Bridging the Supervisory Gap: How Banking Supervision Shapes Organizational Behavior under the SREP

Marcel Horn

zeb.business school, Steinbeis University, Berlin, Germany
Email: mhorn@zeb-bs.de.

Abstract

The Supervisory Review and Evaluation Process (SREP) constitutes a core element of the European banking supervisory framework and serves as the central mechanism through which the European Central Bank (ECB) assesses the risk profiles of significant institutions (SIs) and determines institution-specific supervisory measures within the Banking Union. In particular, the SREP forms the basis for the annual determination of institution-specific Pillar 2 Requirements (P2R), which complement minimum regulatory capital requirements. Despite its regulatory importance, little is known about the determinants shaping P2R, the practical formation of supervisory assessments, and their influence on the behavior of supervised institutions. This study addresses these questions through qualitative expert interviews with senior practitioners from significant European banks and supervisory advisory functions. The preliminary findings indicate that annual P2R are determined not only by formal regulatory criteria but also by qualitative supervisory judgement, governance assessments, supervisory discretion, organizational characteristics, and communication dynamics between banks and supervisors. Moreover, regulatory uncertainty appears to induce proactive organizational adaptation, encouraging institutions to strengthen governance structures, enhance internal coordination, and align organizational processes with perceived supervisory expectations. Rather than portraying the SREP merely as a standardized assessment framework, the preliminary findings suggest that it operates as a hybrid governance and behavioral supervision regime in which qualitative judgement constitutes an inherent element of supervisory practice. By identifying a comprehensive set of formal and informal determinants of institution-specific P2R and by conceptualizing the gap between the official supervisory narrative and supervisory practice, the study contributes to a deeper understanding of modern banking supervision and its behavioral implications.

Keywords: Pillar 2 Requirements (P2R), Determinants of P2R, Supervisory Review and Evaluation Process (SREP), Bank Supervision, Bank Behavior

1 Introduction

The European Central Bank (ECB), acting within the Single Supervisory Mechanism (SSM), directly supervises the largest banking institutions in the euro area, representing approximately 85% of total banking assets. Within the Basel framework, regulatory capital requirements are organized into three pillars: Pillar 1 establishes standardized minimum capital requirements applicable to all institutions, Pillar 2 comprises institution-specific supervisory requirements and expectations determined through the Supervisory Review and Evaluation Process (SREP), while Pillar 3 aims to strengthen market discipline through disclosure obligations. Whereas Pillar 1 requirements amount to a fixed minimum capital ratio of 8% for all institutions, institution-specific Pillar 2 Requirements (P2R) have gained increasing importance in recent years. For the 2026 supervisory cycle, the average P2R for significant institutions under direct ECB supervision amounts to 2.26 percentage points, corresponding to more than one quarter of the minimum Pillar 1 capital requirement and highlighting the growing importance of supervisory assessments within the European prudential framework.

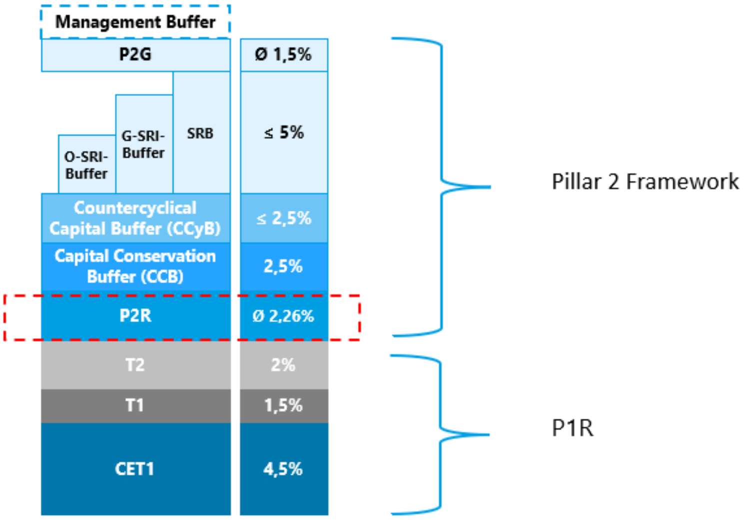

Fig. 1 Structure of regulatory capital requirements under the Basel framework for significant institutions (SI) supervised by the European Central Bank (ECB). Pillar 1 Requirements (P1R) comprise standardized minimum own funds requirements amounting to 8% of risk-weighted assets (4.5% Common Equity Tier 1 (CET1), 1.5% Additional Tier 1 (AT1), and 2% Tier 2 capital). Pillar 2 Requirements (P2R) represent institution-specific binding supervisory capital requirements determined annually within the Supervisory Review and Evaluation Process (SREP), while Pillar 2 Guidance (P2G) reflects non-binding supervisory capital expectations. The capital stack further includes the Capital Conservation Buffer (CCB), the Countercyclical Capital Buffer (CCyB), and institution-specific systemic buffers (G-SRI, O-SRI and Systemic Risk Buffer (SRB)). The figure illustrates that the average P2R for the 2026 supervisory cycle amounts to approximately 2.26 percentage points, corresponding to more than one quarter of the standardized Pillar 1 minimum requirement and highlighting the increasing importance of supervisory judgement within the European capital framework. Source: Adapted from EBA/GL/2022/03 and ECB SREP Methodology Booklet (2023).

Within the SREP, supervisors assess banks across four dimensions: business model, internal governance, capital adequacy (ICAAP), and liquidity adequacy (ILAAP) to evaluate their overall resilience (European Central Bank 2024; European Banking Authority 2025).

While the regulatory framework is extensively documented, the practical process through which supervisory assessments are formed remains only partially transparent. Existing empirical research predominantly focuses on quantitative determinants of capital requirements, such as profitability, credit risk, liquidity indicators, or governance proxies, and generally assumes supervisory decisions to follow a largely rule-based logic (Alves, Citterio, and Marques 2023; De Jonghe, Dewachter, and Ongena 2020; Ferretti, Venturelli, and Azzaretto 2023).

In contrast, the emerging literature on bank supervision emphasizes the importance of supervisory judgement, qualitative assessments, and information acquisition, suggesting that supervision differs fundamentally from regulation by relying on institution-specific interpretation rather than purely formal rules (Hirtle and Kovner 2022; Hirtle, Kovner, and Plosser 2020). More broadly, regulatory governance research highlights that supervision operates through legitimacy, accountability, discretion, and institutional interaction rather than through formal rule application alone (Black 2008; Carletti, Dell'Ariccia, and Marquez 2015).

