

## AFME / GBI P2 ECB Benchmarking study

April 2025



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There is a lack of transparency in the ECB's Pillar 2 SREP process, in particular how final capital requirements are allocated and how firms compare to one another. With the implementation of Basel 3 through CRR3, and a reduction in the use of internal models, there is heightened focus on Pillar 2 requirements. In particular, the extent to which there is any double-counting under CRR3 across Pillar 1 and Pillar 2.

To help firms better understand how to position themselves in light of the changing regulatory environment, GARP Benchmarking Initiative (GBI) has undertaken a data-driven benchmarking study in collaboration with AFME and its members.

### Data collection:

- All information was collected leveraging GBI's proprietary portal to ensure data security and privacy. Information and findings are presented in an aggregated, anonymised fashion and have been subject to strict disclosure protocols.
- 8 financial institutions participated in the study – BNPP, Deutsche Bank, Intesa Sanpaolo, Société Générale and 4 EU-based subsidiaries of non-EU banks, while this is limited it still provides a good indication of how it would impact the broader industry.
- Data used in this study is a combination of data from publicly available sources (e.g. Pillar 3 disclosures and annual reports) and data provided by participating banks (see Annex for a full list of data sources).
- All data sourced was as of end-2023. This allowed banks to reuse data generated for exercises such as Internal Capital Adequacy Process (ICAAP), while facilitating better comparison. Using the previous year end data also allowed us to leverage disclosures such as Pillar 3 disclosures to support reliability and comparability.
- Outcomes of the SREP process – specifically SREP scores, qualitative feedback provided by the ECB, and Pillar 2 Guidance (P2G) – are considered Confidential Supervisory Information (CSI). We therefore used the average P2G of 1.3% that the ECB had disclosed on 19<sup>th</sup> December 2023 as a constant value across all participating banks.
- The Annex to the slides includes a breakdown of the data collection including: i) Definition of Risk taxonomy; ii) Design of Data collection template; iii) Benchmarking approach to analyze the data.

**As an important premise to this study, we think it is important to set out some guiding principles for the application of Pillar 2, which EU supervisors and regulators should take account of when determining future changes in this area:**

- There should be no mechanistic increases to P2R;
- Overall regulatory capital neutrality at the combined P1 and P2R level should be maintained, taking into account reduced model use and application of the output floor;
- The same risk should not be capitalized twice;
- Pillar 2R is there to identify idiosyncratic risk not captured in Pillar 1;
- There is diversity in how model risk is captured by firms and supervisors. Sometimes this is a stand-alone risk and sometimes this is embedded within the risk type;
- There should be transparency on the general methodology for how individual risk are considered (N.B. Claudia Buch has made reference to 'simplifying the Pillar 2 process' which is also welcome).

### 1. Re-baselining Pillar 2R

The study shows a mechanistic increase of EUR 6.3BN (+28bps) CET1 if Pillar 2R is not re-baselined – this will have a significant impact on EU banks' competitiveness.

Even if a bank is not bound by the output floor our study demonstrates that the changes introduced to P1 capital by CRR3 will lead to an overall increase in CET1 capital by virtue of mechanistic increases to Pillar 2R, where the P2R is calculated as a percentage of the TREA. This is not a true reflection of Pillar 2 risk for the unfloored component – for example, an increase in Pillar 1 should not mean the IRRBB is subject to increased risk in P2R.

This capital increase will apply across the industry and is not bank specific.

While the [EBA opinion on the interaction between the Output Floor and Pillar 2](#) recognises the mechanistic increase to P2R, we do not support the observation that this should only be addressed as a temporary measure when a bank is bound by the floor (although we acknowledge this limitation is linked to the EBA's CRD mandate). This does not address the wider potential for P2R to increase as a result of an increase of the unfloored TREA increasing due to Basel 3 implementation.

#### **Recommendation:**

EU regulators should perform a re-baselining exercise across the industry to mitigate any mechanistic increase in P2R. This should not be linked to the bindingness of the output floor.

### 2. Addressing overlaps between Pillar 1 and Pillar 2

Our study shows an estimated overlap of 6.9% between P1 and P2R arising from CRR3 implementation. The majority of this overlap is attributed to credit risk (59%). Even though market risk is a relatively smaller proportion of banks overall balance sheet (7% on sample average), it will nonetheless be heavily penalised (17% overlap). This runs counter to the EU playing a leading role in supporting international capital markets.

We do not support the limited scope of the EBA opinion in respect of overlaps. By limiting scope to the possible duplication caused by a binding Output floor and a P2R add-ons for regulatory model deficiencies, it provides no relief for banks which are not impacted by the Output floor until 2026 or beyond.

