REPORT ON CONVERGENCE OF SUPERVISORY PRACTICES IN 2021

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Abbreviations

AML	Anti-Money Laundering
BCM	Business Continuity Management
BMA	Business Model Analysis
BoS	Board of Supervisors
BRRD	Bank Recovery and Resolution Directive
CA	Competent Authority
CB	Combined Buffer
CCF	Credit Conversion Factor
CET1	Common Equity Tier 1
CFT	Countering the Financing of Terrorism
CI	Credit Institutions
COREP	Common Reporting
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSRBB	Credit Spread Risk in the Banking Book
DoD	Definition of Default
EBA	European Banking Authority
ECB	European Central Bank
ECL	Expected Credit Loss
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
ESA	European Supervisory Authority
ESEP	European Supervisory Examination Programme
ESG	Environmental, Social and Corporate Governance
ESMA	European Securities and Markets Authority
EU	European Union
FINREP	Reporting of financial information
FX	Foreign Exchange
GL	Guideline
GRP	Group Recovery Plan
GSIIs	Global Systemically Important Institutions
HDP	High Default Portfolios
ICAAP	Internal Capital Adequacy Assessment Process
ICT	Information and Communications Technology
IFRS	International Financial Reporting Standards
IMV	Initial Market Valuation
IRB	Internal Ratings Based
IRRBB	Interest Rate Risk in the Banking Book
IT	Information Technology

ITS	Implementing Technical Standards
JD	Joint Decision
KPI	Key Performance Indicator
KRI	Key Risk Indicator
LCR	Liquidity Coverage Ratio
LDP	Low Default Portfolios
LGD	Loss Given Default
MDA	Maximum Distributable Amount
ML/TF	Money Laundering/Terrorist Financing
MREL	Minimum Requirement for Own Funds and Eligible Liabilities
NII	Net Interest Income
NPE	Non-Performing Exposure
NPL	Non-Performing Loan
ORC	Overall Recovery Capacity
PD	Probability of default
P2G	Pillar 2 Guidance
P2R	Pillar 2 Requirements
Q&A	Questions and Answers
RA	Resolution Authority
RTS	Regulatory Technical Standards
RW	Risk weight
RWA	Risk-Weighted Asset
SCOP	Standing Committee on Oversight and Practices
SEP	Supervisory Examination Programme
SGOS	Sub-group on Ongoing Supervision
SME	Small and Medium-sized Enterprises
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism
sVaR	Stressed Value at Risk
SVB	Silicon Valley Banks
TCB	Third-Country Branch
TCG	Third-Country Group
TLAC	Total Loss-Absorbing Capacity
TSCR	Total SREP Capital Requirement
UCITS	Undertakings for Collective Investment in Transferable Securities Directive
UK	United Kingdom
USSP	Union Strategic Supervisory Priorities
UTP	Unlikeliness-to-pay
VaR	Value at Risk
WCCA	Written Coordination and Cooperation Arrangements

Executive Summary

One of the EBA's key objectives, in line with its legal mandate, is to enhance supervisory convergence across the internal market. This report summarises i) how the EBA pursued supervisory convergence in 2021 in the context of the supervisory review and ongoing supervision via the various convergence tools under its disposal; and ii) the EBA's main observations on the respective developments and conclusions. This report has been prepared in accordance with Article 107 of the Capital Requirements Directive[1], which requires the EBA to report annually to the European Parliament and Council on the degree of convergence of supervisory practices.

One of the key activities undertaken by the EBA to strengthen the supervisory convergence in the European Union (EU) is to set out annually key topics for heightened supervisory attention and then to review whether and how the selected topics were covered in supervisory activities, and in the context of supervisory colleges. The 2021 Convergence Plan that was endorsed by the EBA Board of Supervisors (BoS) in October 2020, and subsequently shared with the supervisory community, introduced four key topics for supervisory attention and was still driven by the implications of the COVID-19 pandemic in order to ensure that banks tackle the impacts of the pandemic and adapt well to the new circumstances. Thus, the key topics selected for 2021 were: 1) asset quality and credit risk management; 2) ICT and security risk, operational resilience; 3) profitability and business model; 4) capital and liability management.

Wherever possible the report makes the link with conclusions drawn in the previous (2020) Convergence Report to provide a picture of the trend in the degree of convergence across years. It also ensures a forward-looking perspective by highlighting the areas that would require further consideration and action from competent authorities (CAs) also as part of the 2022 ESEP[2].

Summary of the assessment of convergence of supervisory practices in 2021

In 2021, CAs progressed further with the implementation of the EBA SREP Guidelines[3], thus all outstanding recommendations from the 2016 and 2017 bilateral convergence visits have now been addressed. Supervisory practices have been brought in line with Capital Requirements Directive (CRD V), as the Pillar 2 Requirement (P2R) is now legally binding across the EU, and is consistently taken into account when calculating the trigger point for the maximum distributable amount (MDA) restrictions. The implementation of new methodologies also introduced clear improvements towards a more risk-by-risk determination of the add-ons, and the ICAAP plays a stronger role in the determination of P2R. Notwithstanding, the EBA expects that the operationalisation of the new methodologies will ensure an accountable approach to the P2R setting by communicating the main risk drivers determining the P2 add-on.

[1] Capital Requirements Directive.

[2] 2022 European Supervisory Examination programme (ESEP).

[3] EBA/GL/2018/03.

This report finds that the key topics of the 2021 Convergence Plan were well incorporated into the CAs' supervisory priorities in 2021 and overall, were also well implemented into their supervisory practices throughout the year.

The key topic of capital and liability management has been the most thoroughly implemented in supervisory practices, which is partially due to the fact that the assessment of the capital situation and liability management has always been at the core of banking supervision. The topic of asset quality and credit risk management was also a priority for CAs in 2021, as all CAs closely monitored the impact of the COVID-19 pandemic on institutions' credit quality and the levels of their non-performing exposures (NPEs), with 'high NPL banks' clearly being the focus. CAs also assessed the scope of use of various payment moratoria and any risks of cliff-edge effects. The 'ICT and security risk, operational resilience' as well as 'profitability and business model', received less supervisory attention overall compared to the other two topics, with slightly more than 70% of CAs implementing all the attention points in their supervisory practices.

Notwithstanding the efforts CAs have dedicated to the supervision of the key topics in 2021, the EBA's follow-up identified areas that were not reviewed and assessed by all CAs or where improvements were noted compared to 2020, but still, CAs need further action to achieve further convergence across the EU. Thus i) loan origination practices, ii) cyber risk, including in the context of outsourced services, and iii) digital transformation and its impact on the business model remain points of attention in 2022. The EBA's college-monitoring activity identified the very same areas which could have been better reflected in supervisory assessments. Notably, the 2022 ESEP covers these and other areas, which will help prudential supervisors to address them in their processes and supervisory practices. Further, the EBA will provide training initiatives to CAs on ICT security in 2022 and will consider ways to address digital transformation to support supervisors in this regard.

In the context of convergence in supervisory measures, the EBA's analysis concluded that while CAs' methodologies for setting P2R have been further aligned to the common framework, there is still room for further convergence in the use of the ICAAP as well as in the consistent treatment of risks across the EU. With regard to Pillar 2 Guidance (P2G), while the number of CAs which set the P2G increased in the 2021 cycle, there are some divergent practices, as a number of CAs have not yet adopted it or use somewhat different methodologies. The implementation of CRD V and the second update of the SREP GLs, as well as the application of the EBA Supervisory Risk Taxonomy, will support CAs in achieving greater consistency in supervisory measures.

The conclusions of the annual EU-wide supervisory benchmarking exercise for market and credit risk, as well as the outcome of the IFRS 9 monitoring exercise, are also summarised in the report.

In the sphere of supervisory colleges, the EBA 2021-2023 college-monitoring approach introduced adjustments in the selection of closely monitored colleges in order to allow for the monitoring of a more diverse group of colleges and the maximisation of the benefits of the EBA's presence in colleges. In general, the interactions of closely monitored colleges were well organised in 2021. Some operational arrangements of colleges, in particular certain aspects of the written coordination and cooperation arrangements (WCCAs) and the regular exchange of the early warning indicators, should be strengthened.

Colleges made considerable efforts to complete their group risk/liquidity risk assessments, though in a minority of colleges, consolidating supervisors did not complete and share the mandatory risk-by-risk decomposition of capital. In some colleges, the EBA observed the extension of the joint decision (JD) cycle, which resulted in failure to comply with the 4-month legal deadline available for reaching a joint decision. No issues were observed with the available capital, including its quantity and quality, in closely monitored colleges.

The EBA policy work supporting supervisory convergence in 2021 and training

The EBA worked on various policy products over the course of 2021 to drive further convergence in particular in the cooperation between AML/CFT supervisors and financial intelligence units (FIUs), and in procedures of establishing intermediate EU parent undertakings (IPUs). Additionally, the EBA has updated its internal-governance-related guidelines in line with CRD V to foster diversity and ensure equal opportunities. The EBA also facilitated consistency of supervisory practices in i) the management and supervision of ESG risks; ii) the treatment of 'legacy instruments' by institutions across the EU; iii) the mapping of incoming third-country branches; and iv) recovery planning.

The EBA almost doubled the number of training activities offered in 2021 (20), compared to 2020 (11). A total of 3 647 representatives from all Member States participated in the various training activities and expressed great interest in the topics offered.

Ongoing and future work

In line with its Pillar 2 Roadmap[4], the EBA updated its SREP Guidelines in order to provide additional guidance to supervisors in conducting the common SREP. The updates not only incorporate alignment with CRD V provisions but also channel practical experiences with the implementation of the SREP framework. The EBA has also been committed to fostering a comprehensive Supervisory Risk Taxonomy as a complement to the SREP GLs.

After the second update of the EBA SREP Guidelines, the EBA will prioritise the monitoring of the implementation of the common SREP framework, in particular the practical application of P2, such as the setting of the P2R and P2G, the use of ICAAP and the categorisation of institutions and supervisory engagement.

The interaction of the Union Strategic Supervisory Priorities and the 2021 Convergence Plan

The first cycle of the Union Strategic Supervisory Priorities is about to conclude with the assessment of supervisory activities and actions conducted under its umbrella. Based on its first implementation, the USSPs prove to be a valuable point of entry to allow for discussions on future supervisory developments and long-term trends. From the starting point, the concrete supervisory activities and actions, as well as specific points of attention tend to be enacted via the Convergence Plan. The interplay and sequencing of the USSPs and the Convergence Plan may allow for a strategic debate on the supervisory priorities for the next 3-year cycle, followed by the refinement and operationalisation of supervisory activities and actions under these priorities.

[4] Pillar 2 Roadmap.

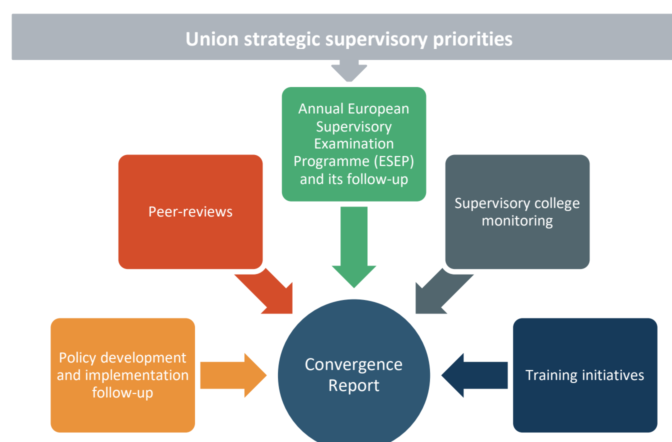
Background and introduction

In line with Article 1(5)(g) of its founding Regulation[5], the EBA is required to foster and promote supervisory convergence across the European Union (EU). In order to pursue its supervisory convergence mandate, in 2021, the EBA actively contributed to establishing high-quality common regulatory and supervisory standards and to ensuring the consistent application of the Single Rulebook, which also encompasses the convergence in the context of the SREP[6]. The EBA also conducted peer reviews of CAs practices to take stock of supervisory practices and worked to ensure the consistent and effective functioning of colleges of supervisors.