Against this background, this study investigates how supervisory assessments are formed in practice and how banking supervision influences the behavior of supervised institutions. Using an exploratory qualitative research design based on semi-structured expert interviews with senior practitioners from significant European banks, the study explores both determinants and behavioral responses within the SREP (Meuser and Nagel 2009; Misoch 2019).

The preliminary findings indicate that supervisory outcomes are shaped not only by formal regulatory criteria but also by governance quality, supervisory discretion, communication dynamics, and organizational credibility. Moreover, regulatory uncertainty appears to induce proactive organizational adaptation, encouraging banks to strengthen governance structures and align internal processes with perceived supervisory expectations. The preliminary findings suggest that the SREP should be understood less as a standardized assessment framework and more as a hybrid governance and behavioral supervision regime, thereby bridging the gap between the official supervisory narrative and supervisory practice.

2 Research Questions

The complexity of modern banking supervision raises important questions regarding both the determinants of institution-specific supervisory outcomes and the mechanisms through which supervisory processes influence organizational behavior. To address these issues, the study is guided by the following two research questions:

RQ1: Which factors determine the level of P2R from the perspective of banking practitioners?

RQ2: How does banking supervision within the SREP influence the behavior of supervised banks?

Together, these research questions provide the conceptual foundation for exploring the interaction between supervisory assessments and organizational responses. They reflect the study's objective of contributing to a more comprehensive understanding of modern banking supervision by integrating perspectives on institution-specific capital requirements with insights into supervisory processes and behavioral adaptation (Black 2008; Hirtle and Kovner 2022).

3 Theoretical Positioning

This study is conceptually grounded in the emerging literature on bank supervision and complemented by theoretical perspectives from principal-agent theory, the Good Management Hypothesis, responsive regulation, principles-based regulation, and supervisory discretion. Together, these approaches provide a comprehensive theoretical framework for understanding the determinants of institution-specific P2R, how supervisory assessments are formed in practice, and how banking supervision within the SREP may influence the organizational behavior of supervised institutions.

3.1 Bank Supervision as Distinct from Banking Regulation

The emerging literature on bank supervision emphasizes the fundamental distinction between banking regulation and banking supervision. While regulation defines formal rules, minimum standards, and quantitative requirements applicable to all institutions, supervision focuses on institution-specific assessments of governance quality, risk management, organizational resilience, and managerial capabilities.

Hirtle and Kovner (2022) argue that supervision constitutes a distinct economic activity because many aspects of overall bank resilience cannot be adequately captured by standardized regulatory metrics. Instead, supervisors acquire and evaluate qualitative information, exercise judgement, and assess whether institutions are capable of managing current and future risks effectively. Consequently, supervision extends beyond the enforcement of formal rules and incorporates qualitative evaluations that are inherently context-dependent.

The SREP represents the institutional manifestation of this supervisory philosophy within the European Banking Union. Although embedded in a harmonized regulatory framework, the SREP requires institution-specific assessments across business model, governance, capital adequacy, and liquidity adequacy, thereby combining standardized methodologies with qualitative supervisory judgement.

3.2 Principal-Agent Theory and Information Asymmetry

Principal-agent theory provides an important theoretical perspective for understanding supervisory interactions. The theory assumes that agents possess private information and may act opportunistically unless appropriate monitoring mechanisms reduce information asymmetries (Jensen and Meckling 1976).

Applied to banking supervision, supervised institutions may possess superior information regarding their internal processes, organizational weaknesses, and risk exposures, while supervisors seek to reduce these asymmetries through ongoing monitoring, dialogue, and assessment. From this perspective, supervisory processes can be interpreted as mechanisms designed to mitigate hidden information and hidden action problems.

The theory therefore provides a useful conceptual lens for analyzing the informational dimension of supervisory interactions within the SREP and the role of communication between banks and supervisory authorities.

3.3 Good Management Hypothesis

The Good Management Hypothesis suggests that superior management quality is associated with more effective risk management, greater operational efficiency, and lower risk profiles, implying that well-managed institutions are less likely to experience financial distress and supervisory concerns (Berger and DeYoung 1997).

From this perspective, supervisory assessments may capture not only observable risk indicators but also underlying managerial quality and organizational capabilities. The hypothesis therefore provides a theoretical framework for understanding whether supervisory evaluations primarily reflect existing management quality or whether supervisory expectations encourage organizational improvements over time.

The concept is particularly relevant within the SREP, where business model sustainability, governance arrangements, ICAAP, and ILAAP constitute the central pillars of the supervisory assessment and form the basis for determining institution-specific supervisory measures. Consequently, superior management quality may be expected to manifest itself through stronger performance across these assessment dimensions and ultimately contribute to more favorable supervisory outcomes.

3.4 Responsive Regulation

Responsive Regulation views supervision as an adaptive process in which regulatory intervention depends on the behavior and responsiveness of regulated institutions rather than solely on predefined rules (Ayres and Braithwaite 1992).

Rather than applying identical supervisory measures across institutions, regulators adjust the intensity and form of their interventions according to the observed behavior and responsiveness of regulated entities. This perspective emphasizes that regulation and supervision operate through continuous interaction, mutual responsiveness, and adaptive learning processes rather than through the uniform application of predefined enforcement measures.

Within the SREP context, Responsive Regulation provides a useful theoretical framework for understanding supervision as an adaptive and iterative process in which supervisory actions and institutional behavior continuously influence one another. The theory therefore offers a conceptual foundation for analyzing how supervisory processes extend beyond the application of formal rules and evolve through ongoing interaction between supervisors and supervised institutions.

3.5 Principles-Based versus Rules-Based Supervision

A further theoretical distinction concerns principles-based and rules-based approaches to regulation and supervision. Rules-based systems rely on detailed prescriptions and objective compliance criteria, whereas principles-based systems formulate broader objectives and require institutions to demonstrate that their internal arrangements adequately address institution-specific risks (Black 2008).

Banking supervision inherently contains principles-based elements because governance effectiveness, organizational resilience, and risk culture cannot be fully standardized or measured through quantitative indicators alone. Consequently, supervisory authorities must interpret qualitative information and assess whether institutions are capable of managing risks appropriately given their individual business model and organizational complexity.