While the output floor is a driver of the overlaps, there are other more granular bottom-up risk drivers and factors derived from Basel 3 which also lead to overlap such as the reduced scope of modelling for large corporates and operational risk. This is taken into account in our study.

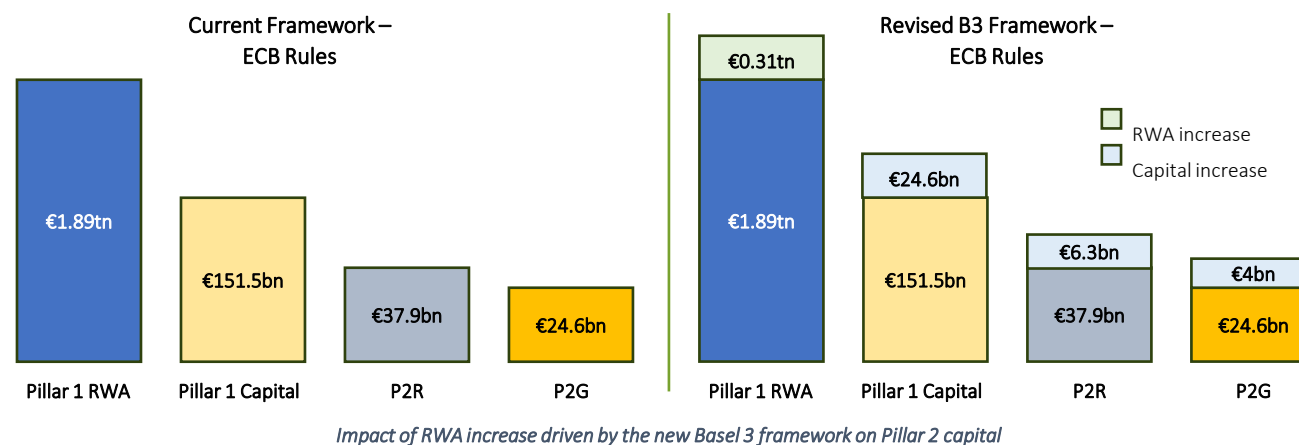
#### Recommendations:

- As per the approach of the PRA\*, we recommend the EU undertakes a quantitative impact assessment of Pillar 2 capital requirements concurrently with CRR3 implementation to address potential double counting for banks on an individual basis.
- This should be done in parallel with ECB methodology review of P2R to drive consistency. Further, the ECB should consult on its plans to simplify the Pillar 2 methodology. Identifying and addressing potential overlaps should be part of this process of simplification, irrespective of whether the output floor binds or not.
- The EBA also has a role to play in line with its founding mandate to promote harmonisation of the single rulebook to provide guidance on addressing overlaps at an EU wide level. It is important for Pillar 1 and Pillar 2 overlaps to be identified on a consistent basis with transparent criteria.

\*In CP 16/22 The PRA states: "As a principle, the PRA would not double count capital requirements for the same risks in Pillar 1 and Pillar 2A. This means that, to the extent that the proposals set out in this CP improve risk-capture in Pillar 1, the Pillar 2A capital requirements would be adjusted accordingly." The PRA has since stated it intends to undertake an off-cycle review in advance of implementation to identify such overlaps.