This report has been prepared in accordance with the EBA's mandate of promoting convergence of supervisory practices and its purpose is to summarise the main activities undertaken by the EBA to strengthen the supervisory convergence in 2021 and to report on the respective observations and conclusions.

The report provides an analysis of the degree of progress in the convergence of supervisory methodologies and supervisory measures and introduces the EBA's observations on the convergence achieved through the implementation of the 2021 Convergence Plan (Section 1). Furthermore, the report explains how convergence in the context of supervisory colleges evolved over the course of 2021 (Section 2) and summarises the main policy developments concerning Pillar 2 and ongoing supervision (Section 3 and 4). The training activities supporting the implementation of the various policy products that the EBA issued are also a vital convergence tool, therefore the 2021 training activities are also described in the report (Section 5). Finally, the report addresses the implementation of the USSPs that are the overarching guiding principles for supervisors across the European Union (Section 6).

Figure 1. Supervisory convergence tools



[5] Regulation (EU) No 1093/2010.

[6] As per Article 107 of the CRD, the EBA shall report annually to the European Parliament and the Council on the degree of convergence of supervisory practices under the SREP across Member States.

1. Convergence in the SREP and ongoing supervision

In the context of the SREP and ongoing supervision, the degree of convergence of supervisory practices is assessed based on the following key areas: i) the implementation of the recommendations from the EBA's 2016-2017 bilateral visits; ii) the implementation of the annual convergence plan that puts forward key areas for supervisory attention; iii) supervisory outcomes (measures); and iv) benchmarking of internal models and IFRS 9.

1.1 Status of the implementation of SREP GLs

In 2021, CAs further implemented the SREP Guidelines, thus all outstanding recommendations from the 2016 and 2017 bilateral convergence visits have now been addressed. Supervisory practices have been brought in line with CRD V, as P2R now qualifies as a legally binding requirement across the EU, and it is consistently taken into account when calculating the trigger point for MDA restrictions. CAs also ensured that they communicate the TSCR to all institutions in their jurisdictions, as described in the SREP Guidelines. The implementation of new methodologies also introduced clear improvements towards a more risk-by-risk determination of the add-ons, and the ICAAP plays a stronger role in the determination of P2R. Notwithstanding, the EBA expects that the operationalisation of the new methodologies will ensure an accountable approach to the P2R setting by communicating the main risk drivers determining the P2 add-on.

As part of its mandate to foster supervisory convergence across the European Union (EU), the EBA conducted a series of bilateral visits to CAs in 2016 and 2017 to discuss various aspects of the implementation of the SREP framework and to understand how the SREP GLs, that were published in December 2014 and applicable from 1 January 2017, are being applied.

These visits resulted in several recommendations and observations that the EBA followed up yearly by assessing the CAs' efforts to further enhance and refine their methodologies and practices for the common SREP framework. After the 2020 round of follow-ups, the remaining recommendations concerned the capital adequacy assessment and Pillar 2 requirements setting practices.

The role of TSCR and the legally binding nature of P2R in the context of the MDA trigger and calculation under Articles 141 and 142 of the CRD is explained in the EBA's Opinion on MDA[7]. Based on the observations from the bilateral visits, the EBA noted in its 2016 Convergence report some instances in which authorities did not fully follow the MDA Opinion, as TSCR was not applied in a legally binding and directly enforceable manner, or MDA calculations disregarded P2R.

[7] Opinion of the European Banking Authority on the interaction of Pillar 1, Pillar 2 and combined buffer requirements and restrictions on distributions.

In the meantime, CRD V clarified in Recital 14 and Article 141a, that P2R should be positioned in the relevant stacking order of own-funds requirements above the relevant minimum own-funds requirement and below the combined buffer requirement or the leverage ratio buffer requirement, as applicable. This means that P2R became legally binding in nature and must be considered in the MDA calculation and trigger. With the implementation of CRDV into local law, the concerned CAs informed the EBA in the 2021 round of follow-ups that P2R qualifies as a legally binding requirement, and it is taken into account when calculating the trigger point for MDA restrictions. One of the CAs already implemented the provisions in their governing processes and decision templates as well as issued these legally binding decisions in 2021. In the case of the other CA, the legislative proposal was approved in 2021. The CAs also ensured that they communicated the TSCR, as described in the SREP Guidelines, to all institutions in their jurisdictions.

The bilateral visits conducted in 2016 also gave rise to recommendations addressing the mechanics of determining additional own-funds requirements and called on some CAs to review their respective practices. The observations mainly related to the setting of the P2 requirements in a holistic manner without decomposing it based on the underlying risk drivers. The implementation of new methodologies also introduced clear improvements in 2021 towards a more risk-by-risk determination of the add-ons, and the ICAAP plays a stronger role in the determination of P2R. The EBA sees such efforts as a positive development in view of the changes brought by the new banking package, in particular, that the role of the ICAAP has been enhanced by CRD V, resulting in the further strengthening of the institution-specific nature of the SREP.

The last remaining aspect was the setting of additional own-funds requirement for business and strategic risk, based on the outcomes of the BMA, which was also clarified in the context of the second review of the EBA SREP Guidelines. The EBA notes the appropriate consideration of the business and strategic risk in the SREP by the respective CAs, in particular, that there is no automaticity in the setting of the capital add-on to cover concerns about business model and strategy, as that is eventually decided after having explored measures other than additional own-funds requirements, as stressed in the revised SREP Guidelines.

Having said that, the EBA has concluded the follow-up of the 2016-2017 recommendations in the 2021 follow-up cycle and recognises the efforts made by the CAs in ensuring binding P2 decisions, the clear improvements towards a more risk-by-risk dimension of their SREP, and the stronger role of the ICAAP to ensure full consistency with the CRD V and the revised EBA SREP Guidelines.

The EBA expects that the operationalisation of the new methodologies will ensure an accountable approach to the P2R setting by communicating the main risk drivers determining the P2 add-on, enhanced dialogue with institutions and further enhancement of the ICAAPs.

1.2 Implementation of the 2021 Convergence Plan

This report finds that the key topics of the 2021 Convergence Plan were well incorporated into CAs' supervisory priorities in 2021 and were also well implemented overall into their supervisory practices throughout the year.

The capital and liability management key topic has been the most thoroughly implemented in supervisory practices, which is partially due to the fact that the assessment of the capital situation and liability management has always been at the core of banking supervision. Asset quality and credit risk management was also a priority for CAs in 2021, as all CAs closely monitored the impact of the COVID-19 pandemic on institutions' credit quality and the levels of their NPEs, with 'high NPL banks' clearly being the focus. The CAs also assessed the scope of various payment moratoria and any risks of cliff-edge effects. The ICT and security risk, operational resilience, as well as profitability and business model, received less supervisory attention overall compared to the other two topics, with slightly more than 70% of CAs implementing all the attention points in their supervisory practices.

Notwithstanding the efforts CAs dedicated to the supervision of the key topics in 2021, the EBA follow-up identified areas that were not reviewed and assessed by all CAs or where improvements were noted compared to 2020, but still, CAs need further action to achieve further convergence across the EU. Thus i) loan origination practices; ii) cyber risk, including in the context of outsourced services; and iii) digital transformation and its impact on the business model remain points of attention in 2022. Notably, the 2022 ESEP covers these and other areas, which will help prudential supervisors to address them in their processes and supervisory practices. Further, the EBA will provide training initiatives to CAs on ICT security in 2022 and will consider ways to address digital transformation to support supervisors in this regard.

The EBA drives the convergence process by annually setting out key topics for heightened supervisory attention in order to i) inform CAs' processes for selecting supervisory priorities; and to ii) influence their supervisory practices on the selected topics.

To ensure supervisors' ability to address these key areas in their 2021 activities, the Convergence Plan, together with a set of attention points called objective elements[8] were shared with the supervisory community in November 2020. These were set out to convey more detailed focus points to CAs and to allow for a structured follow-up on the degree of convergence in their supervision across the EU.

The 2021 Convergence Plan was still driven by the implications of the COVID-19 pandemic in order to capture its effects on the banking sector, as well as to ensure that banks adapt to the new circumstances by taking effective measures subject to supervisory scrutiny. Thus, the key topics

[8] Attention points and objective elements refer to the same action points per key topic and used interchangeably in this report.

selected for 2021 were: 1) asset quality and credit risk management; 2) ICT and security risk, operational resilience; 3) profitability and business model; 4) capital and liability management.

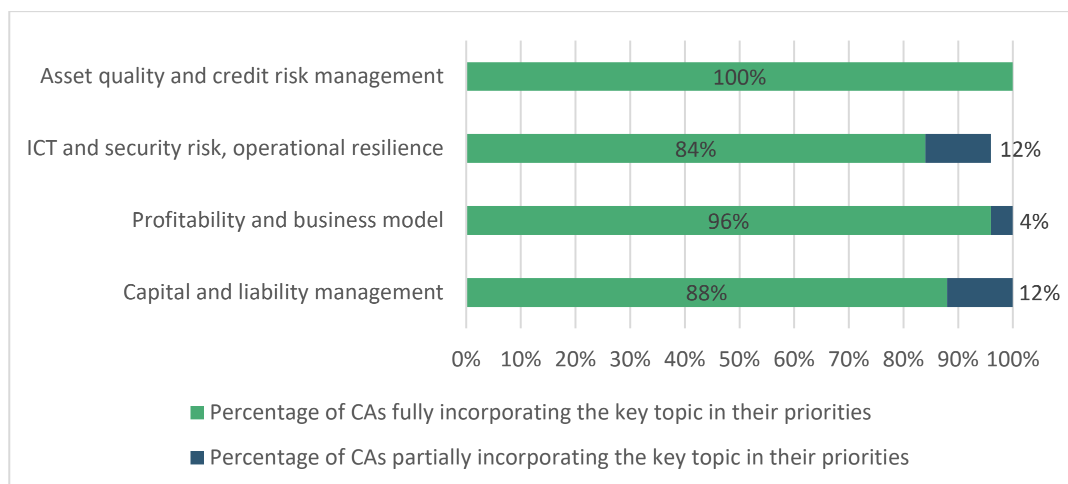
Asset quality and credit risk management has come to the forefront of supervisory attention, due to its sensitivity to the impact of the pandemic. Topics 2)-4) were preserved from 2020, even if the attention points shifted somewhat for 2021, and the profitability aspect was extended with a long-term view (i.e. the sustainable operation of banks).

At the end of 2021 the EBA followed up on whether the key topics were reflected in supervisory priorities and incorporated into supervisory work. For that purpose, the relevant subgroup of the SCOP collected information, which was then analysed in a desk-based review and summarised in this section of the report[9].

Key topics incorporated into supervisory priorities

The outcome of the follow-up shows that the key topics put forward by the EBA in its 2021 Convergence Plan, were well incorporated into CAs' supervisory priorities in 2021.

Figure 2. Key topics incorporated into CAs' supervisory priorities in 2021



The topic of 'Asset quality and credit risk management', as expected, was considered a priority by all CAs, and was addressed mainly from the perspective of the impact of the COVID-19 pandemic. Of the CAs, 88% included the 'ICT and security risk, operational resilience' topic among their key supervisory priorities for 2021, and an additional 12% partially incorporated it. Only 1 CA did not include the topic as a priority for 2021 but indicated that it is among the key areas of attention for 2022.

All CAs implemented the 'profitability and business model' key item in their supervisory priorities, except one, which partially incorporated it without considering the effects of digital transformation on the business model.