This theoretical distinction provides an important conceptual foundation for understanding the qualitative nature of supervisory assessments within the SREP framework.

3.6 Supervisory Discretion

Closely related to principles-based supervision is the concept of supervisory discretion. Supervisory discretion refers to the authority of supervisors to exercise professional judgement when applying regulatory standards to institution-specific circumstances.

The literature argues that discretion is an inherent feature of effective bank supervision because emerging risks, governance weaknesses, and organizational deficiencies often cannot be adequately captured through standardized indicators alone. Supervisory judgement therefore enables authorities to incorporate qualitative information, institution-specific characteristics, and forward-looking assessments into supervisory decision-making (Hirtle and Kovner 2022).

At the same time, supervisory discretion creates important challenges regarding transparency, consistency, predictability, legitimacy, and accountability. The need to balance methodological harmonization with institution-specific judgement therefore represents a defining characteristic of modern banking supervision and one of the central tensions of principles-based supervisory frameworks (Black 2008; Hirtle and Kovner 2022).

3.7 Conceptual Framework

Taken together, the theoretical perspectives presented above suggest that the SREP should not be understood merely as a standardized supervisory assessment framework or as the application of predefined regulatory requirements. Rather, it represents a multidimensional supervisory process in which institution-specific assessments emerge from the interaction of formal regulatory criteria, qualitative evaluations, supervisory judgement, and ongoing exchanges between supervisors and supervised institutions.

From this perspective, the determination of institution-specific P2R cannot be explained solely by observable risk indicators but must also be understood in light of organizational characteristics and supervisory processes. The theoretical framework therefore provides a conceptual basis for analyzing both the formal and informal determinants shaping supervisory outcomes within the SREP.

Principal-agent theory highlights the importance of information asymmetries between supervisors and supervised institutions. The Good Management Hypothesis emphasizes the role of managerial quality and organizational capabilities for supervisory assessments. Responsive Regulation conceptualizes supervision as an adaptive and iterative process, while principles-based supervision and supervisory discretion explain why institution-specific judgement constitutes an inherent element of modern supervisory practice.

Taken together, these perspectives provide the theoretical foundation for addressing the two research questions of this study. First, they offer a framework for identifying and interpreting the determinants of institution-specific P2R within the SREP. Second, they facilitate the analysis of how the supervisory process itself may shape the organizational behavior of supervised institutions.

4 Methodology

4.1 Research Design

This study follows an exploratory qualitative research design grounded in an interpretivist research perspective. The underlying assumption is that the determination of institution-specific P2R within the SREP cannot be fully explained through observable regulatory indicators alone but requires an understanding of the subjective interpretations, experiences, and decision-making processes of the actors involved.

A qualitative approach is particularly appropriate given the limited understanding of the formal and informal determinants of P2R and the largely opaque nature of supervisory decision-making. While regulatory publications provide a structured description of the SREP methodology, they reveal only limited insights into how institution-specific supervisory outcomes are formed in practice and whether additional determinants beyond the documented framework influence supervisory assessments. Semi-structured expert interviews therefore provide access to tacit knowledge and practice-based experience that cannot be observed through quantitative data or regulatory documents alone.

Rather than testing predefined hypotheses, the study adopts an exploratory-inductive research logic aimed at generating an empirically grounded understanding of the determinants of P2R and the behavioral implications of the SREP. The objective is to contribute to theory building by identifying both formally documented and practice-based mechanisms shaping institution-specific supervisory outcomes and organizational adaptation within the supervisory process (Meuser and Nagel 2009; Misoch 2019).

4.2 Sampling Strategy and Expert Selection

The interview sample was selected using a purposive sampling strategy aimed at identifying experts with direct experience in the SREP. Purposive sampling is particularly appropriate for exploratory qualitative research because it facilitates the selection of participants who possess specialized knowledge and are able to provide in-depth insights into complex organizational phenomena (Patton 2002; Palinkas et al. 2015). Eligibility required participants to hold senior positions with substantial responsibility for supervisory interactions or institution-wide risk management and to possess extensive practical experience in dealing with supervisory authorities.

Access to the field was established through the author's professional network and subsequently expanded using a snowball sampling approach, whereby interviewees recommended additional experts with complementary perspectives and institutional backgrounds. To ensure broad institutional coverage and avoid overrepresenting individual organizations, the sampling strategy aimed to include only one expert interview per significant institution. Consequently, the focus was placed on maximizing variation across institutional contexts rather than collecting multiple perspectives from the same organization. Snowball sampling is particularly suitable for accessing specialized expert populations and facilitates the identification of highly knowledgeable informants through professional networks (Noy 2008). This procedure ensured access to individuals with specialized expertise while simultaneously increasing the diversity of organizational contexts represented in the sample.

At the current stage, seven semi-structured expert interviews have been conducted, representing six distinct institutional contexts. Five interviews were conducted with senior practitioners from five different significant banking institutions, while two interviews involved senior regulatory experts from a leading international financial services consultancy. Owing to their long-standing advisory activities for significant institutions in the context of supervisory reviews and regulatory interactions, these experts contribute a cross-institutional perspective that complements the institution-specific experiences of the banking practitioners.

The participating banking institutions cover different business model categories according to the ECB's business model classification. Specifically, the sample includes three complex commercial banks and two specialized lenders, thereby reflecting substantial variation in business activities, organizational complexity, and supervisory environments. Complemented by the cross-institutional perspective provided by the regulatory advisory experts, the sample combines institution-specific experience with insights gained across multiple supervised institutions. Rather than aiming for statistical representativeness, the sampling strategy deliberately pursues analytical diversity, increasing the likelihood of identifying both common determinants of institution-specific P2R and business-model-specific differences in supervisory assessments and organizational responses (Farnè and Vouldis 2017).

Measured by total assets, the participating institutions collectively represent approximately EUR 2.5 trillion, corresponding to roughly one half of the aggregate balance sheet volume of all German significant institutions supervised by the ECB. The combination of different business model categories and supervisory contexts enables the analysis to capture both common supervisory mechanisms and institution-specific differences in the determinants of P2R and the organizational responses to supervisory expectations. An overview of the interview sample and its characteristics is provided in Appendix A1.