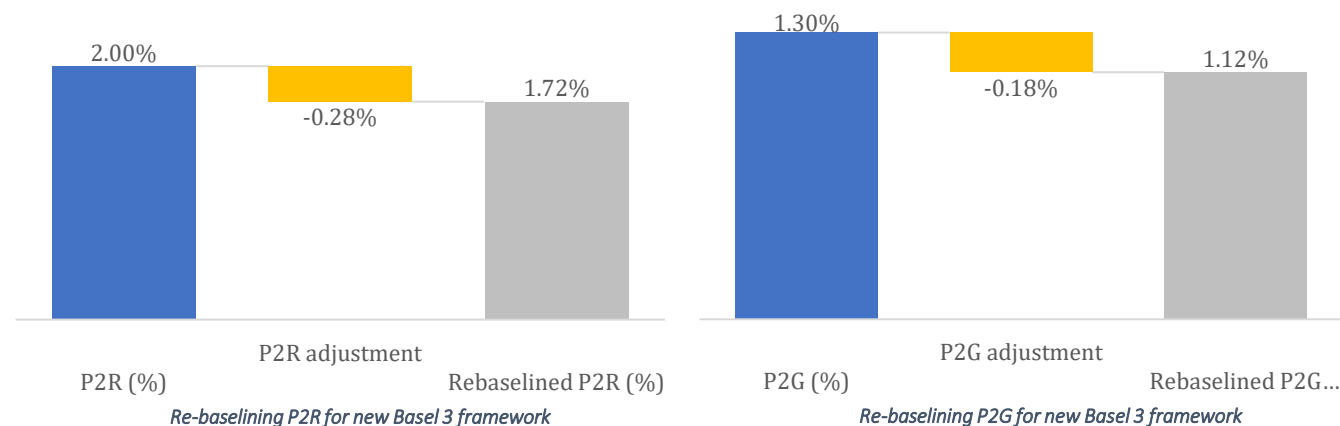
## Key Findings

- The transition to CRR3 will:
  - Increase total RWAs by 16.2% relative to current requirements (CRR2)
  - Result in a mechanistic aggregate increase in P2R capital of €6.3 BN and P2G capital by €4 BN.\*
- To neutralize the combined €10.3 BN impact
  - P2R would need to be re-baselined by -28 bps.
  - P2G would need to be re-baselined by -18 bps.
- Perceived overlap of 6.9% of existing P2R translates into 12 bps reduction in P2R.



## Key Recommendation

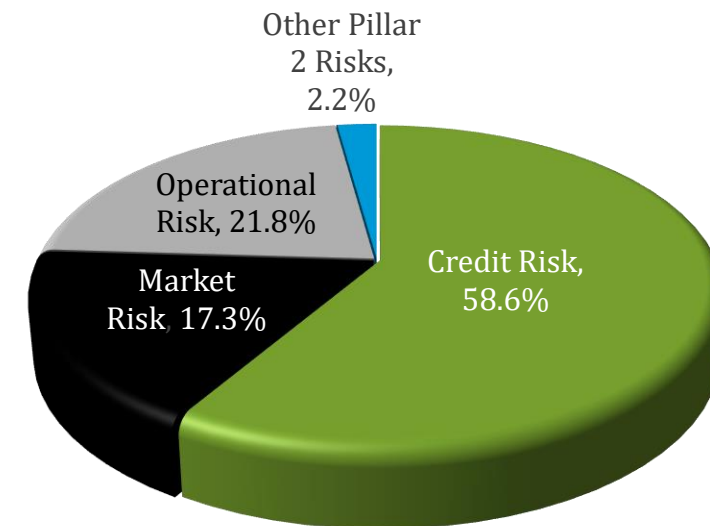
- EU regulators should perform a re-baselining exercise to mitigate any mechanistic increase in P2R as soon as possible. This should not be limited to when a bank is bound by the Output Floor as per the EBA opinion.
- The timing of this is critical, given that the EU has now gone live with CRR3, which entered into force 1 Jan 2025.



\*These impacts are all in and fully loaded – including FRTB which is yet to be implemented.

### Key Findings

- Estimates indicate a perceived overlap of 6.9% between existing Pillar 2 and new Pillar 1 requirements, driven mainly by overlaps in model risk which accounts for 55.5% (see slide 9).
- Broken down by risk types, credit risk accounts for the largest single portion of the overlap (59%). Market risk accounts for 17.3 % despite being a much smaller proportion of banks' balance sheets. This will impact upon banks' international competitiveness.

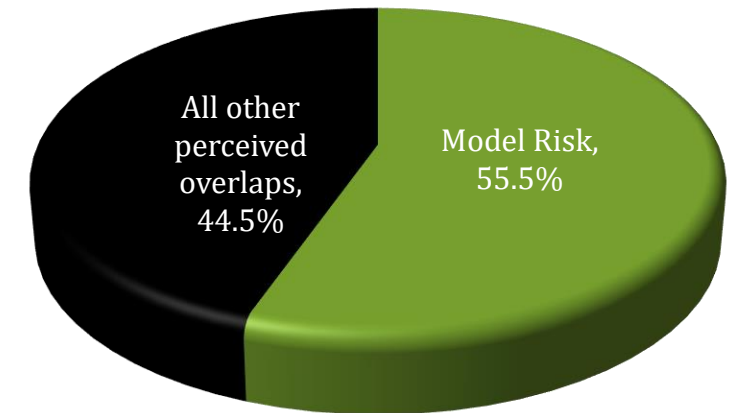


### Key recommendations

- In line with the approach of other jurisdictions such as the PRA, EU regulators should undertake a granular and targeted quantitative impact assessment (QIS) to validate the full extent of overlaps under the different risk types for banks on an individual basis and seek to address these in the P2 methodology.
- The QIS should come **in addition to** the re-baselining.
- The EBA opinion in respect of overlaps was too narrow in scope – limited to only when a bank is bound by the floor and add-ons for model risk deficiencies rather than the overall impact of the more conservative nature of Basel 3.
- Timing is urgent - with the P2R reform not expected until 2026 and the P2R methodology to determine the impact of add-ons for model deficiencies for example will remain unchanged in the interim. By extension, this means the additional capital banks are required to hold under (e.g. F-IRB portfolios) will not be compensated for yet by the P2R. In this respect, initial dialogue with JSTs to mitigate this could be helpful.