'Capital and liability management' was also among CAs' key priorities, as put forward by the EBA 2021 Convergence Plan, as 88% of CAs fully incorporated it into local priorities and an additional

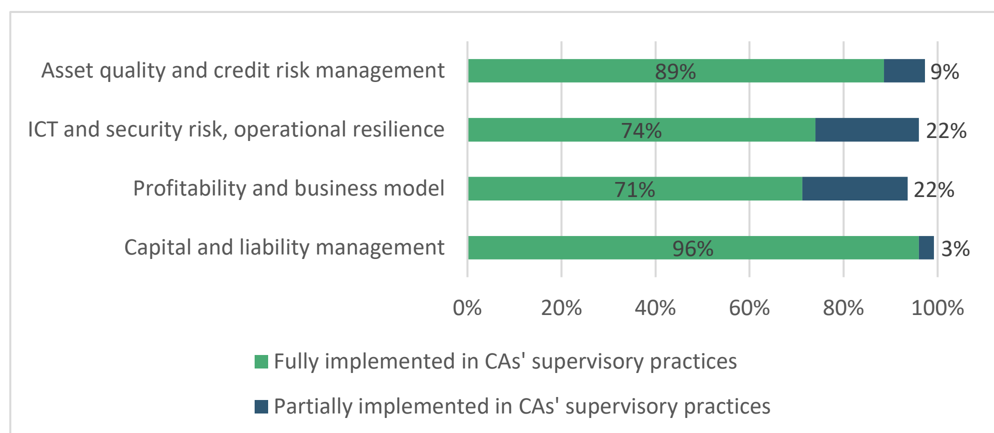
[9] Twenty-five CAs contributed to the information collection.

12% partially reflected it among their priorities. It should nevertheless be added that while some CAs did not classify 'capital and liability management' a priority as such, they considered the supervisory assessment of this area their core supervisory activity. This is unambiguously reflected in the degree of implementation of this specific topic in supervisory practices, as explained in the next subsection 'Key topics implemented in supervisory practices'.

Key topics implemented in supervisory practices

To assess how far CAs' supervisory practices were influenced by the 2021 Convergence Plan, the EBA followed up on the implementation of the individual attention points, the results of which were aggregated to provide an overall picture per key topic. The more attention points / objective elements a key topic has, the more supervisory attention it would require in general, compared to the key topic, which has fewer attention points defined. Figure 3 shows that overall, supervisors implemented the attention points put forward by the EBA for 2021 in their supervisory activities.

Figure 3. Key topics implemented in supervisory practices in 2021



The 'capital and liability management' key topic has been the most thoroughly implemented in supervisory practices, which is partially due to the fact that the assessment of the capital situation and liability management has always been at the core of banking supervision. The other factor contributing to this high level of implementation is that the topic entailed a limited number of attention points. The 'asset quality and credit risk management' topic was 89% fully implemented and 9% partially implemented by CAs. This result should be considered given the relatively large number of attention points under this topic, which clearly outnumbered the attention points of the other three priorities. Finally, while more than 70% of the attention points related to 'ICT and security risk, operational resilience' as well as the 'profitability and business model' key topics were fully implemented with an additional 22% partially implemented, these two topics received less attention from CAs when compared to the other two topics.

The more detailed analysis of the implementation of the key topics as well as the related supervisory findings are summarised in the following subsections.

1.2.1 Asset quality and credit risk management

The topic was a priority for CAs in 2021 and was addressed as part of ongoing supervision and SREP, including the quarterly monitoring of key risk indicators (KRIs) and via horizontal analysis. All CAs closely monitored the impact of the COVID-19 pandemic on credit quality and the levels of non-performing exposures (NPEs). CAs assessed the scope of various payment moratoria and any risks of cliff-edge effects, and the potential increase in NPEs after the expiry of the moratoria and other public support measures, where applicable[10].

According to CAs, the ongoing supervisory dialogue with institutions was indispensable to understand and, as much as possible, envisage the impact of the pandemic. Some CAs have performed thematic analyses to understand the impairment and capital effects of the moratorium, while others tested the NPE expectations assuming the expiry of the moratoria, as part of their supervisory stress test.

CAs have also been reviewing institutions' governance arrangements and practices for NPE management and whether institutions have suitable procedures to monitor and manage NPEs and, where relevant, have put in place and apply suitable NPE/NPL management strategies in line with the EBA Guidelines on management of non-performing and forborne exposures, (EBA/GL/2018/06)[11] (NPE management GLs). Many CAs reported that they had also assessed whether institutions' NPE strategy was aligned with the overall strategy and they continued monitoring the implementation of NPE reduction plans and targets. Some CAs specifically scrutinised internal policies for UTP and forbearance.

In the implementation of the EBA NPE Management GLs, in particular on NPE management strategies, CAs focused mainly on 'high NPL banks', including by horizontal analysis. It was observed that some of these banks have not always adopted arrangements in compliance with EBA GLs or not implemented them accordingly, which was further addressed by supervisors.

One CA informed the EBA that it established a working group to ensure measures were in place to monitor bank's implementation of the EBA NPE management GLs and its treatment of distressed debt and NPEs.

Based on observations from CAs, one can conclude that cliff-edge effects have not materialised after the expiration of the moratoria and other support measures, and most of the CAs have not identified systematic asset quality deteriorations either. Many CAs confirmed institutions' conservative assessment of public support measures, timely classification and provisioning induced by COVID-19. Some CAs noted a slight overall deterioration in the credit portfolio due to COVID-19, which however did not cause major concern. Nevertheless, certain institutions were more impacted by the pandemic depending on their individual portfolio, which is then followed up on an institution-by-institution basis. Most CAs reported that key risk indicators (KRIs) reflect improving asset quality and impairments on an aggregated level.

[10] More CAs referred to the (very) limited use of PGSs in their jurisdiction.

[11] EBA Guidelines on management of non-performing and forborne exposures, (EBA/GL/2018/06).

The implementation of the objective element that referred to the adequate provisioning of non-performing exposures, was mainly followed again on a risk-based approach, i.e. institutions with high NPL ratios were under supervisory scrutiny.

CAs assessed institutions' policies on impairment and write-off practices and whether they estimated loss allowances for non-performing and forborne exposures in a prudent and timely manner. A core objective of these assessments was to ensure that risk classification and the respective provisioning was appropriate and timely and reflected the impact of COVID-19.

Some CAs conducted on-site inspections, while others relied on a combination of on-site inspection and the external auditor's reports, and others conducted horizontal analyses. These activities resulted, in some instances, in adjustments of the macroeconomic scenarios used and/or in the recalculation of the PD and LGD parameters.

While some CAs reported that overall, the banks' policies are sound and facilitate timely provisioning, others reported that policies of primarily small and non-complex institutions were not always fully consistent and sound, thus leading to findings on the level of provisions. Issues were also raised on the frequency and method of collateral valuations.

Having said that, the EBA noted that CAs moved forward with the implementation of the provisions of the EBA NPE management GLs compared to 2019[12].

While 'sound lending standards and practices' was not singled out as a separate key topic for 2021, it was flagged for CAs' attention under the umbrella of 'Asset quality and credit risk management'. The main reason for continuing to prioritise the topic is that, in 2020, due to the outbreak of the COVID-19 pandemic, even if 'loan origination standards' was a specific key topic for attention, it has ultimately received considerably less attention than originally planned, due to supervisory refocusing.

Thus, considerable gaps remained in the supervisory follow-up of this area, as at least 40% of CAs had not yet started analysing institutions' credit-granting practices in 2020[13], i.e. whether they were in line with the EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06)[14] (Loan origination GLs) that apply from 30 June 2021, including the review of the creditworthiness assessment framework and practices.

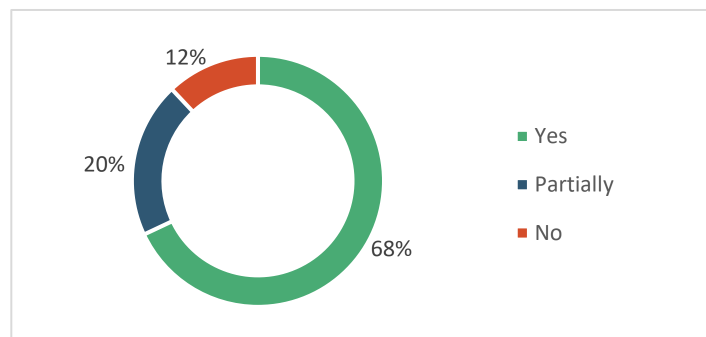
The outcome of the 2021 review was that supervisors, while still busy with the close monitoring of the pandemic, moved forward with the follow-up of the implementation of the Loan origination Guidelines, as 68% of CAs verified whether institutions performed a gap analysis on their credit-granting practices and prepared a suitable plan for implementation of the Loan origination GLs.

[12] The 2020 Convergence Report highlighted that all CAs have to implement the provision of the GLs in their supervisory practices.

[13] Conclusion of the EBA report on the convergence of supervisory practices in 2020.

[14] EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06).

Figure 4. Verification of institutions' gap analysis is completed (% of CAs)



'Partially' answers signalled either i) materiality considerations, i.e. that an assessment across all institutions has not been conducted on the materiality of credit risk; or that a portion of institutions was requested to undertake the gap analysis. One of the respondents that answered 'no' noted that it has not planned a gap analysis, per se, although it incorporated the provisions of the GLs into its manual allowing for future follow-up. The rest of the respondents that answered 'no' intend to undertake the assessment in 2022. The EBA, while acknowledging the progress, considers that the full implementation of the loan origination GLs will also require CAs' attention in 2022, thus the item is among the focus points of the 2022 ESEP.

The attention points based on the EBA Guidelines on the application of the definition of default (EBA/GL/2016/07)[15] (DoD GLs) and Regulation (EU) 2018/171 on the materiality threshold for credit obligations past due[16], were also well assessed in 2021, with 90% of CAs incorporating these into their supervisory work.

CAs reported a wide range of activities to ensure that institutions apply the new definition of default, and its impact was also closely monitored, some of which were on-site while others were off-site activities, i.e. desk-based assessments. The most comprehensive reviews included the analysis of internal policies, as well as the granular review of the loan portfolio (both on- and off-site). Other CAs sent letters and guides to IRB banks on the expectations or undertook compulsory DoD validation reviews for IRB banks. Others evaluated this according to the applications on model changes.

Overall, while considerable efforts have been made by institutions over the past years to implement the DoD GLs and regulation, they should work further to improve the processes, in particular related to the indications of UTP or the reclassification of exposures from default to non-default status. Some issues with classification were also noted, for example that the forbearance operations were not classified as such and/or distressed restructuring was not classified as NPL.

Area for further attention:

- **Loan origination practices is still an area for supervisory attention and was included in the 2022 ESEP.**

[15] EBA Guidelines on the application of the definition of default (EBA/GL/2016/07).

[16] Regulation (EU) 2018/171 on the materiality threshold for credit obligations past due.

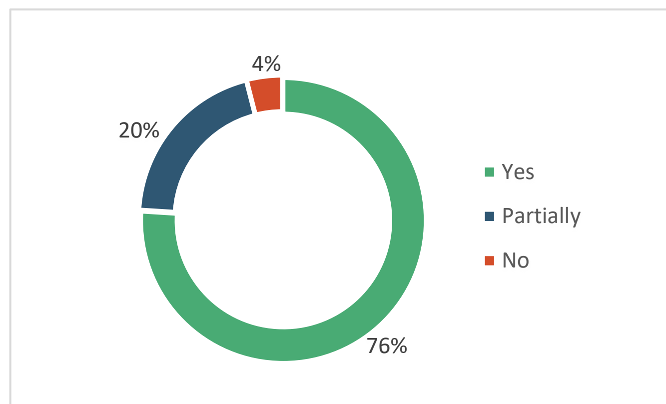
1.2.2 ICT and security risk, operational resilience

Considerable supervisory work had already been done in 2019 and 2020 in 'ICT and security risk and operational resilience' when supervisors reviewed credit institutions' practices for the identification, monitoring, assessment and mitigation of ICT risks, and ensured that ICT strategy existed in most of them. In 2020, the scope of the review was narrower due to the refocusing of supervisory attention, and covered mainly business continuity management (BCM), security and cyber risk management; and the outsourcing of critical services, along with a risk-driven selection of the targeted institutions.