4.3 Qualitative Phase: Expert Interviews

The empirical analysis is based on semi-structured expert interviews with senior professionals from German significant institutions directly supervised under the SSM, as well as senior regulatory experts from a leading international financial services consultancy with extensive experience in supervisory processes. The participating experts occupy senior management positions with direct responsibility for institution-wide risk management. The consultancy experts complement these institution-specific perspectives through many years of advising significant institutions on SREP-related matters and supervisory reviews across a broad range of banking organizations.

The interview sample is characterized by a high level of professional expertise and extensive practical experience. Individual interviewees possess between more than five and approximately thirty years of professional experience in banking supervision, risk management, and regulatory affairs. Furthermore, the sample includes both male and female experts, thereby incorporating diverse professional perspectives from senior management functions. All participants are directly involved in SREP-related processes or the preparation and execution of supervisory reviews.

The interview guideline was developed deductively based on the two overarching research questions of the study. The first block focuses on identifying formal and informal determinants influencing P2R, while the second block examines the interaction between supervisory authorities and supervised institutions and its implications for organizational behavior. Additional questions address supervisory discretion, communication processes, regulatory uncertainty, governance mechanisms, and the perceived steering effects of the SREP process. The semi-structured design ensures comparability across interviews while simultaneously allowing respondents to elaborate on institution-specific experiences and emerging themes. The complete interview guideline is provided in Appendix A2.

Semi-structured expert interviews were chosen because they enable the systematic collection of both explicit procedural knowledge and tacit experiential knowledge regarding supervisory behavior, organizational responses, and regulatory uncertainty while providing sufficient flexibility to explore previously unanticipated aspects emerging during the interview process (Meuser and Nagel 2009; Misoch 2019). Interviews were conducted using a common interview guideline but allowed for adaptive probing and follow-up questions depending on the interviewees' professional background and specific expertise.

Following the first interview round, a second round of comparable size is planned to achieve theoretical saturation and to further validate and refine the emerging conceptual categories. This iterative research design enables continuous comparison between interviews and supports the progressive development of an empirically grounded analytical framework for understanding the determinants of P2R and the behavioral effects of modern banking supervision.

4.4 Data Analysis and Bias Control

The interview material is analyzed using qualitative content analysis supported by MAXQDA. The analytical procedure combines deductive category development based on the existing literature and regulatory framework with inductive coding to identify emerging themes from the empirical material. This hybrid approach enables the systematic identification of both formally documented and practice-based determinants of institution-specific P2R while preserving openness to previously unexplored concepts (Kuckartz and Rädiker 2019).

The coding process follows an iterative multi-stage procedure inspired by the logic of open, axial, and selective coding. During the initial coding stage, interview transcripts were systematically decomposed into meaningful units and assigned first-order codes reflecting the terminology and perspectives of the interviewees. In a second step, related codes were grouped into higher-order categories and linked through conceptual relationships. Finally, these categories were synthesized into aggregate themes representing broader explanatory mechanisms underlying supervisory assessments and banks' behavioral responses. While inspired by Grounded Theory procedures, the

Table 1 Informance Scale for evaluating interview statements

Dimension	Assessment criterion	Purpose for the analysis
Transparency	Degree to which the statement is specific, clear, and sufficiently detailed.	Identifies statements that provide rich and interpretable information rather than vague or generic assessments.
Evidential support	Extent to which the statement is supported by concrete examples, observed practices, or direct professional experience.	Distinguishes experience-based knowledge from abstract opinion or speculation.
Self-protection	Degree to which the statement may be shaped by defensive, reputational, or institution-protective motives.	Helps identify potential self-serving bias and supports a cautious interpretation of strategically sensitive statements.
Reflexivity	Extent to which the interviewee reflects on uncertainty, alternative interpretations, limitations, or the institutional context of the statement.	Enhances interpretability by identifying statements that demonstrate critical self-awareness and contextualization.

objective was not to develop a formal grounded theory but rather to construct a comprehensive and empirically grounded framework of determinants shaping supervisory outcomes.

To ensure methodological transparency and analytical consistency, a structured code tree and codebook were developed throughout the coding process. The codebook documents all categories, definitions, inclusion and exclusion criteria, and exemplary quotations used during the analysis, thereby enhancing the traceability and replicability of the coding decisions. An overview of the final code tree and the corresponding codebook is provided in the following section.

Given the exploratory nature of qualitative expert interviews and the potential for strategic self-presentation, particular attention was devoted to assessing the informational quality of interview statements. Therefore, the analysis incorporates an Informance Scale evaluating each statement with respect to transparency, evidential support, self-protection, and reflexivity. Rather than treating all statements as equally informative, this approach enables a differentiated assessment of the credibility and interpretative value of the empirical material and mitigates the risk of self-serving bias (Castleberry and Nolen 2018).

Additional measures were implemented to enhance the trustworthiness of the analysis. Coding was conducted iteratively across interviews, allowing emerging categories to be continuously refined and contrasted with previously coded material. Contradictory statements and deviant cases were explicitly retained and analyzed to avoid premature theoretical closure. Furthermore, the second wave of interviews serves as a form of theoretical validation by testing the robustness and completeness of the emerging conceptual framework across additional experts and institutional contexts.

4.5 Methodological Contribution

A central methodological contribution of the study lies in the systematic identification and structuring of supervisory determinants and behavioral mechanisms that extend beyond formal regulatory frameworks. Existing empirical research predominantly relies on quantitative proxy variables and therefore captures only part of supervisory practice (Pereira Pedro, Ramalho, and da Silva 2023). By contrast, the qualitative approach adopted in this study enables the identification of governance assessments, supervisory discretion, communication dynamics, and organizational adaptation that cannot be directly observed through quantitative data.

The chosen methodology is therefore particularly suited to address the research questions, as it allows the reconstruction of supervisory practice from the perspective of experienced practitioners and contributes to a deeper theoretical understanding of modern banking supervision as a governance and behavioral steering regime (Hirtle and Kovner 2022; Black 2008).

5 Preliminary Findings

5.1 Classification of determinants

Based on the qualitative evidence, the study proposes a four-dimensional framework for understanding the determinants of P2R. First, formal determinants comprise objectively observable and largely codified regulatory factors which provide the formal basis for supervisory assessments. Second, qualitative determinants capture organizational characteristics that cannot be fully measured through standardized indicators but require supervisory judgement, including governance quality, risk culture, internal control systems, and the effectiveness of ICAAP and ILAAP processes. Third, interactional determinants emerge from the ongoing relationship between supervisory authorities and supervised institutions and encompass factors such as communication quality, transparency, credibility, responsiveness, and the overall supervisory dialogue. Finally, behavioral determinants reflect the strategic and organizational adaptations of banks in response to supervisory expectations and regulatory uncertainty, including proactive governance improvements, early issue disclosure, enhanced internal coordination, and the institutionalization of supervisory processes.