## Key Findings

- Overlap tied to Model risk is identified as having significant impact across P2R. Out of the perceived overlap of 6.9%, Model risk accounts for more than half (55.5%) of this.
- This is primarily driven by the introduction of the Output Floor and is visible in Default and Migration Risk.
- Other areas include Operational risk (removal of AMA) and Market risk (new methodology for FRTB and CVA).



## Key Recommendation

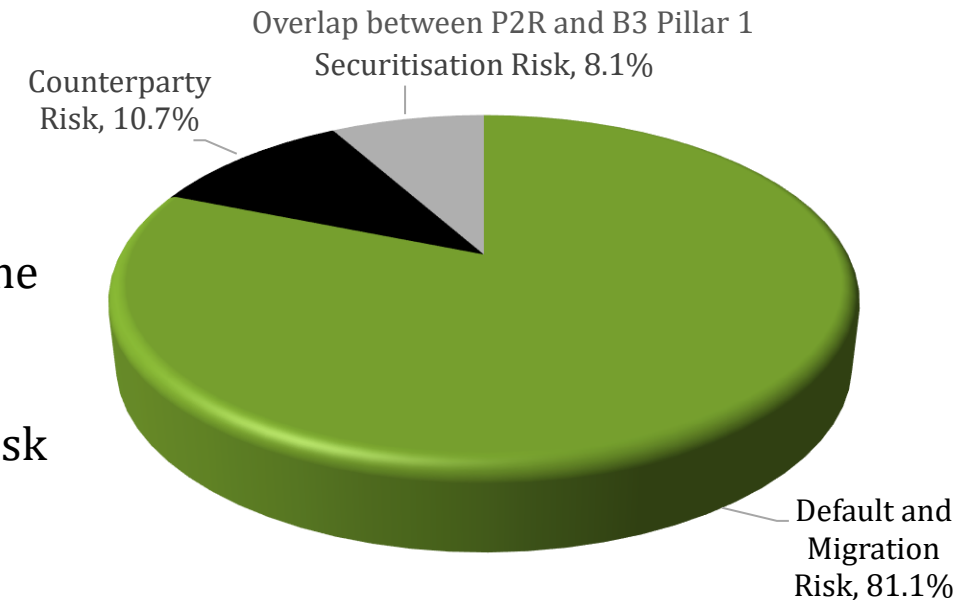
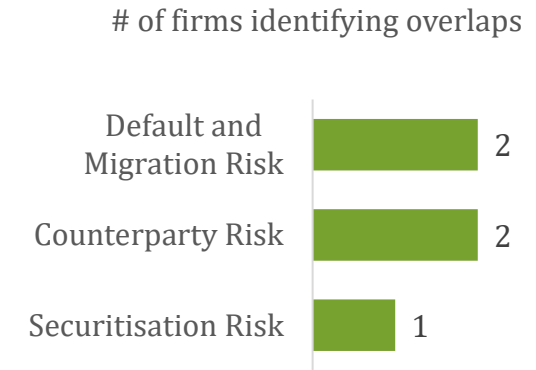
- A granular and targeted QIS should be performed to understand how model risk is accounted for by banks in their internal Pillar 2 assessment, noting that there are a variety of ways firms are already capturing these risks.

## Key Findings

- Most Credit Risk overlaps relate to Default and Migration Risk (81.1% of total Credit Risk overlaps), followed by Counterparty Credit Risk (10.7%).
- The Output floor is cited as the primary driver of overlap within the 'default and migration' credit risk bucket. This is owing to more penal methodology under SA-CR which feeds through when the floor is binding.

## Key Recommendations

- Investigate any required P2R offset, resulting from the impact of the Output floor.
- Investigate other areas of overlap linked to Counterparty Credit Risk including how SA-CCR feeds into the Output floor.