The 2019 Convergence Report[17] highlighted the need for further supervisory focus on suitable ICT risk governance, an area which was not a priority in 2020 due to the COVID-19 related readjustment of supervisory activities but was included in the EBA 2021 Convergence Plan. In particular, the clear roles and responsibilities for ICT and security risk management should be ensured by the management body, and the availability of suitable staff, including quantity and skills, as well as an appropriate budget for ICT operational needs was expected to be reviewed by CAs.

The outcome of the EBA's follow-up is reflected in Figure 5, according to which 76% of CAs reviewed this attention point, with 20% of CAs partially addressing them.

Figure 5. Supervisory review of internal governance on ICT and security risk management (% of CAs)



More CAs confirmed that suitable internal governance on ICT and security risk management and effective information security measures were an integral part of their IT on-site inspections, while a large proportion of CAs continued to rely on a dedicated ICT self-assessment questionnaire, the submission frequency of which is linked to the intensity of the supervisory engagement, i.e. submitted less frequently by small and non-complex institutions. In addition, information from annual audit reports also fed into the supervisory assessment.

The few CAs that did not assess or only partially assessed the ICT governance and risk management framework of institutions referred to the fact that they adopted the EBA ICT and security risk management Guidelines (EBA/GL/2019/04)[18] (EBA ICT Risk Management GLs) either at the end of 2021, or are in the process of adopting them, thus the assessment of institutions' adherence to the

[17] See EBA'S 2019 Convergence Report.

[18] EBA ICT and security risk management Guidelines (EBA/GL/2019/04).

provisions of the guidelines will be completed later. These CAs nevertheless confirmed that their existing regulatory framework was largely in line with the EBA ICT Risk Management GLs.

Another area that CAs were expected to verify over the course of 2021 is whether cybersecurity is part of financial institutions' overall information security risk management, and whether they established effective information security measures to ensure appropriate preparedness for cybersecurity. While 80% of CAs reviewed the overall framework when this is broken down into more detailed attention points, like the maintenance of an appropriate level of cybersecurity during the activation of business continuity plans (BCPs), or the inclusion of a range of different scenarios in institutions' BCPs, including a cyber-attack scenario (along with an impact assessment), they have only been reviewed by 64% of the CAs. The EBA considers that including a cyber-attack scenario in the institution's BCP would further facilitate its readiness for successfully handling such disruptions/disasters and support recovery efforts. The EBA aims to further strengthen CAs preparedness to supervise cyber risk and scrutinise institutions' actions to ensure an appropriate level of cybersecurity, thus it plans to organise an ICT security workshop in 2022[19].

The last attention point under the 'ICT and security risk and operational resilience' key topic was ICT requirements for third-party providers and exit strategies, which was reviewed by 74% of CAs, while it was partially covered by 22% of CAs. There were some differences in the supervisory reactions to this attention point, which is largely due to the operational specificities of the local banking systems. Some CAs reported that the area was not systematically covered in the SREP because institutions' critical activities did not heavily rely on outsourcing, while other CAs thoroughly analysed this due to critical activities being outsourced.

In 2021, CAs worked to ensure that contracts and service-level agreements with third-party providers include appropriate and proportionate ICT security requirements, including minimum cybersecurity requirements. This was mainly done as part of the notification of new critical or important outsourcing. The analysis usually covered the governance processes, due diligence performed by the institution, activities to be outsourced, contingency measures in the event of failure, etc. Business continuity is a key element of these targeted risk assessments, and the institution must assess the service providers' ability to continue in a crisis and have contingency measures in place. In other jurisdictions, institutions were requested to align their old contracts to the requirements of the EBA Guidelines on outsourcing arrangements (EBA/GL/2019/02)[20].

Area for further attention:

- **Cyber risk, including in the context of outsourced services, is still an area for supervisory attention and is included in the 2022 ESEP.**

[19] The EBA organised a workshop on cybersecurity in September 2016, and one on IT risk supervision and the cloud in December 2018.

[20] EBA Guidelines on outsourcing arrangements (EBA/GL/2019/02).

1.2.3 Profitability and business model

The supervisory assessment of institutions' profitability was already a focus point in 2020, although due to the COVID-19 outbreak, supervisory activities were mainly focused on understanding how the banking sector in general and individual institutions, in particular, have been impacted.

The EBA 2021 Convergence Plan kept this area of focus, with special attention on measures taken by the institution to improve/preserve profitability and to see whether there is i) a shift in the institution's risk appetite towards high-risk elements; and ii) a change in the revenue mix and/or in cost reduction measures that would jeopardise sustainable operation. Compared to 2020, the time horizon of the assessment was also extended with forward-looking strategic elements and considerations of digital transformation.

In this context, all CAs except 1, reviewed the measures taken by institutions to improve/preserve profitability and to address potential further pressure on interest margins. This was mainly covered in the SREP BMA assessment and relied on tools/indicators to monitor revenue mix and cost structure. Thematic reviews were also conducted focusing mainly on institutions that are highly sensitive to low interest rates. Others reported that they had more frequent supervisory meetings with institutions in 2021. Some CAs flagged that a combination of measures was adopted by institutions to maintain profitability, for example streamlined processes, introduction, or further development of digital channels, restructuring of the network (such as branch closure), or potential increase in assets. Overall, CAs did not report increased risk appetite in 2021 nor material increase in high-risk products and services.

Some CAs did a thorough assessment of institutions' expansion submission when they sought to expand or change their business activities. One of the objectives of this was to assess whether the strategic plan is credible and would lead to a capital accretive business model. Banks were eager to move away from reliance on net interest income (NII) towards fees and commissions.

With a focus on assessing COVID-19 and Brexit[21] implications, banks' strategic plans, were also fully assessed by all CAs, except 1. The assessment of banks' profitability projections were complemented by benchmarking and back-testing, and with annual strategy sessions with institutions. If aspects of the plans were questionable, for example, the cost base deemed unsustainable, institutions were requested to review their strategy. The CA which did not implement this attention point stressed that COVID-19 had no major impact on the profitability of small and non-complex institutions, thus strategic plans were not considerably revised.

An additional aspect under the scope of the long-term sustainable operation, was incorporated into the 2021 Convergence Plan, namely, to understand the effects of digital transformation on the institutions' business, in particular via appropriate metrics[22] and the potential impacts and risks of the acceleration of digital strategies due to the COVID-19 pandemic.

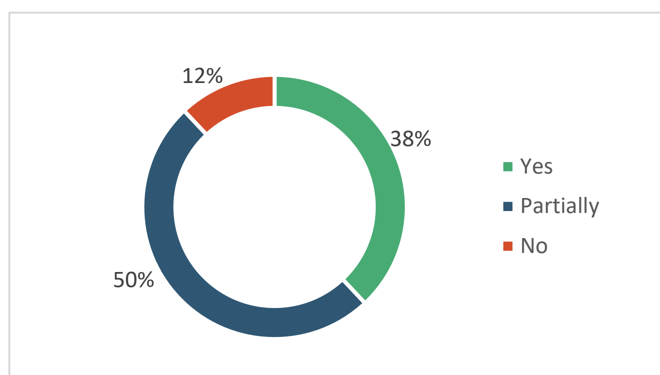
[21] Where relevant.

[22] E.g. revenues streams from digital v. traditional channels, reduction in costs due to digital transformation or level of dependency to ICT providers, etc.

The EBA's desk-based analysis showed that this aspect of the 2021 Convergence Plan received the least supervisory attention, as only 38% of CAs explored these dimensions fully, while an additional 50% only partially and 12% of CAs did not devote attention to this topic at all. A number of CAs which have not or partially analysed this aspect referred to the lack of readily available data, which however could be requested from institutions and could be subject to peer comparison across competing institutions and allow for the identification of potential weaknesses in the business model.

Thus, the EBA considers that the supervisory assessment and understanding of the scale of the digital transformation of institutions, also in comparison to their peers, and the effect of digital transformation on their long-term sustainability is important and necessary. This is also to ensure that potential risks, including ICT and cyber risk, of this transformation are identified and addressed by supervisors. Therefore, digital transformation and its implementation remain a key attention point for prudential supervisors as put forward by the 2022 ESEP. Lastly, as noted above, the monitoring of digital transformation could be enhanced through reliable and related data as well as consistent metrics/indicators. The EBA will consider ways to address this issue and support the supervisors in this regard.

Figure 6. Assessing and understanding the effects of digital transformation (% of CAs)



Area for further attention:

- **Digital transformation and its impact on the business model is still an area for supervisory attention and is included in the 2022 ESEP.**

1.2.4 Capital and liability management

All CAs paid particular attention to capital adequacy of institutions in 2021, and not only under normal circumstances, but also under stressed conditions. The outcome of the 2021 EU-wide stress-test exercise facilitated a capital adequacy assessment for the participating institutions. In addition, some CAs reported that they undertook supervisory stress tests for all institutions under their supervision. The forward-looking analysis of own-funds forms part of the regular capital adequacy assessments to ensure that the institutions have sufficient capital and/or management actions in place to continue as a going concern over a 3-year time horizon. The projections, if deemed too optimistic, were challenged with engagement taking place and feedback provided.

Under the capital adequacy assessment, supervisors reviewed dividend policies and plans, as well as share buyback considerations to ensure that they reflect a conservative approach that supports maintaining sound capitalisation on a current and forward-looking trajectory in addition to considering business perspectives. Banks were advised to exercise prudence when deciding on distributions. Supervisors also considered the impact dividend payments would have on capital, as well as on performance of banks during the COVID-19 pandemic. At most institutions these policies were adjusted to cope with the challenges triggered by the pandemic.

The vast majority of CAs noted the relatively strong aggregate capital position of institutions under their supervision and considered the capital and liability management of the institutions adequate overall. Nevertheless, a few institutions needed the special attention of the CA due to its capital situation, while in some MS, the cooperative sector is ripe for mergers and acquisitions to increase competitiveness and profitability.

Another related aspect that the EBA put forward under the umbrella of the capital adequacy was institutions' crisis management activities, in particular whether recovery scenarios were revisited and whether recovery options were implementable in the context of the COVID-19 pandemic.

All CAs acted upon this attention point and placed key focus on the review and challenge of institutions' recovery plans. Areas of focus in reviewing the plans and in subsequent discussions with institutions were the credibility, feasibility and valuation of recovery options in line with the EBA statement on additional supervisory measures in the COVID-19 pandemic on institutions' recovery plans[23], as well as the suitability and severity of recovery scenarios. Some CAs specifically communicated the recovery plan relief measures to institutions, others encouraged institutions to benefit from the lessons learnt from the crisis in updating their scenarios. Weaknesses were identified across recovery plans in key areas such as recovery options and their viability in a crisis and calculations of the ORC.

The build-up of the MREL and TLAC by institutions was also an area that CAs worked on in 2021 and engaged with resolution authorities (RAs) to understand whether all resolution entities of GSIIs were compliant with the intermediary target of TLAC and have plans in place to meet end-state MREL/TLAC requirements. While more CAs reported that they either do not have resolution entities of GSIIs in their jurisdiction, or that the resolution strategy of local small and non-complex institutions was liquidation, the CAs for which the item was relevant have dealt with it mostly on a risk-based approach and liaised with their respective RA counterparts as well as with the institution. The capacity of banks with MREL deficit to meet the intermediary targets was evaluated in cooperation with the RA. Overall, MREL plans were considered to be realistic.

[23] EBA statement on additional supervisory measures in the COVID-19 pandemic on recovery planning.

