jasper Hanebuth	CFO Barclays Europe	
Stefano Biondi	CRO Banca Mediolanum	
Leonardo Bellucci	CRO Banca Monte dei Paschi di Siena	
Mario Alberto Pedranzini	CEO Banca Popolare di Sondrio	
Cesare Poletti	CRO Banca Popolare di Sondrio	
Andrea Rovellini	CRO Banco BPM	
Emanuele Cristini	CRO BPER Banca	
Sandro Bolognesi	General Manager Cassa Centrale Banca - Credito Cooperativo Italiano	
Luigi Ianesi	Head of Corporate Governance Credito Emiliano Holding	
Guido Moscon	Head of Regulatory Affairs FinecoBank	

Meeting with EBF (C-Suite)	Affiliation	Date
Francesco Romito	CFO Iccrea Banca	
Stefano Del Punta	CFO Intesa Sanpaolo	
Pierpaolo Montana	CRO Mediobanca - Banca di Credito Finanziario	
Francesco Correale	Head of Group Regulatory Affairs UniCredit	
Stefano Porro	CFO UniCredit	
Inga Preimane	Member of the Management Board BluOr Bank	
Jūlija Ļebedinska- Ļitvinova	CRO Citadele Bank	
Valters Ābele	CFO Citadele Bank	
Mari Mõis	Head of Compliance division Luminor Bank	
Kārlis Danēvičs	CRO Member of the Management Board SEB Bank	
Ruta Malacanova	CRO Swedbank	
Linda Pļavinska	acting CRO Baltic Banking Swedbank	
Torsten Bäumer	Executive Director Head Credit & Risk Bank Julius Baer Europe	
Mehtap Numanoglu	CRO Brown Brothers Harriman	
Massimo Politi	CRO China Construction Bank (Europe)	
Stephan Jeandey	CRO Clearstream	
Nina Marusczyk	Regulatory Reporting & Assurance, TMEL 4 Credit Suisse	
Insa Redenius	Head of Corporate Audit State Street Bank International (SSBI)	
Francesco Carboni	Head of Compliance Advisory and Deputy Head of Compliance State Street Bank International (SSBI)	
Pedro Fontela Coimbra	CFO Banco CTT	
Marta Eirea	Chairman of the Executive Committee Banco Finantia	
Luís Seabra	Executive Board Member Caixa Central de Crédito Agrícola Mútuo (CCCAM)	
João Tudela Martins	CRO, Member of the Board of Directors Caixa Geral de Depósitos (CGD)	
Nuno Carvalho	Executive Board Member Haitong Bank	
Miguel Bragança	CFO and Vice-Chairman of the Executive Committee Millennium BCP	
José Miguel Pessanha	CRO Millennium BCP	
Bernhard Henhappel	CRO Tatra Banka	
Juraj Lörinc	Manager responsible for SREP and Supervisory relationship Všeobecná úverová banka	
Ana Fernandez Manrique	Head of Regulation & Internal Control BBVA	
Alberto Buffa Di Perrero	Delegated C-level Santander	

Type	Meetings of the Expert Group	Date
Biweekly meetings	First meeting SREP WPG	01-Sep-22
In-person meeting	Meeting SREP WPG	13-Sep-22
Biweekly meetings	Meeting SREP WPG	22-Sep-22
Biweekly meetings	Meeting SREP WPG	14-Oct-22
Biweekly meetings	Meeting SREP WPG	27-Oct-22
Biweekly meetings	Meeting SREP WPG	10-Nov-22
Biweekly meetings	Meeting SREP WPG	23-Nov-22
In-person meeting	Meeting SREP WPG	15/16-Dec-22
Biweekly meetings	Meeting SREP WPG	10-Jan-23
Biweekly meetings	Meeting SREP WPG	23-Jan-23
Biweekly meetings	Meeting SREP WPG	27-Jan-23
Biweekly meetings	Meeting SREP WPG	07-Feb-23
Biweekly meetings	P2R discussion	10-Feb-23
Biweekly meetings	Meeting SREP WPG	13-Feb-23
Biweekly meetings	Meeting SREP WPG	21-Feb-23
Biweekly meetings	Meeting SREP WPG	23-Feb-23
In-person meeting	Meeting SREP WPG	27/28-Feb-23
Biweekly meetings	Meeting SREP WPG	10-Mar-23
Biweekly meetings	Meeting SREP WPG	13-Mar-23
Biweekly meetings	Meeting SREP WPG	17-Mar-23
In-person meeting	Supervisory Board Presentation	23-Mar-23
Biweekly meetings	Meeting SREP WPG	29-Mar-23