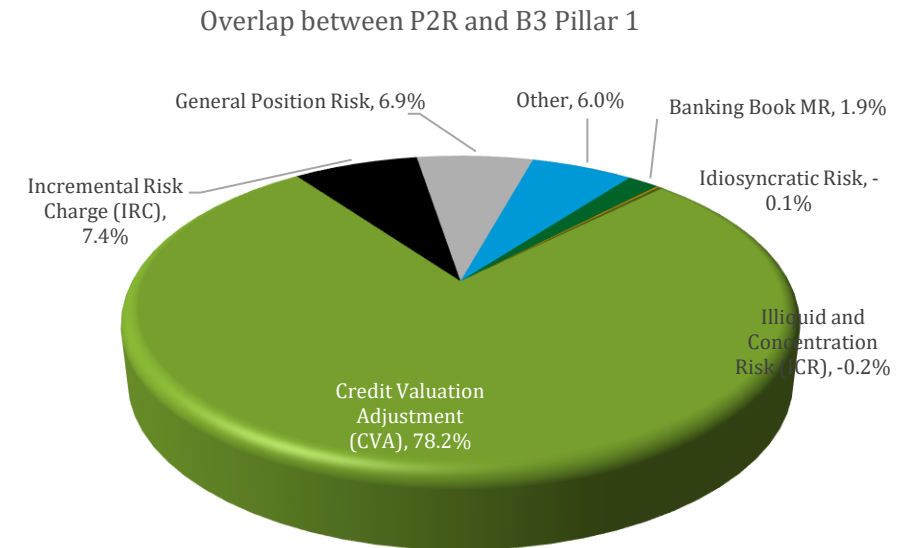
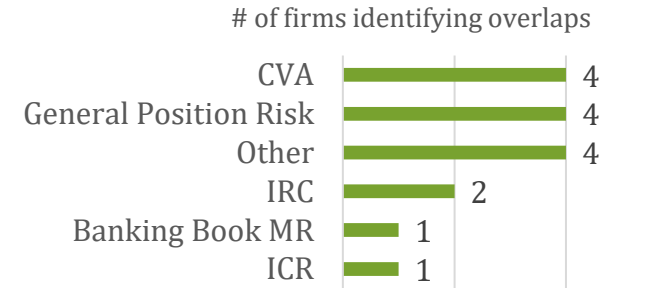


### Key Findings

- Half of the peer group identified CVA (78.2%) as having the most overlap owing in part to the more punitive methodology under BA-CVA and SA-CVA.
- Overlap for Incremental Risk Charge (7.4%) reflects the more punitive methodology when moving to SA-DRC or IMC-DRC.
- Half the banks identified some overlap for the Other (6%) risk, related to RNIV and RNIM under the current framework which are impacted by modellability requirements under FRTB.

### Key Recommendations

- Investigate any required P2 offset resulting from the new FRTB framework e.g. by adjusting the market risk add-ons for areas previously captured under Pillar 2R that will now be covered in Pillar 1 such as illiquid and concentrated positions.
- Even though the EU has kept CVA exemptions, the move to BA-CVA and SA-CVA methodology is penal – the EU should consider offsets pending a wider Basel review.



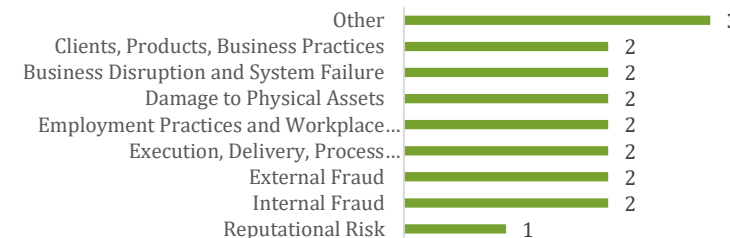
## Key Findings

- Clients, Products and Business Practices (41.2%) is identified as the most significant area of overlap.
- Drivers relate to firms already accounting for Model Risk, with others citing the removal of AMA.