1.3 Convergence in the application of P2R-P2G

Based on the EBA's analysis it can be concluded that while CAs' methodologies for setting the P2R have been aligned further to the common framework, the EBA believes that there is still room for further convergence in the use of the ICAAP, as well as in the consistent treatment of risks across the EU. With regard to the P2G, the results of the data collection showed that considerably more CAs set the P2G in the 2021 cycle than in the latest period in 2019[24]. Nevertheless, there are some divergent practices, as a number of CAs have not yet adopted it or use somewhat different methodologies, which are not always in line with the requirements.

The implementation of CRD V and the second update of the SREP GLs as well as the application of the EBA Supervisory Risk Taxonomy will support CAs in achieving greater consistency in the identification and measurement of risks under the SREP. With the practical application of the CRD V provisions, the quality of capital that is available to meet the requirements will also be further harmonised.

The analysis of the P2R and the P2G set by CAs as the outcome of their SREP review is a key component of the annual Convergence Reports as part of the EBA's work on enhancing supervisory convergence.

Data analysed

In order to observe the trends in the P2R and P2G, the EBA has launched a survey to collect data for 2020[25], the results of which are presented in this report. The sample used in the data collection is composed of 192 banks that are under the direct supervision of 27 national competent authorities[26] (NCAs) from 26 EEA countries and represent 58% of the European banking sector's assets. The sample is uneven in terms of the size of the analysed institutions, comprises 81 systemic banks, 40 medium-sized banks and 79 institutions with consolidated assets below EUR 5 bn[27]. In terms of SREP categorisation, the sample is also uneven; it comprises 92 banks classified in SREP Category 1, 33 banks classified in SREP Category 2, 41 banks classified in SREP Category 3, and 18 banks classified in SREP Category 4.

Analysis of the P2R

The harmonisation in the implementation of SREP methodologies and comparable supervisory practices across CAs is a priority for the EBA, ultimately leading to consistent supervisory outcomes and a level playing field for banks in the EU.

[24] The 2019 exercise collected data for end 2018.

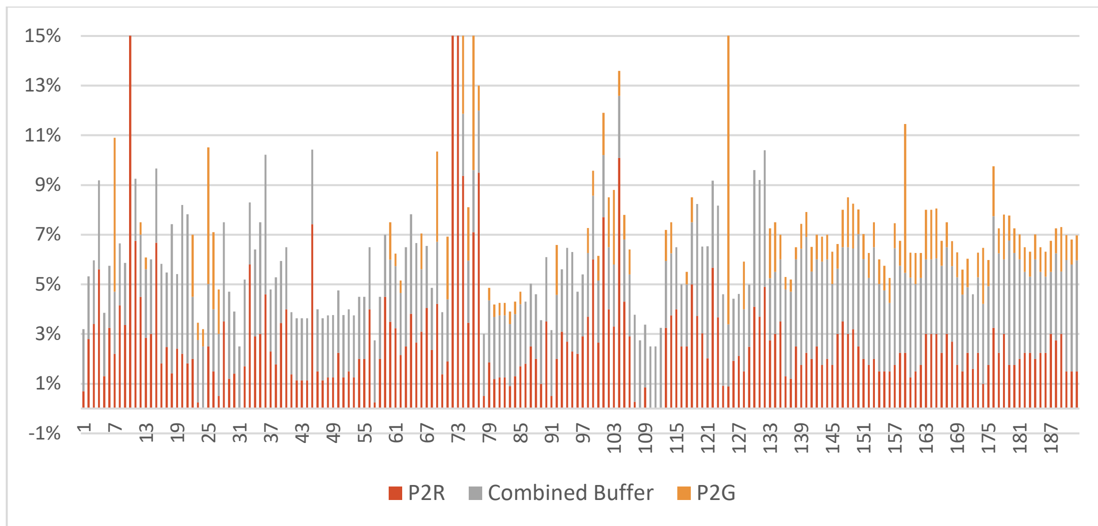
[25] The 2021 exercise collected data for end 2020.

[26] The 27 CAs in the sample are those of Austria, Belgium, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the SSM.

[27] Of which 8 of them are considered systemic.

Figure 7 discloses the P2R and P2G applied in the sample and illustrates that P2R can diverge across banks, similar to the P2G.

Figure 7. Total SREP capital requirements and P2G applied in a sample of banks, December 2020 data



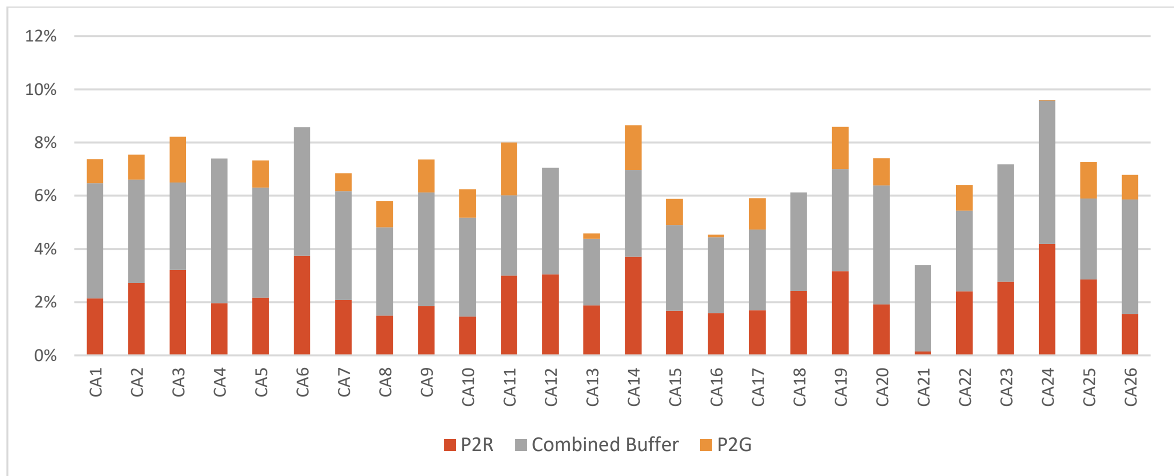
Sources: EBA calculations based on the results of the data collection. The chart has been applied an upper limit of 15%, with 6 banks of the sample above that limit.

This variation in the application of capital requirements can partially be justified by the different risk profiles and business models, but at the same time it reveals some differences in supervisory practices and methodologies. In particular, the extent to which the ICAAP is considered in setting P2R which depends primarily on the reliability of the ICAAP, as well as on other factors, such as the availability of supervisory benchmarks for some (institution) specific risks. The choice on the extent of the use of ICAAP has an impact on the Pillar 2 add-ons. While some CAs rely entirely on their own methodologies and use certain benchmarking tools, others use a combination of own and institutions' methodologies (i.e. hybrid approaches).

According to the outcomes of the EBA survey, the application of P2R appears to be a common practice among all CAs. All CAs in the previous data collection period[28] as well as in the current period applied P2R. Even if the sample of banks applied in the 2019 and 2021 reporting periods are not directly comparable and they do not allow for appropriate trend analysis, Figure 8 of the 2021 reporting period shows lower average P2R than in 2019[29].

[28] The results of which were included in the 2019 Report on convergence of supervisory practices.
[29] The highest P2R per CA, on average, in 2021 is 4%, while in 2019, it was around 10%.

Figure 8. Total SREP capital requirements and P2G, weighted average by competent authority, December 2020 data

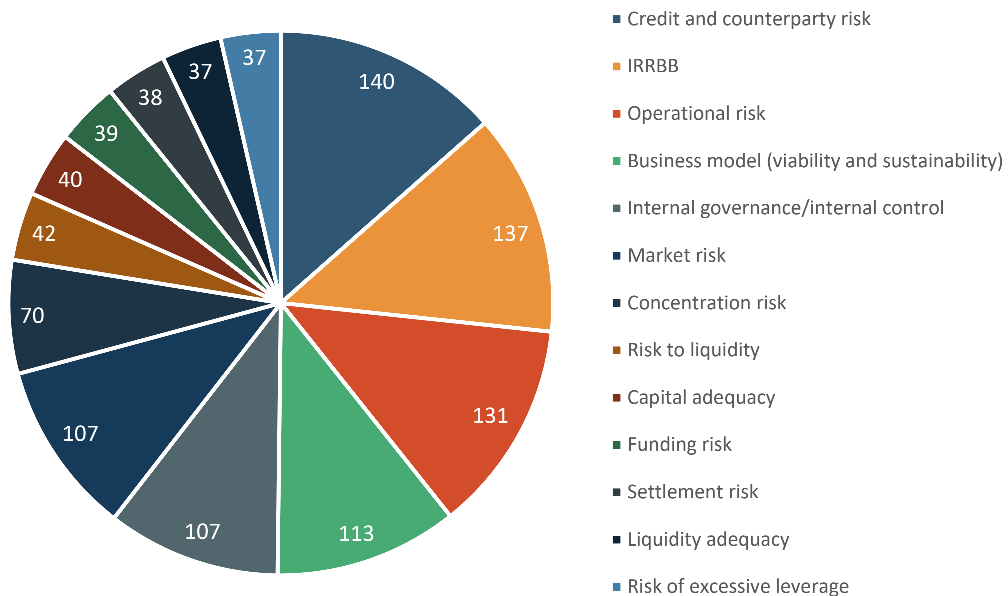


Some differences also arise in the types of risks covered by P2R and their granularity, which might partially be justified by the specificities of the local market in a given jurisdiction. Nevertheless, similarity in the methodology could also be observed in terms of what P2R is aimed to cover. In the survey, most jurisdictions (24 out of 27 respondents) stated that their methodology to obtain P2R considers risks underestimated in Pillar 1. The rest use P2R to cover risks not adequately captured in Pillar 1[30]. Among the 24 jurisdictions that cover Pillar 1 risks with P2R, 23 of them also use P2R to cover risks excluded or not explicitly addressed in the Pillar 1 framework. So, most jurisdictions (23 out of 27) are aligned with the methodology for setting P2R of considering Pillar 1 risks, as well as additional risks not addressed in Pillar 1 and they set the Pillar 1 floor on a risk-by-risk basis.

Figure 9 shows the number of banks that account for P2 add-ons of each of the risks considered. More than half of the banks of the sample have add-ons related to Pillar 1 risks (credit, market and operational risk) and add-ons related to risks not captured by Pillar 1 (IRRBB and concentration risk). Thus, the implementation of the risk-by-risk approach for obtaining the total level of P2R, considers both Pillar 1 and Pillar 2 risks.

[30] For example, IRRBB, concentration risk, maturity risk, risk weight floor for corporate exposures and risk weight floor for exposures covered by commercial real estate.