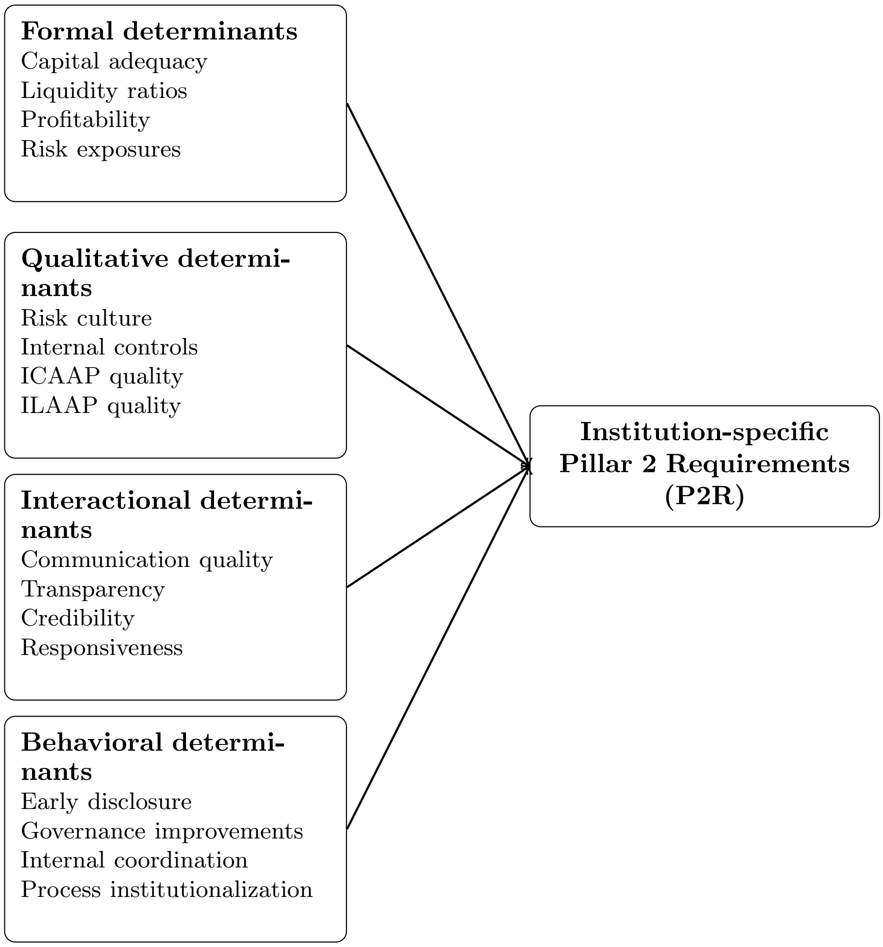

Fig. 2 Conceptual framework of determinants shaping institution-specific Pillar 2 Requirements (P2R). The framework distinguishes four complementary dimensions influencing supervisory assessments within the Supervisory Review and Evaluation Process (SREP). Formal determinants comprise objectively measurable and largely codified regulatory indicators, including capital adequacy, liquidity, profitability, and risk exposures. Qualitative determinants capture organizational characteristics requiring supervisory judgement, such as governance quality, risk culture, internal control systems, and the effectiveness of the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP). Interactional determinants arise from the continuous exchange between supervisory authorities and supervised institutions and include communication quality, transparency, credibility, and supervisory dialogue. Behavioral determinants reflect the strategic and organizational adaptation of banks to supervisory expectations and regulatory uncertainty, including proactive governance improvements, early issue disclosure, and the institutionalization of supervisory processes. Rather than operating independently, these four dimensions interact throughout the supervisory process and jointly shape supervisory perceptions and the determination of institution-specific P2R. Source: Author's own conceptualization based on qualitative expert interviews and the relevant literature.

Rather than acting independently, these four dimensions interact dynamically throughout the SREP and jointly shape supervisory perceptions and the determination of P2R. The framework therefore extends existing literature by conceptualizing P2R not merely as the outcome of quantitative risk metrics and qualitative judgement but as the product of a multidimensional supervisory governance process integrating regulatory, organizational, interactional, and behavioral factors.

5.2 Beyond Standardization: The SREP as Qualitative Supervision

Official supervisory publications present the SREP as a harmonized and methodologically consistent assessment framework. The ECB states that the purpose of the SREP is to allow banks' risk profiles to be assessed "consistently" and emphasizes the application of a "common methodology" across all significant institutions to facilitate peer comparisons and transversal analyses (European Central Bank 2025a, 2024). At the same time, supervisory publications implicitly acknowledge that the process cannot be purely mechanical. The SREP is described as assessing "the way a bank deals with its risks" and culminates in a "holistic, forward-looking assessment of the overall viability of the institution", thereby requiring qualitative supervisory judgement and institution-specific interpretation rather than a simple aggregation of quantitative indicators (European Central Bank 2024; European Central Bank 2025b). The preliminary empirical findings of this study build on this observation by suggesting that qualitative assessment and supervisory discretion are not merely complementary elements but constitute fundamental mechanisms through which modern banking supervision operates in practice.

The interviews consistently indicate that the SREP is perceived by practitioners as extending beyond a purely formalized and standardized supervisory assessment process. While the official SREP framework comprises four established assessment dimensions: business model, internal governance, ICAAP, and ILAAP interviewees emphasize that the evaluation of these dimensions itself relies heavily on qualitative judgement and institution-specific interpretation.

This observation aligns with the emerging literature on bank supervision, which distinguishes supervision from regulation. Whereas regulation primarily establishes standardized rules and minimum requirements, supervision evaluates how institutions identify, govern, and manage risks using qualitative information and professional judgement (Hirtle & Kovner, 2022). The preliminary findings therefore suggest that the SREP should be understood not merely as a standardized assessment framework but as a supervisory process in which qualitative evaluation constitutes an inherent component of the assessment methodology.