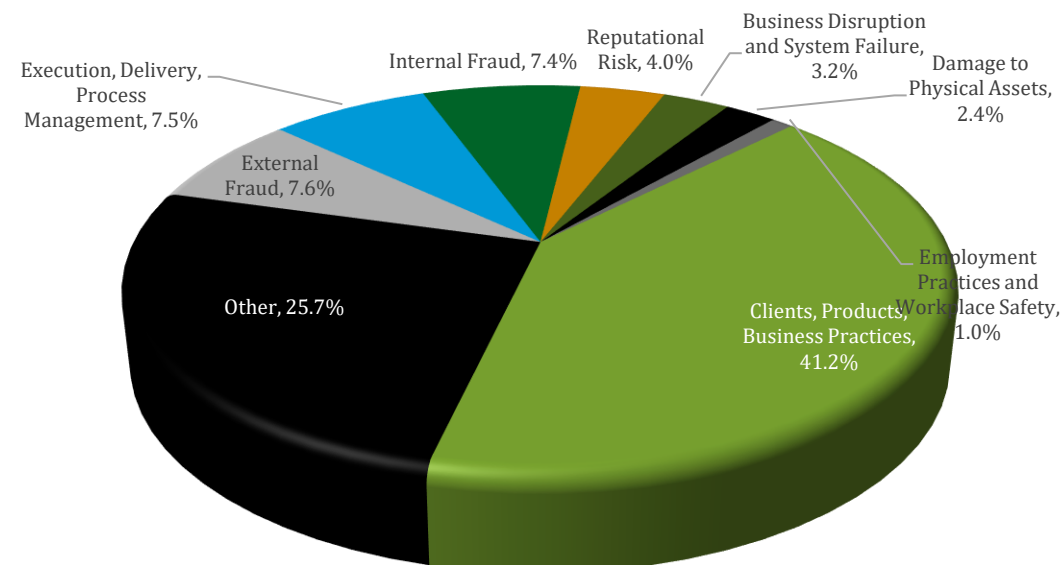
## Key Recommendation

- In line with other major jurisdictions, consider adjusting firms' existing P2R Operational Risk requirements in line with any changes in P1 RWAs so that the total nominal Operational Risk requirements remain unchanged under CRR3.

# of firms identifying overlaps



Overlap between P2R and B3 Pillar 1





### • Participating Banks

8 financial institutions participated in the study – BNPP, Deutsche Bank, Intesa Sanpaolo, Société Générale and 4 EU-based subsidiaries of non-EU banks.

### • Data Requirements

- Basel Monitoring Workbooks for Q4 2023
  - Some banks provided impacts based on internal assessments
- ICAAP capital requirements for end-2023 – based on ECB Short-term exercise (STE) ICAAP reporting templates
  - Common risk taxonomy by study group
- Judgement-based inputs on the overlap of risks between existing Pillar 2 and the new Basel 3 Pillar 1

### • Data Assumptions

- Basel 3 RWAs – fully phased-in output floor
- CVA RWAs – exemption recognition under CRR 3
- Pillar 1 capital – 8% minimum (no capital buffers)
- P2G – 1.3% assumed for each institution per 2022 ECB SREP results

### • Data Limitations

- Firms were asked to apply expert-judgement to determine the amount of overlap / underlap tied to Pillar 2 risks for each of the risk factors in the taxonomy (see next slide for full taxonomy)
- ICAAP Economic capital is a holistic measure of risk and not split between Pillar 1 and Pillar 2; whereas some risks are only covered under Pillar 2, e.g. IRRBB

### Study Objective

- All else being equal, Pillar 1 RWA increases under Basel 3 cause a mechanistic increase in Pillar 2 capital requirements. The study seeks to inform the quantum of re-baselining required to reverse this effect.
  - The study seeks to understand where there may be double counting and/or missing risk across Pillar 1 and 2, resulting from the new Basel 3 framework
    - Current Pillar 2 capital requirements align with B2.5
    - While underlying risks remain the same, the new framework may lead to the same risk being capitalised under Pillar 1 and Pillar 2.
- Review current Pillar 2 to identify specific risks covered or missed in revised Basel 3 Pillar 1