Figure 9. Number of banks per P2R add-on applied for each risk, December 2020 data



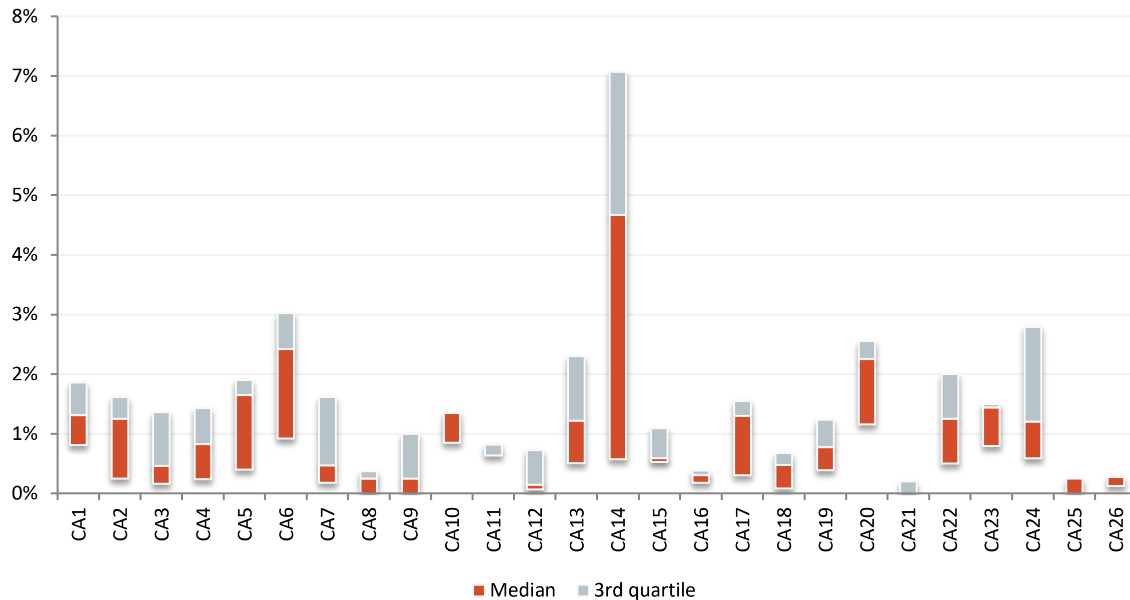
In 2019, most CAs applied P2R add-ons to credit risk, market risk, operational risk and IRRBB. According to the analysis based on the end 2020 data, credit risk[31], operational risk, IRRBB and risks linked to the business model mostly triggered the add-ons, thus there seems to be some reorientation towards risks to the business model. The most notable additional risks applied by CAs are reputational risk, FX lending risk and strategic risk, as well as AML risk which seems to be also increasingly considered for the purposes of setting P2R.

The EBA believes that there is still room for further convergence in the consistent treatment of risks across the EU. Greater convergence of practices is expected in the coming years, considering especially the implementation of the CRD V and the second update of the SREP GLs that will become applicable on 1 January 2023. Furthermore, the application of the EBA Supervisory Risk Taxonomy, which includes a mapping with the FINREP/COREP reporting, will also support CAs in achieving greater consistency in the identification and measurement of risks.

Figure 10 illustrates the ranges of P2Rs applied at the end of December 2020, based on which the largest range applied by CA14 is 4.1%. The largest two ranges of P2R applied in the 2019 exercise was considerably larger than this, and the ranges, in general, seem to be narrower than in 2019. Even if exact conclusions cannot be drawn due to the differences in the sample, the variability in the applied P2 add-on seems to have shrunken.

[31] Including counterparty risk.

Figure 10. Ranges of P2R applied as of December 2020 data



Quality of capital to meet P2R

The composition of additional own-funds requirements was clarified in Article 104a (4) of the CRD. Around 45% of the banks sampled are above the minimum requirement of 56.25% of Common Equity Tier 1 (CET 1). Among the rest, half of the sample is slightly below the requirement, but 5 outlier banks are far from the minimum requirement. With the practical application of the CRD V provisions, the quality of the capital that is available to meet the requirements will also be further harmonised.

Analysis of the P2G

It should be noted that the P2G is included in Article 104b of the CRD V and thus, CAs should develop their methodology to apply P2G to the institutions under their direct supervision.

Reverting to Figure 8, there is an improvement in the number of CAs implementing the P2G, compared with the previous assessment, in 2019. While in 2019, only 12 out of 22 CAs were applying the P2G, Figure 8 shows that, in 2021, 20 of the 27 CAs implemented the P2G. While this is a positive development overall, Figure 11 depicts the divergence in the P2G levels among those authorities with at least 2 banks in the sample with a positive P2G value.

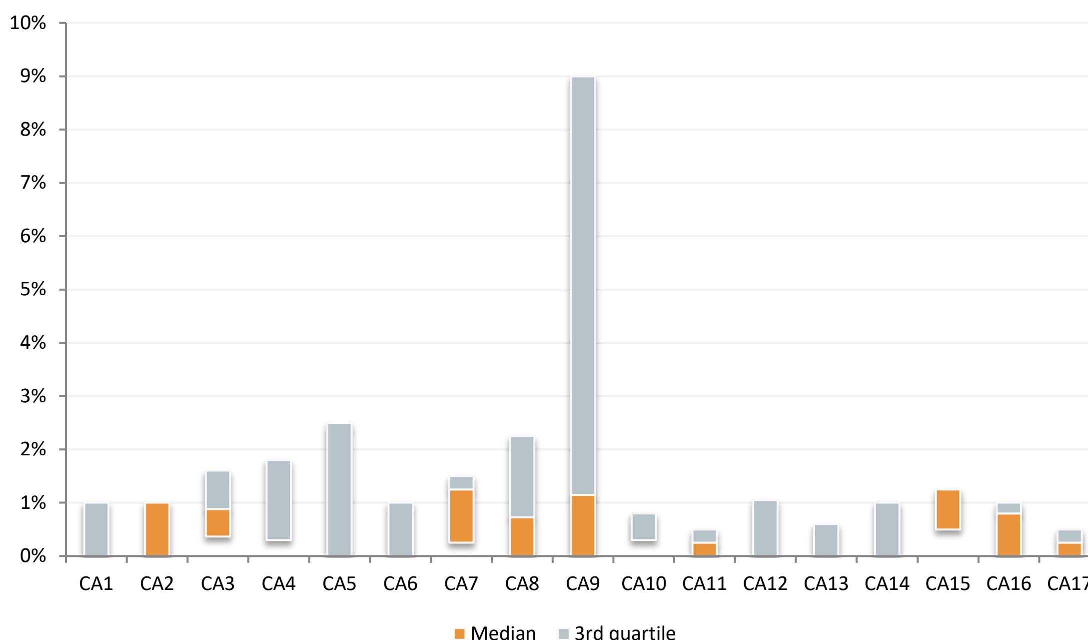
Regarding the methodologies used for the calculation of the P2G, 3 CAs do not apply the P2G based on stress-test results and 7 CAs apply either caps or floors in the P2G calculation, which is not a purely institution-specific calculation as prescribed in CRD V. Thus, the EBA would expect to see further convergence in the setting of the P2G in the future that should entail either the development of CAs' P2G methodology or its update in line with the CRD V and the second update of the SREP GLs.

The EBA observed that the main areas where differences occur in the methodologies of setting the P2G include i) the fixed threshold set out for the P2G setting; ii) the degree to which the CAs use

expert judgement and adjustments in their quantifications; and iii) the application of floors and caps at the P2G level.

While the different sample does not allow for a direct comparison with the 2019 results, there seems to be a general tendency to decrease dispersion in the P2G ranges.

Figure 11. Ranges of P2G applied as of December 2020 data



Sources: EBA calculations based on the results of the data collection. Weighted average (by consolidated assets) considering countries where at least 2 banks with a positive P2G value, 1 country with only 1 bank with a positive P2G were excluded from the calculations.

1.4 Supervisory Convergence in other areas of ongoing supervision

The annual EU-wide supervisory benchmarking exercise for market risk models shows a stable low in the dispersion in the IMVs, except for a small number of instruments. From a risk-factor perspective, equity, interest rate and commodity portfolios exhibit a lower level of dispersion than the FX and credit-spread asset classes. The 2021 credit risk benchmarking exercise focused on the impact of the COVID-19 pandemic on the IRB parameters and the impact of the IRB roadmap implementation. The report concludes that the main impact of the crisis on IRB parameters is yet to be experienced.

The IFRS 9 monitoring report concludes that while EU institutions have made significant efforts to implement and adapt their systems to the IFRS 9 requirements since its implementation date, the level of judgement incorporated into the standard leaves open the possibility to a wide variety of practices.

Since 2015, the EBA has been conducting an annual EU-wide supervisory benchmarking exercise for credit and market risk models, in accordance with Article 78 of the CRD. This article requires, *inter alia*, that i) CAs conduct an annual assessment of the quality of internal models; and ii) the EBA produces reports to assist CAs in this assessment. This benchmarking exercise is a regular EU-

wide supervisory convergence tool, covering the entire population of institutions authorised to use internal models for calculating own-funds requirements. The EBA calculates benchmark values on selected portfolios, which allows a comparison of individual institutions' risk parameters. It helps CAs to identify internal models that show significant deviation of risk parameters and risk-weighted assets (RWAs) and potential significant underestimations compared to those of their peers. The benchmarking portfolios, templates, definitions, IT solutions and reporting instructions are communicated by the EBA through implementing technical standards (ITS) that are updated every year (Regulation (EU) No 2016/2070[32]). The EBA publishes two horizontal reports on the outcomes of the yearly benchmarking exercises, one with respect to credit risk and one for market risk.

1.4.1 Benchmarking exercise of internal models

Market Risk Benchmarking exercise 2021

The Market Risk report summarises the data submission collected from the end of 2020 to September 2021, and the questionnaire responses provided by the CAs on the banks participating in the exercise.

The primary considerations are that the 2021 analysis shows a stable low in the dispersion in the IMVs, except for a small number of instruments. This relatively good quality of the submission was expected because of the clarification provided with respect to the previous exercises. Some variability in IMVs persists despite the clarification, but the more common issues (wrong unit, wrong booking etc.) have been addressed, where possible, and the quality of the data has improved during the exercise thanks to successive resubmissions.

Nonetheless, data quality is still paramount for the benchmarking exercise, and banks and competent authorities should continue to pay attention to it, especially considering the future challenges (additional instruments / new data collection – i.e. sensitivity measures).

From a risk-factor perspective, equity, interest rate and commodity portfolios exhibit a lower level of dispersion than the FX and credit-spread asset classes. Except for IMV, in general, variability is substantially higher with respect to the previous exercise. This is likely to be due to a substantial increase in the market volatility during 2020, which impacted the level of the Risk measures, increasing the dispersion. This aspect was analysed in detail in Annex 2 of the report.

Regarding the single risk measures, across all asset classes except for credit spread, the overall variability for VaR is slightly lower than the observed variability for sVaR (27% and 31% respectively, compared with 18% and 29% in 2020). More complex measures such as incremental risk charge (IRC) show a higher level of dispersion (43% compared with 49% in 2020).

Credit Risk Benchmarking exercise 2021

The 2021 credit risk benchmarking exercise focused on two aspects: The impact of the COVID-19 pandemic on the IRB parameters and the impact of the IRB roadmap implementation.

[32] Regulation (EU) No 2016/2070.

The usual follow-up on the top outlier portfolios via interviews with the banks has been dropped (again) in 2021. Not only due to the pandemic, but also because many models are in the process of being redeveloped or recalibrated to achieve compliance with the regulatory products of EBAs IRB roadmap.

The focus report provides in-depth analysis of the potential and observed impact from the COVID-19 pandemic. This analysis is based on the data submissions from 100 banks, which were made between April and August 2021 with the relevant reference date being 31 December 2020. The report consists of two documents, a focus report on i) the impact of the COVID-19 pandemic on the IRB parameters; and ii) the impact of the IRB roadmap and a chart pack providing comprehensive horizontal views on the credit risk benchmarking data with analyses that are constant in the methodology over time.

As regards the potential impact of the crisis, the report notes that heterogeneity of the impact is expected not only due to the different extent to which the underlying loans (obligors) are affected by the pandemic, but also because of the institutions' relevant processes for assigning and reviewing IRB ratings.

For assessing the impact of the pandemic on the IRB parameters, analysis is provided in particular on the development of average RWs, PDs and default rates between 31 December 2019 and 31 December 2020 for the different benchmarking portfolios. For the analysis of the development of average PDs, more emphasis is put on the potential impact of the newly issued public guarantee schemes. Moratoria are more likely to have impacted the default rates, which is why a potential impact of the moratoria is analysed with respect to the observed average default rates.

For both, the development of average PDs and the development of average default rates in benchmarking portfolios analysis on disentangling potential impact from the IRB roadmap implementation and the new definition of default is provided.