5.3 Supervisory Discretion within a Harmonized Framework

While the previous section demonstrates that the SREP extends beyond a purely standardized assessment framework, the interviews further reveal that qualitative supervision inevitably entails supervisory discretion. Across interviews, practitioners consistently described supervisory assessments as involving considerable interpretative flexibility, particularly in areas such as governance quality, organizational effectiveness, management credibility, remediation progress, and business model sustainability. Although supported by common methodological standards and peer benchmarking, these assessments cannot be reduced to mechanical scoring exercises but require professional judgement by supervisory authorities.

From a theoretical perspective, these preliminary findings are consistent with the literature on principles-based supervision and supervisory discretion (Black 2008; Hirtle and Kovner 2022). Unlike rules-based approaches that rely on predefined quantitative thresholds, principles-based supervision requires supervisors to evaluate whether institutions are capable of identifying, governing, and mitigating risks under changing circumstances. Consequently, supervisory judgement is not an exception to the SREP methodology but an integral component of its implementation.

The preliminary findings can further be interpreted through the lens of information asymmetry and principal-agent theory. Because essential organizational characteristics such as governance quality, risk culture, managerial effectiveness, and institutional resilience cannot be directly observed or fully quantified, supervisors face persistent information asymmetries when assessing supervised institutions. Qualitative judgement therefore serves as a mechanism to reduce informational uncertainty and to incorporate aspects of organizational capability that remain outside standardized regulatory metrics.

Importantly, interviewees did not perceive supervisory discretion as arbitrary or inconsistent. Instead, discretion was generally regarded as a necessary consequence of supervising highly complex organizations whose resilience depends not only on measurable risk exposures but also on their ability to respond effectively to uncertainty and changing environments. Rather than undermining harmonization, supervisory discretion appears to complement the standardized elements of the SREP by enabling institution-specific assessments where formal rules alone would be insufficient.

These preliminary findings suggest that supervisory discretion should be understood as an institutional necessity rather than a methodological weakness. Modern banking supervision therefore combines standardized regulatory frameworks with qualitative supervisory judgement, resulting in a hybrid governance mechanism that seeks to balance consistency with flexibility in the assessment of institution-specific risks.

5.4 Supervisory Interaction and Information Asymmetry

The interviews further provide insights into the interaction between banks and supervisory authorities. Contrary to the classical expectation that banks strategically withhold information from supervisors, interviewees consistently describe extensive transparency, proactive communication, and early disclosure of emerging issues.

These observations only partially support the assumptions of classical principal-agent theory. Instead of informational asymmetry resulting primarily from superior information held by banks, the interviews suggest that the remaining asymmetry concerns supervisory interpretation. Banks generally know their own organization but possess limited knowledge regarding how supervisory authorities interpret, prioritize, and ultimately translate qualitative information into supervisory assessments and institution-specific requirements.

The preliminary findings therefore indicate that supervisory relationships may be characterized less by informational asymmetry than by interpretative asymmetry.

5.5 Behavioral Responses to Supervisory Expectations

The interviews further suggest that supervisory expectations influence organizational behavior beyond formal regulatory compliance. Institutions report strengthening governance structures, institutionalizing supervisory findings, enhancing internal coordination, and proactively addressing potential supervisory concerns.

These observations appear more consistent with the Good Management Hypothesis than with an opportunistic interpretation of bank behavior. Rather than engaging primarily in symbolic compliance or regulatory gaming, banks seem to respond to supervisory expectations through substantive organizational improvements. At the same time, the preliminary findings are compatible with the concept of Responsive Regulation, according to which supervisory interaction itself becomes an instrument for influencing institutional behavior.

Consequently, the SREP appears to function not only as an assessment mechanism but also as an instrument of organizational steering.

5.6 Towards a Supervisory Gap

Taken together, the preliminary findings reveal a central theoretical tension between the official representation of the SREP and its practical implementation.

Official supervisory communication predominantly presents the SREP as a harmonized, consistent, and methodologically standardized assessment process. In contrast, practitioners describe supervisory assessments as qualitative, interpretative, context-dependent, and strongly influenced by professional judgement.

Building on the literature on bank supervision, this study conceptualizes this discrepancy as a *supervisory gap*. The gap does not necessarily imply inconsistency or arbitrariness. Rather, it reflects the inherent nature of modern supervision, which requires supervisors to evaluate organizational resilience, governance quality, and risk management capabilities through qualitative assessment under uncertainty.

The preliminary findings therefore suggest that the SREP should be understood less as a purely standardized framework for determining institution-specific capital requirements and more as a hybrid governance and behavioral steering regime in which supervisory judgement and organizational adaptation jointly shape supervisory outcomes.

6 Limitations and Future Research

The preliminary findings of this study should be interpreted in light of several methodological and conceptual limitations. First, the empirical evidence is based on a qualitative research design and a limited number of expert interviews. Although the purposive sampling strategy ensured access to highly knowledgeable practitioners and substantial analytical diversity, the preliminary findings do not aim for statistical generalizability. Rather, they provide context-specific explanations and conceptual insights into supervisory practice. The planned second wave of interviews will further contribute to theoretical saturation and strengthen the robustness and internal consistency of the emerging analytical framework.

Second, the study relies on subjective perceptions of experts involved in supervisory processes. While these practitioners possess unique experiential knowledge that is not accessible through regulatory documents or quantitative data, their assessments may be influenced by organizational perspectives, retrospective interpretation, or strategic self-presentation. To mitigate these risks, the analysis incorporates an Informance Scale and explicitly considers transparency, evidential support, reflexivity, and potential self-protection in the interpretation of interview statements. Nevertheless, the preliminary findings remain interpretative and should be understood as reflecting experienced supervisory practice rather than objective causal relationships.

Third, the empirical setting is limited to significant institutions within the German banking sector. Although the participating institutions represent approximately one half of the aggregate balance sheet volume of all German significant institutions and encompass diverse business models and organizational structures, supervisory cultures and interaction patterns may differ across Member States within the Banking Union. National institutional traditions, historical supervisory practices, and organizational cultures could influence how supervisory discretion is exercised in practice. Future research should therefore extend the analysis to a cross-country setting in order to investigate whether the identified mechanisms represent general characteristics of European banking supervision or exhibit systematic national variation (Carletti, Dell'Ariccia, and Marquez 2015; Haselmann, Singla, and Vig 2022).