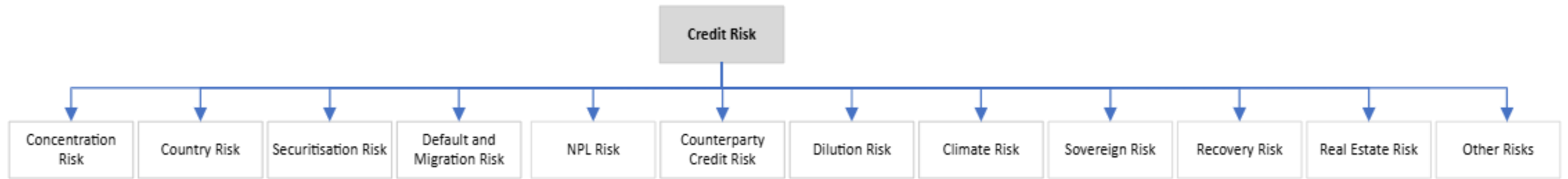
### Benchmarking

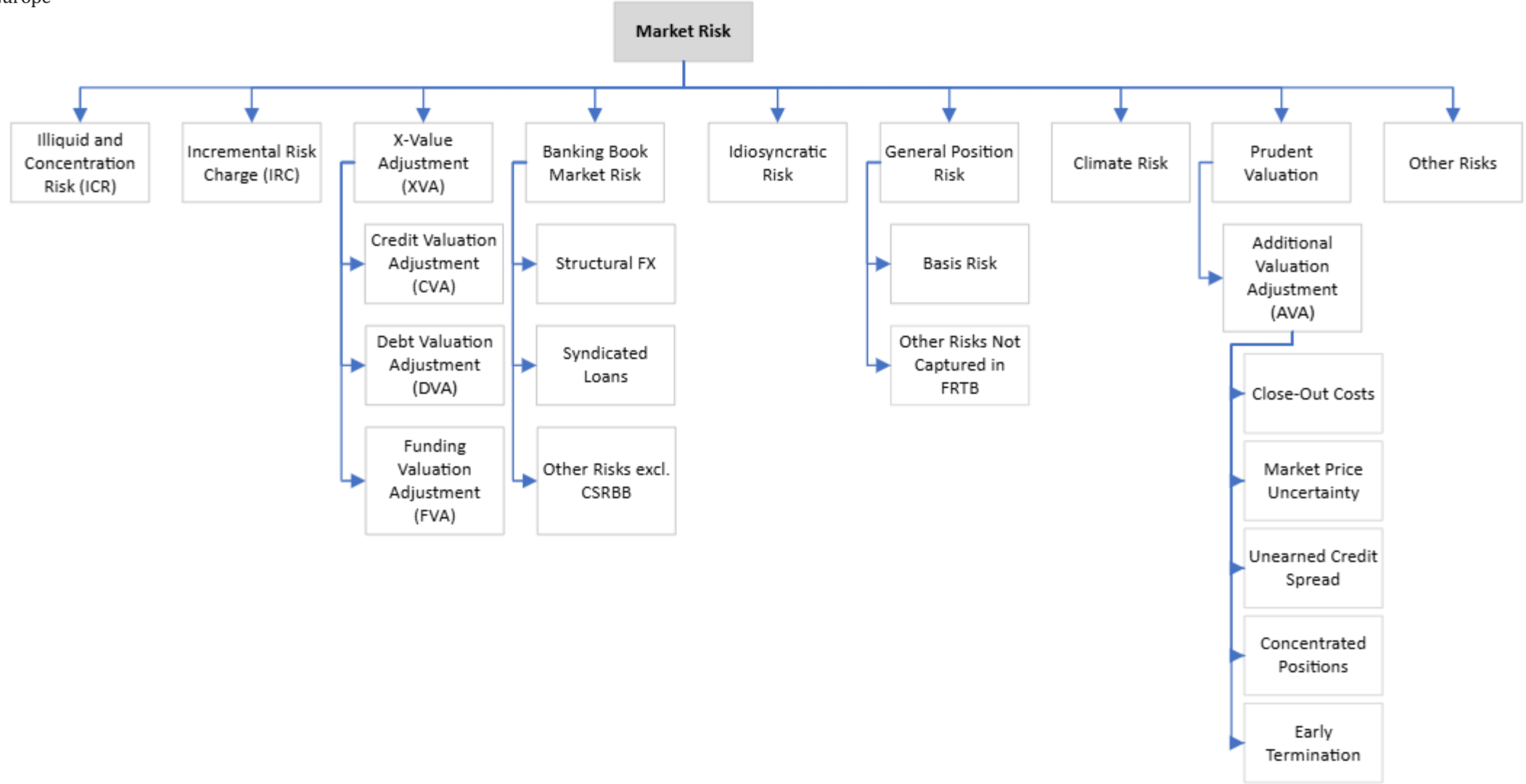
- Individual bank inputs combined into one “Aggregate Bank” for purpose of data aggregation and industry benchmarking
- Ratios calculated as weighted-averages
  - The sum of each bank’s contribution to the numerator divided by the sum of each bank’s contribution to the denominator