The IRB roadmap refers to a number of RTS and Guidelines aimed at harmonising the implementation of the IRB approach. A core component of the EBA's review of the IRB approach is the DoD GLs and the Draft Regulatory Technical Standards on the materiality threshold for credit obligations past due[33], where the deadline for implementation was the end of 2020 (i.e. application date from 1 January 2021). In addition, the GL on PD and LGD will apply starting from 1 January 2022 (for most portfolios).

In order to monitor the impact of implementation of the IRB roadmap on the benchmarking metrics, the EBA included some questions on the status of the implementation in the qualitative questionnaire to supervisors which is issued to CAs to guide the individual assessments based on the SVB data collection from the banks. To some extent, this analysis enables the disentanglement of effects from the COVID-19 pandemic and the IRB roadmap implementation.

The report concludes that the main impact of the crisis on IRB parameters may only be yet to come, i.e. once the crisis is reflected in annual balance sheets, which are taken into account in the ratings and once the national support measures are taken off, and finally, if losses are to be realised. In the meantime, it is important that regulators and supervisors remain vigilant and limit e.g. divergence

[33] Draft Regulatory Technical Standards on the materiality threshold for credit obligations past due.

in the approaches that banks used to reflect the potentially increased risk of obligors which benefitted from public guarantee scheme and moratoria. It may be relevant to provide COVID-19 impact assessment as well in the coming years potentially with additional analysis on the credit conversion factor (CCF), defaulted exposures and the downturn modelling.

1.4.2 IFRS 9 Benchmarking exercise

The EBA continues to work on monitoring and scrutinising the implementation of IFRS 9, as well as its interaction with prudential requirements. In this context, in November 2021, the EBA published a report summarising the findings from the monitoring activities conducted since the publication of its last report in December 2018[34] and including, in particular, the findings stemming from the EBA 'IFRS 9 benchmarking exercise' as well as the observations from the qualitative assessment performed with the aim of monitoring EU institutions' practices. The assessment performed also covered a period of time after the COVID-19 outbreak. The aim of the report is, *inter alia*, to assist supervisors to evaluate the quality and adequacy of IFRS 9 ECL models, in order to contribute to a high-quality and consistent application of the IFRS 9 standard in the EU. In addition, the conclusions presented in the above-mentioned report on the classification and measurement of financial instruments provided a good basis to react to the first phase of the post-implementation review of IFRS 9 carried out by the IASB.

The EBA noted that, while EU institutions have made significant efforts to implement and adapt their systems to the IFRS 9 requirements since its implementation, the level of judgement in the standard leaves open the possibility to use a wide variety of practices. While no single practice turned out to be a strong driver of the ultimate levels of provisioning, some practices observed would deserve further scrutiny from supervisors. In addition, the COVID-19 pandemic resulted in extraordinary circumstances that pushed IFRS 9 models outside their ordinary working hypothesis, thereby increasing the use of overlays at the level of IFRS 9 risk parameters or directly at the level of the final ECL amount. Therefore, the use of overlays across EU institutions should be subject to continued monitoring in order to understand whether (and to what extent) institutions will adjust their ECL models to incorporate the effects currently captured via overlays/manual adjustments and/or whether part of the overlays considered will be maintained and for how long.

In line with the staggered approach presented in the IFRS 9 roadmap[35], the EBA will continue to work on the integration of the HDPs[36] in the IFRS 9 templates of the ITS on supervisory benchmarking and on their extension to institutions applying the standardised approach for credit risk, for which further consideration would be needed, given the more limited modelling experience.

[34] EBA report on first observations on the impact and implementation of IFRS 9 by EU institutions.

[35] EBA Roadmap for IFRS 9 deliverables, July 2019.

[36] High Default Portfolios are considered to be exposures to Residential Mortgages, SMEs, Corporates (other than Large Corporates) and SME retail.

2. Convergence in supervisory colleges

The EBA 2021-2023 college-monitoring approach introduced adjustments in the selection of closely monitored colleges in order to allow for the monitoring of a more diverse group of colleges and the maximisation of the benefits of EBA's presence in the monitored colleges.

In general, the interactions of closely monitored colleges were well organised in 2021. Some operational arrangements, in particular certain aspects of the WCCAs and the regular exchange of the early warning indicators, should be strengthened.

The EBA's follow-up of how colleges implemented the 2021 Convergence Plan concluded that while overall, the key topics were well covered in college activities, some of the attention points could have been better reflected in supervisory assessments, such as the loan origination practices, the ICT requirements for third-party providers, and cybersecurity preparedness and the impact of digital transformation.

Colleges made considerable efforts in completing their group risk / liquidity risk assessments, though in a minority of colleges, consolidating supervisors did not complete and share the mandatory annexes of ITS on the JD with the risk-by-risk decomposition of capital. In some colleges, the EBA observed the extension of the JD cycle, which resulted in the failure to comply with the 4-month legal deadline available for reaching a joint decision. No issues were observed with the available capital, including its quantity and quality, in closely monitored colleges.

While all closely monitored colleges, which were required to reach a JD on the GRP, have done so within the legal timeframe, this was not the case for some indirectly monitored colleges.

2.1 Monitoring of supervisory colleges in 2021

Based on the information obtained from EEA consolidating supervisors, the number of active supervisory colleges decreased compared to 2020. Overall, 45 colleges were reported as active for 2021 and were included in the 2021 list of supervisory colleges[37], compared to 56 in 2020. Additionally, three active colleges were reported for third-country banking groups at the EEA sub-consolidated level, raising the total number of active supervisory colleges to 48.

The considerable decrease in the EEA supervisory colleges is largely due to the UK's withdrawal from the EU, as the seven UK colleges that were still on the list in 2020, have been eliminated for 2021. Furthermore, the close cooperation between the ECB and the Bulgarian National Bank[38] and

[37] See annex to the EBA report on supervisory colleges in 2020.

[38] ECB establishes close cooperation with Bulgaria's central bank.

the Croatian National Bank[39] also led to the discontinuation of some colleges where these competent authorities were the only members.

As part of its mandate to facilitate supervisory cooperation in supervisory colleges and enhance their effective and efficient work, the EBA monitors the functioning of supervisory colleges. Out of the 48 active supervisory colleges, the EBA closely monitors 9 based on its 2021-2023 college-monitoring approach. While this constitutes a nominal reduction compared to the 12 colleges followed closely in the period 2018-2020, it follows proportionately the decrease in the number of banking group colleges active in the EEA.

Additionally, the new EBA 2021-2023 college-monitoring approach entails important adjustments as the selection of the closely monitored colleges takes into account additional considerations and criteria to maximise the benefits of the EBA's presence in supervisory colleges. In essence, the exclusive focus on large, systemic banking groups shifted to accommodate smaller institutions with cross-border presence in the EU, allowing for the monitoring of a more diverse group of colleges in terms of business model, origin, geographical spread and size.

Over the past years, the EBA's supervisory college-monitoring approach, has continuously adapted to the increasing experience supervisory colleges gained in organising and managing the joint decision cycles. At the start of the EBA's college-monitoring activity, it focused more on procedural aspects along with the formation of supervisory colleges, then the attention shifted towards the main college deliverables[40] with colleges becoming more experienced in operational matters and implementing the provisions of Commission Delegated Regulation (EU) 2016/98[41] and Commission Implementing Regulation (EU) 2016/99[42]. The EBA also aims to identify synergies between prudential and AML/CFT colleges to enhance their cooperation.

Accordingly, the EBA's college-monitoring activity in 2021 aimed to i) ensure that supervisory colleges are functioning well, and that they are able to effectively deliver on their mandatory tasks, and that they serve as the forum for coordinating supervisory matters; ii) facilitate the EBA's supervisory convergence work, including the implementation of the 2021 Convergence Plan; and iii) serve as a feedback loop for policy development and sharing observed good practices.

Supported by the EBA's Management Board, the novelty of the new monitoring approach for the period 2021-2023 relies on i) reinforcing supporting activities to colleges, in the form of college workshops/training activities; and ii) introducing some key success factors/qualitative key performance indicators (qualitative KPIs) for measuring and enhancing the effective functioning of supervisory colleges. To establish these KPIs, the EBA not only relies on its college-monitoring experience, but also launched a survey in 2021 for supervisors involved in supervisory colleges to gather their input. As part of the enhanced training activities on colleges, the EBA organised a

[39] ECB establishes close cooperation with Croatia's central bank.

[40] Used interchangeably with mandatory deliverables and key deliverables and refers primarily to the group risk and liquidity risk assessment; the joint decision on capital and liquidity; and to the assessment of the group recovery plan and respective joint decision.

[41] Commission Delegated Regulation (EU) 2016/98.

[42] Commission Implementing Regulation (EU) 2016/99.

training activity[43] in 2021 to facilitate the common understanding of the requirements related to supervisory colleges and to discuss practical experiences and challenges.

The EBA's involvement in supervisory colleges selected for close monitoring includes the participation in college interactions dedicated to the mandatory deliverables and following their development and related agreements in the supervisory college. The EBA also keeps close contact with CAs' staff responsible for managing the college and reviews, comments and signs WCCAs for these colleges. The EBA, via its direct participation in these colleges, also identifies potential disagreements early on.

The rest of the EEA colleges[44] qualify for the status of 'indirectly monitored colleges'. The EBA 2021-2023 monitoring approach continued with the previous practice, that foresaw interactions with these colleges on a thematic basis, including targeted communications, e.g. on the 2021 Convergence Plan and related objective elements on the EU-wide stress test, etc. and relied on authorities' self-assessments in a number of areas: i) college organisation and functioning; ii) the status of the college deliverables; iii) how the 2021 key topics were addressed in the college work.

In 2021, under the biennial information collection, 35 indirectly monitored colleges submitted their self-assessment. The analysis concerning the indirectly monitored colleges included in this chapter of the report relies on the information content of the self-assessment templates.

2.2 College interactions and organisational aspects

Closely monitored colleges

In general, the interactions of closely monitored colleges were well organised in 2021. Nevertheless, the EBA staff observation was that the quality of interactions varied, with some discussions being clearly interactive, while others were less engaging. Although the consolidating supervisors were quite proactive in promoting open discussions and encouraging other college members to raise queries, there were occasions when host CAs missed the opportunity to ask questions during the meetings, for example, from the banking group. All in all, the EBA signals that albeit host CAs were eager to share their supervisory experiences, the work of the closely monitored colleges could benefit from a more open discussion and further curiosity towards each other's supervisory concerns to facilitate the further identification of common issues.

On the other hand, the EBA notes that the need for improvement in the earlier sharing of the meeting documents stressed in previous years has been improved. In 2021, the agenda and meeting documents were distributed well in advance in most of the colleges, which facilitated contributions and discussions.

Overall, all except 1 of the 9 closely monitored colleges have WCCAs in place to facilitate the effective group supervision in accordance with Article 115 of the CRD. Out of the 9 colleges, 6 updated their WCCA over the course of 2021, while 2 of them are in the process of updating it. The

[43] For more information in this regard, please consult Section 5 of this Report – Training as a convergence tool.

[44] 39 colleges, i.e., 48 minus the 9, which are closely monitored.

one that has not managed to reach an agreement so far referred to the need to further align and clarify some provisions based on the feedback of a third-country authority that is under way.

While the quality of the WCCAs improved over the course of the past years, in particular with regard to the descriptions of the terms of participation of the observers, there is still room for further improvement in this regard, as well as in other areas. In particular, instead of the umbrella provisions referring to the observers in general, the provisions could be further enhanced to specify the participation, rights, and responsibilities of the different types of observers in the college, for example, third-country observers or observers in accordance with Article 9(1) of Regulation (EU) 468/2014 of the ECB[45], i.e. CAs participating in the banking union (BU).

Another relatively weak area of the arrangements that supervisory colleges will have to further develop in 2022, is cooperation with the resolution college or resolution authority. Article 5(m) and (n) of Commission Delegated Regulation (RTS) 2016/98 on the functioning of supervisory colleges[46] expects the WCCA to include a description m) of the framework for providing coordinated input to the resolution college, in particular for resolution plans, assessment of resolvability and to remove impediments; and n) of the role of the consolidating supervisor in particular for coordinating the provisions of this input through the group-level resolution authority.