Fourth, the study adopts an exploratory and theory-building perspective. Its primary objective is to identify and structure relevant determinants of P2R rather than to estimate their relative importance or causal effects. Consequently, the proposed analytical framework should be understood as a conceptual foundation for subsequent empirical research rather than a finalized explanatory model. Future quantitative studies could operationalize the identified determinants and examine their explanatory power using supervisory data, survey evidence, or panel econometric approaches.

Finally, the preliminary findings raise broader questions regarding the governance of modern banking supervision. The observed interaction between standardized regulatory frameworks, supervisory discretion, and organizational behavioral adaptation suggests that supervision may itself shape institutional behavior beyond the formal enforcement of regulatory requirements. Future research could therefore investigate the dynamic feedback mechanisms between supervisory expectations and organizational responses, contributing to a deeper understanding of supervision as a governance mechanism rather than merely a compliance function. Such research would further strengthen the integration of institutional theory, behavioral economics, and banking supervision and advance the emerging literature on supervisory governance.

7 Conclusion

The preliminary findings suggest that the SREP cannot be adequately understood as a purely standardized framework for determining P2R. Instead, supervisory outcomes emerge from a complex interaction of formal regulatory requirements, qualitative supervisory judgement, organizational governance, communication processes, and behavioral adaptation. Banking supervision therefore extends beyond the enforcement of regulatory compliance and operates as an institution-specific governance mechanism under conditions of uncertainty.

The study contributes to the emerging literature on bank supervision by integrating insights from principal-agent theory, principles-based supervision, responsive regulation, and the Good Management Hypothesis into a common analytical framework. Rather than viewing supervision as the mechanical application of regulatory rules, the preliminary findings conceptualize supervision as an interpretative process in which qualitative judgement, organizational interaction, and supervisory communication become central determinants of supervisory outcomes. In doing so, the study extends existing research on the determinants of P2R by incorporating behavioral and governance-related mechanisms that have received limited attention in the literature.

A central theoretical contribution is the conceptualization of a *supervisory gap* between the official representation of the SREP as a harmonized and methodologically standardized assessment process and its practical implementation as a qualitative, context-dependent, and judgement-based supervisory regime. Importantly, this gap should not be interpreted as evidence of inconsistency or arbitrariness but rather as an inherent characteristic of effective supervision in environments characterized by organizational complexity, uncertainty, and incomplete information. Qualitative supervisory discretion therefore emerges not as a weakness of the supervisory framework but as a necessary prerequisite for institution-specific supervision.

From a practical perspective, the preliminary findings indicate that supervisory uncertainty may itself constitute an important governance instrument. By encouraging institutions to strengthen governance structures, improve internal coordination, and proactively address supervisory expectations, qualitative supervision generates behavioral effects that extend beyond formal compliance with regulatory requirements. Consequently, an excessive shift toward mechanistic or fully standardized supervisory methodologies could unintentionally weaken these governance effects and foster rule-oriented “tick-the-box” compliance rather than genuine organizational resilience and sound risk management.

More broadly, the study suggests that future research should increasingly conceptualize banking supervision as a governance process rather than merely a regulatory function. Understanding how supervisory expectations, qualitative judgement, and organizational adaptation interact may contribute to the development of a more comprehensive theory of supervisory governance. By bridging the gap between the formal supervisory methodology and supervisory practice, this study provides a first step toward such an integrated perspective and offers a conceptual foundation for future qualitative and quantitative research on the behavioral dimensions of modern banking supervision.

Funding

This research did not receive any specific grant from funding agencies in the public, commercial, or not-for-profit sectors.

Data availability

The qualitative interview data underlying this study are not publicly available due to confidentiality agreements and the protection of participants' anonymity. Aggregated findings and anonymized excerpts are presented within the manuscript.

Declaration of competing interests

The author declares that there are no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

Appendix

Table A1 Overview of the interview sample

Interview	Institution category	Function	Gender	Professional experience
E1	Specialized lender	Head of Risk Controlling	Male	>20 years
E2	Specialized lender	Deputy Head of Risk Controlling	Female	>5 years
E3	Complex commercial bank	Deputy Head of Risk Governance	Male	15 years
E4	Complex commercial bank	Head of Risk Controlling	Male	>30 years
E5	Complex commercial bank	Head of Capital Management	Male	>30 years
E6	International financial services consultancy	Senior Manager, Regulatory Advisory	Male	>15 years
E7	International financial services consultancy	Senior Manager, Regulatory Advisory	Male	>30 years

Table A2: Interview Guide

No.	Interview question
(1)	**Information phase** • Welcome and appreciation for participation. • Short introduction of interviewer and interviewee. • Explanation of the research objectives. • Explanation of confidentiality, data protection, audio recording and transcription procedures. • Audio recording started only after explicit verbal consent. • Signing of the informed consent and data protection declaration.
(2.1)	When you think about the importance of the SREP for your institution, what is the first thing that comes to your mind? *Follow-up: What importance does the SREP capital add-on have for your institution?*
(2.2)	How do you perceive the determination of the SREP capital add-on by the supervisory authority and the underlying supervisory process? *Follow-up: Which changes or developments have you observed during recent years?*
(2.3)	What are the consequences of a high SREP capital add-on for your institution?
(2.4)	How would you describe the interaction between your institution and the supervisory authority within the SREP process?
(3.1)	When thinking about the determination of your institution's SREP capital add-on, which factors do you consider particularly relevant for the supervisory assessment? *Follow-up: Are there factors that officially play little or no role but nevertheless become relevant in supervisory practice?*
(3.2)	Which characteristics do you generally observe among banks with comparatively high or low SREP capital add-ons? *Follow-up: How do these characteristics apply to your own institution?*
(3.3)	Which external influences, such as macroeconomic developments or industry trends, affect the determination of the SREP capital add-on in your experience?
(3.4a)	If a bank intended to improve its assessment in the Business Model component of the SREP, which managerial levers would be most relevant?
(3.4b)	If a bank intended to improve its ICAAP assessment, which managerial levers would be most relevant?
(3.4c)	If a bank intended to improve its ILAAP assessment, which managerial levers would be most relevant?
(3.4d)	If a bank intended to improve its Governance assessment, which managerial levers would be most relevant?
(3.5)	To what extent does the SREP assessment reflect your institution's actual risk situation? *Follow-up: Do you perceive the results as transparent and comprehensible?*
(3.6)	Returning to the interaction with supervisors: How has the relationship between your institution and the supervisory authority evolved over recent years?
(3.7)	Are there situations within the SREP process in which subjective judgments of supervisors play a role?
(3.8)	How would you describe the relationship between employees of your institution and representatives of the supervisory authority?
(3.9)	If you wanted to influence the supervisory authority's perception, how could this be achieved? *Examples: verbal communication, personal relationships, presentation of quantitative information.*
(3.10)	In which situations does your institution behave proactively or reactively within the SREP process, and what triggers this behavior?
(3.11)	Where do you experience clarity and where uncertainty within the SREP process? *Follow-up: Do you perceive room for interpretation or information asymmetries?*
(4.1)	Considering the recent EBA consultation paper on the SREP methodology: • How might these changes affect the interaction between banks and supervisors? • Which factors could become more relevant for determining institution-specific SREP capital add-ons in the future?