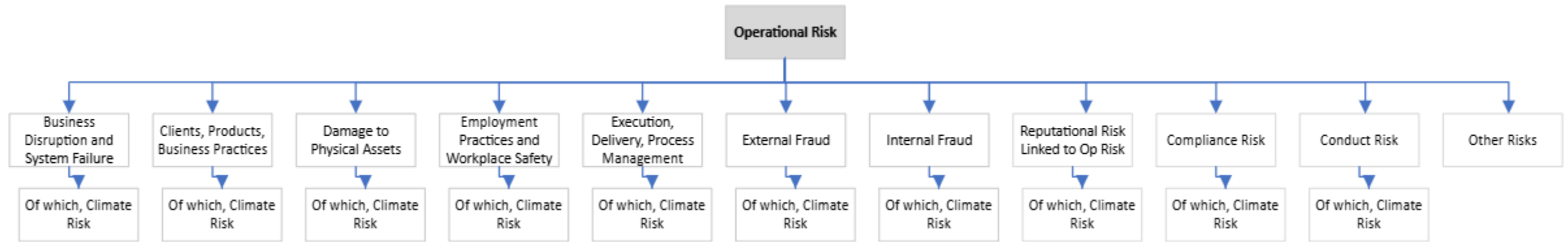
### Overlap/Underlap Estimation

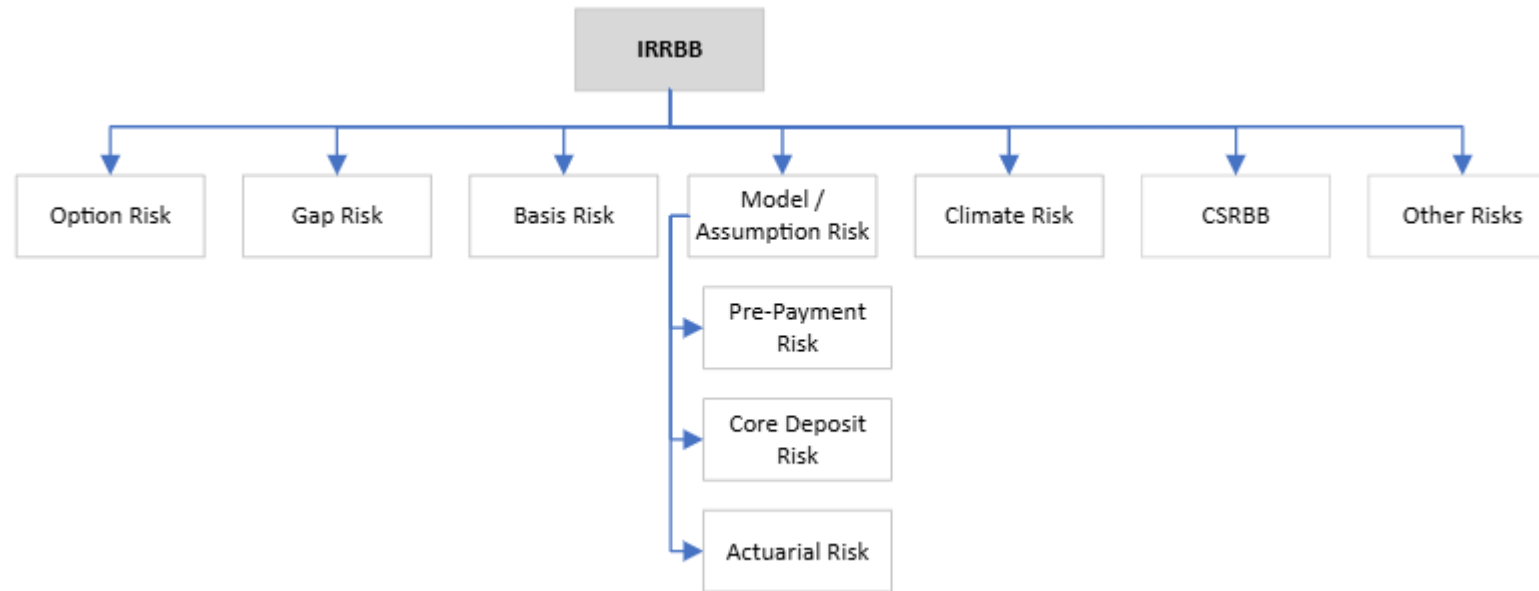
- For each ICAAP risk subcategory, firms were asked to estimate how much of the existing Pillar 2 capital requirement is covered or missed by the revised Basel 3 Pillar 1 capital requirement
  - Potential overlaps include the Output Floor (which implies lower model risk) and CVA (which is more punitive under Basel 3)
  - Potential underlaps include ...
- For each bank’s estimated overlap between existing Pillar 2 and revised Pillar 1, ICAAP allocation to:
  - Pillar 1 estimated as  $8\% / (8\% + P2R)$
  - Pillar 2 estimated as  $P2R / (8\% + P2R)$

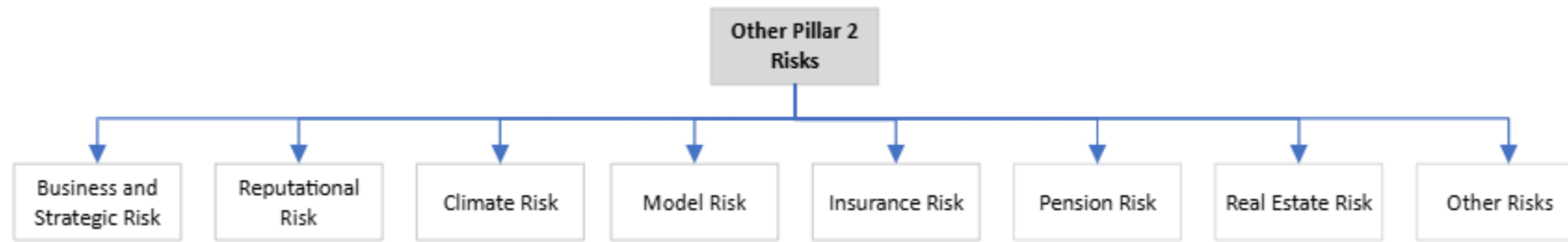












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