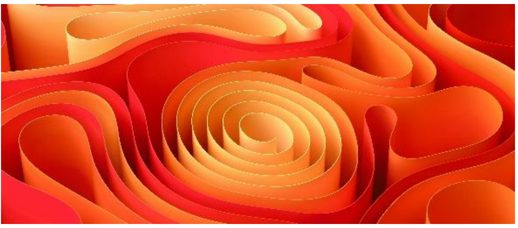
Pills

Regulatory/Supervisory Pills | N.48 March 2025



TOPICS:

Banking System

SOURCE

European Central Bank

ECB: Reviewing the Pillar 2 Requirement Methodology

- ECB is revising **its Pillar 2 capital requirement methodology** to enhance the effectiveness and efficiency of European banking supervision. Pillar 2 capital requirements (P2R) are determined through the **Supervisory Review and Evaluation Process (SREP),** which assesses individual bank risks.
- The ECB's current Pillar 2 methodology has contributed to financial stability, enabling banks to withstand economic shocks such as the COVID-19 pandemic and geopolitical tensions. However, **the banking environment is evolving**, with increasing macroeconomic, environmental, and digitalization-related risks. The ECB seeks to **streamline the methodology** to better address these challenges while ensuring capital adequacy.
- **Key Changes in the Revised Methodology - Stronger Risk Linkage**: Pillar 2 requirements will be **directly tied to specific risk areas** instead of being derived from overall ICAAP (Internal Capital Adequacy Assessment Process) outcomes; **Simplification:** The procedural steps will be reduced, making the methodology **more intuitive** for banks; **Enhanced Supervisory Judgment**: Supervisors will have **greater discretion** in evaluating risk factors, ensuring a more forward-looking approach; **Stricter Consequences for Weaknesses**: Unresolved **governance and control deficiencies** will be more directly reflected in Pillar 2 requirements.
- The **new methodology will be tested in 2025** and officially applied in **the 2026 SREP cycle**, with revised capital requirements effective from **January 1, 2027**.