No.	Interview question
(4.2)	Who is responsible for coordinating the SREP process within your institution? *Follow-up: Is the process managed proactively or mainly accompanied reactively?*
(5.a)	If you were part of this research project, which topics related to SREP capital requirements or supervisory interaction would deserve greater attention?
(5.b)	Are there additional experts or institutions you would recommend for participation in this research project?
(5.c)	To what extent did you feel able to speak openly about these topics?
(5.d)	The interview will be transcribed. Participants may review, approve, or request modifications to the transcript.
(5.e)	Closing remarks and appreciation for participation.

References

Aghamanoukjan, A., Buber, R., & Meyer, M. (2009). Qualitative interviews. In R. Buber & H. H. Holzmüller (Eds.), *Handbuch qualitative Forschungsmethoden in der Betriebswirtschaftlichen Forschung* (415–435). Gabler.

Alves, C. F., Citterio, A., & Marques, B. P. (2023). Bank-specific capital requirements: Short- and long-run determinants. *Finance Research Letters, 52*.

Ayres, I., & Braithwaite, J. (1992). *Responsive regulation: Transcending the deregulation debate*. Oxford University Press.

Berger, A. N., & DeYoung, R. (1997). Problem loans and cost efficiency in commercial banks. *Journal of Banking & Finance, 21*(6), 849–870.

Black, J. (2008). Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation & Governance, 2*, 137–164.

Carletti, E., Dell'Ariccia, G., & Marquez, R. (2015). *Supervisory incentives in a banking union* (Working paper).

Castleberry, A., & Nolen, A. (2018). Thematic analysis of qualitative research data: Is it as easy as it sounds? *Currents in Pharmacy Teaching and Learning, 10*, 807–815.

De Jonghe, O., Dewachter, H., & Ongena, S. (2020). Bank capital requirements and credit supply: Evidence from Pillar 2 decisions. *Journal of Corporate Finance, 60*.

European Banking Authority. (2022). *Guidelines on common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP) and supervisory stress testing under Directive 2013/36/EU* (EBA/GL/2022/03). European Banking Authority.

European Banking Authority. (2025). *Consultation paper: Draft guidelines on common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP) and supervisory stress testing under Directive 2013/36/EU* (EBA/CP/2025/21).

European Central Bank. (2023). *SREP Methodology Booklet*. Frankfurt am Main: European Central Bank.

European Central Bank. (2024a). *Supervisory manual*. European Central Bank.

European Central Bank. (2024b). Supervisory Methodology 2024.

European Central Bank. (2025a). Supervisory Review and Evaluation Process (SREP). ECB Banking Supervision. Available at: https://www.bankingsupervision.europa.eu/activities/srep/html/index.en.html.

European Central Bank. (2025b). Supervisory Methodology 2025. ECB Banking Supervision. Available at: https://www.bankingsupervision.europa.eu/activities/srep/2025/html/ssm.srep202511_supervisorymethodology202

Farnè, M., & Vouldis, A. (2017). *Business models of the banks in the euro area* (ECB Working Paper Series No. 2070). European Central Bank.

Ferretti, R., Venturelli, V., & Azzaretto, A. (2023). Does individual SREP results reveal real news? *Finance Research Letters, 57*.

Flick, U. (2022). *An introduction to qualitative research* (7th ed.). Sage Publications.

Glaser, B. G., & Strauss, A. L. (1967). *The discovery of grounded theory: Strategies for qualitative research*. Aldine Publishing Company.

Haselmann, R., Singla, S., & Vig, V. (2022). *Supranational supervision* (LawFin Working Paper No. 46). Goethe University.

Hirtle, B., & Kovner, A. (2022). Bank supervision. *Annual Review of Financial Economics, 14*, 39–56.

Hirtle, B., Kovner, A., & Plosser, M. (2020). The impact of supervision on bank performance. *Journal of Finance, 75*(5), 2765–2808.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3*(4), 305–360.

Kuckartz, U., & Rädiker, S. (2019). *Analyzing qualitative data with MAXQDA: Text, audio, and video*. Springer.

Kuckartz, U., & Rädiker, S. (2020). *Fokussierte Interviewanalyse mit MAXQDA: Schritt für Schritt*. Springer.

Lincoln, Y. S., & Guba, E. G. (1985). *Naturalistic inquiry*. Sage Publications.

Meuser, M., & Nagel, U. (2009). Das Experteninterview – konzeptionelle Grundlagen und methodische Anlage. In S. Pickel, G. Pickel, H.-J. Lauth, & D. Jahn (Eds.), *Methoden der vergleichenden Politik- und Sozialwissenschaft* (pp. 465–479). VS Verlag für Sozialwissenschaften.

Misoch, S. (2019). *Qualitative interviews* (2nd ed.). De Gruyter.

Noy, C. (2008). Sampling knowledge: The hermeneutics of snowball sampling in qualitative research. *International Journal of Social Research Methodology, 11*(4), 327–344.

Palinkas, L. A., Horwitz, S. M., Green, C. A., Wisdom, J. P., Duan, N., & Hoagwood, K. (2015). Purposeful sampling for qualitative data collection and analysis in mixed method implementation research. *Administration and Policy in Mental Health and Mental Health Services Research, 42*(5), 533–544.

Patton, M. Q. (2002). Qualitative Research and Evaluation Methods. Sage Publications.

Pereira Pedro, C., Ramalho, J. J. S., & da Silva, J. V. (2023). How to measure banking regulation and supervision. *Research in International Business and Finance, 66*.