In this context, it is important to provide a better sense of the role of the consolidating supervisor in coordinating the supervisory college input to the resolution college. While indeed it is helpful that the supervisory authorities are members of the resolution college and this does aid coordination, the EBA argues that the requirements of the RTS (and ITS) need to be fulfilled so that the consolidating supervisor commits to communicating the 'collective' supervisory view, in addition to individual authorities expressing their position. This is important in matters such as group capital, SREP and interconnections between the recovery and resolution plans and enhances coordination and cooperation. Having resolution colleges established for a couple of years now, the EBA believes that the relevant sections of the WCCA should also benefit from the respective experiences.

For the implementation of the arrangements laid down in the WCCAs, only 3 of the 9 closely monitored (33%) colleges met the requirements of exchanging quantitative information in the college framework to identify early warning signs, potential risks and vulnerabilities for the group under their supervision as required by Article 10 of Commission Implementing Regulation 2016/99[47]. At the same time, this means that two thirds of the closely monitored colleges did not exchange the values of the agreed indicators that are annexed to their WCCAs. The EBA finds this practice worrying, even if during the pandemic some key risk indicators have been followed and exchanged in supervisory colleges. Therefore, it is expected from colleges that i) they exchange these indicators at least annually[48] and if necessary; ii) update their list of indicators (annexed to the WCCA) to ensure those are the relevant indicators to depict the trend in the risk profile of the

[45] Regulation (EU) 468/2014.

[46] Commission Delegated Regulation (RTS) 2016/98 on the functioning of supervisory colleges.

[47] Commission Implementing Regulation 2016/99.

[48] Article 10(4) of the Commission Implementing Regulation (EU) 2016/99.

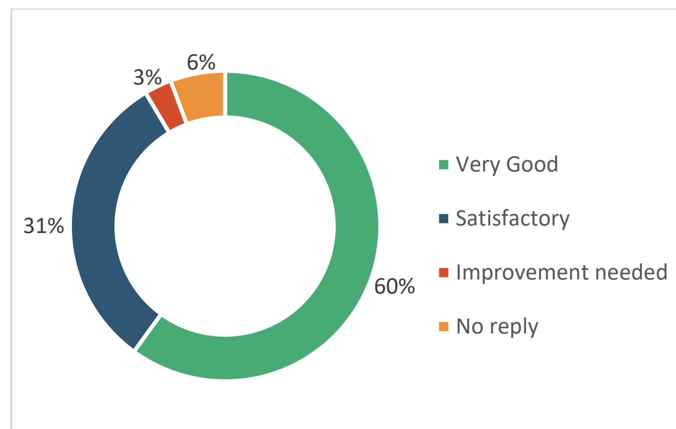
group and its entities and thus facilitate the early identification of potential risks as required by the regulation.

Indirectly monitored colleges

Colleges not selected for close monitoring also held various interactions over the course of 2021. Regarding the sharing of the draft agenda before the meeting, 46% of the colleges reported circulating the draft agenda 15 working days before the meeting, and 40% between 5 and 15 days in advance, which the EBA finds satisfactory overall. However, the EBA would expect to see some improvements in the circulation of the meeting documents since 46% shared the documents less than 5 working days in advance.

Most colleges (91%) reported that there was opportunity for supervisory college members to suggest items to be covered by the bank representatives in their interventions, which were taken on board by the consolidating supervisor. In general, discussions were reported to be of good quality and in-depth (Figure 12), with open information sharing from all parties. Host CAs were actively involved in the college meeting, exchanged different viewpoints, and the consolidating supervisor facilitated the discussion and encouraged participation.

Figure 12. Quality and depth of college discussions



Overall, the indirectly monitored colleges have WCCAs in place (91%), of which 83% either already exchanged information on the indicators in 2021 or which was in progress at the time of the submission of the template. For the rest of the colleges, this aspect should be further improved.

Areas for further attention in supervisory colleges:

- **further curiosity towards each other's supervisory concerns to facilitate the identification of common issues/concerns;**
- **timely sharing of the meeting documents[49] (indirectly monitored colleges);**
- **host CAs to better utilise the proximity of the banking group at meetings and raise questions and concerns they may have;**
- **host engagement to be improved in some colleges;**

[49] At least one week in advance.

- **provisions on the terms of participations could be enhanced with specifying the participation, rights and responsibilities of the different types of observers;**
- **improvement of the WCCAs in describing the cooperation with the resolution college;**
- **ensuring that the values of the agreed indicators that are annexed to the WCCA, are exchanged in the college.**

2.3 Implementation of the 2021 Convergence Plan in supervisory colleges

The implementation of the annual convergence plan is equally important in the supervision of cross-border banking groups, as that enhances the structured risk analysis of the respective banking group and facilitates the identification of shared interest areas of the key topics and attention points.

The EBA disseminated its 2021 Convergence Plan to all supervisory colleges in early November 2020 to inform them about the common key areas for attention for 2021 and to support colleges with the planning of their supervisory activities for 2021. In November, colleges received the more detailed attention points that helped them to identify appropriate supervisory activities for each key topic. The EBA staff presented the key topics during the first college interactions in 2021 that made engagement on the topics possible.

Colleges were expected to address the key topics within their respective college SEPs, including via joint activities, where relevant, and cover those in college discussions. The Convergence Plan also aimed to trigger the respective supervisory assessments, the outcome of which was expected to be channelled into the college deliverables, in particular, in the group risk / liquidity risk assessments, as well as in the respective joint decisions for further actions, if this latter was warranted by the outcome of the risk assessment.

2.3.1 Closely monitored colleges

In the colleges that the EBA monitors closely, the EBA staff follows the implementation of the annual convergence plan via its direct participation. The EBA found that in 8 of the 9 closely monitored colleges, the consolidating supervisor provided an overview presentation at one of the college meetings to explain how supervisory activities conducted at the group-level address the key topics and related attention points. Then hosts supervisors were also invited to join the discussion and explain their respective activities, but host CAs also explain their activities during the risk discussions.

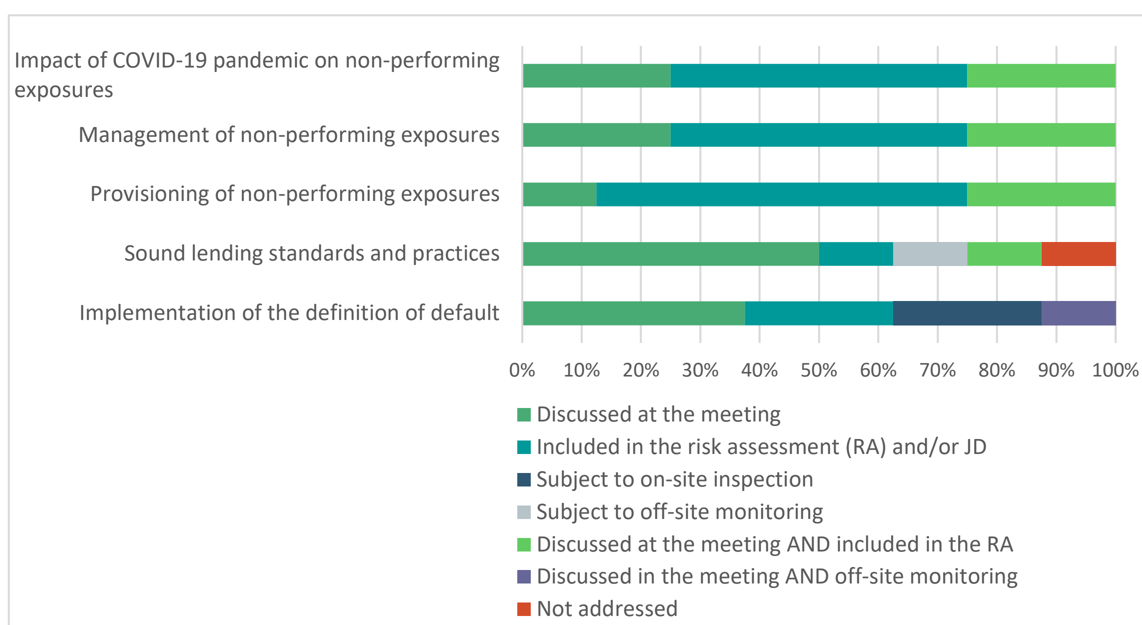
This section explains how the key topics and objective elements have been covered by the closely monitored colleges[50] in 2021.

[50] In one college, it was not possible to establish the extent of coverage of the key topics before the college was selected for close monitoring by the EBA (June 2021), therefore this college was left out of the analysis included in this section of the report.

Asset quality and credit risk management

Figure 13 depicts that the topic and its main sub-elements were well covered overall by the closely monitored supervisory colleges, in particular the management and provisioning of NPEs and the impact of COVID-19 on the level of NPEs. With regard to the implementation of the DoD, supervisors undertook on-site inspections as well as conducted off-site activities, the outcome of which in some cases has not yet been factored into the group risk assessments. It is clearly visible from the chart that the area which was least analysed in the group risk assessments was lending practices. This observation corresponds to the respective conclusion from the implementation of the 2021 Convergence plan by all CAs in Chapter 1.2.1, therefore further attention on the topic will be required from CAs in 2022. The EBA encourages CAs in supervisory colleges to include the outcome of their supervisory assessment on the topic in the group risk assessment report.

Figure 13. Asset quality and credit risk management (% of colleges)



Area for further attention in closely monitored colleges:

- **The assessment of the loan origination practices should be better reflected in the group risk assessments.**

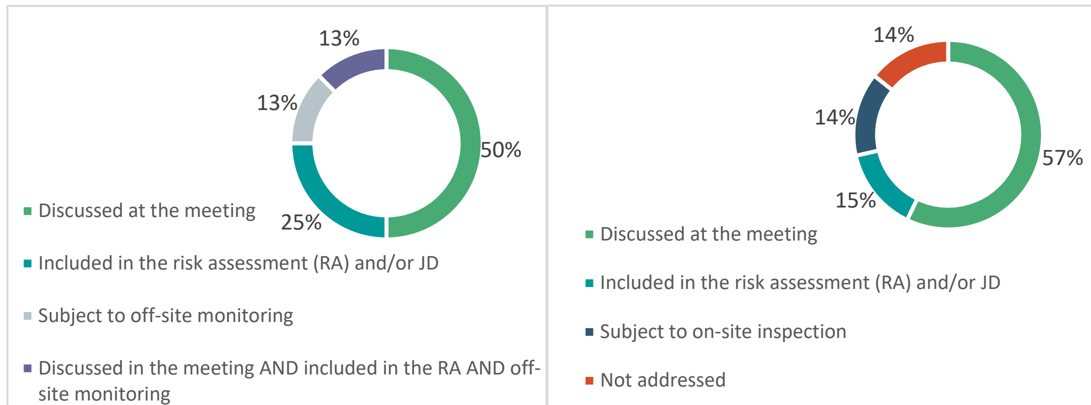
ICT and security risk, operational resilience

The internal governance on ICT risk management and the information security measures were well covered in supervisory risk assessments and college discussions. On the other hand, the topics of ICT requirements for third-party providers and exit strategies as well as cybersecurity preparedness have only been included in the group risk assessment by 15% and 38% of the closely monitored colleges respectively. While some college discussions took place and on-site or off-site activities were conducted respectively, the EBA believes that their more profound assessment under the group risk assessment would be vital to ensure that supervisors identify i) risks linked to material outsourced services (and see whether institutions properly manage these risks); as well as ii) areas

for improvement in institutions' cybersecurity preparedness. The topics thus remain under close supervisory attention for 2022 and are included in the 2022 ESEP.

Figure 14 (right): ICT requirements for third-party providers and exit strategies

Figure 15 (left): Cybersecurity preparedness



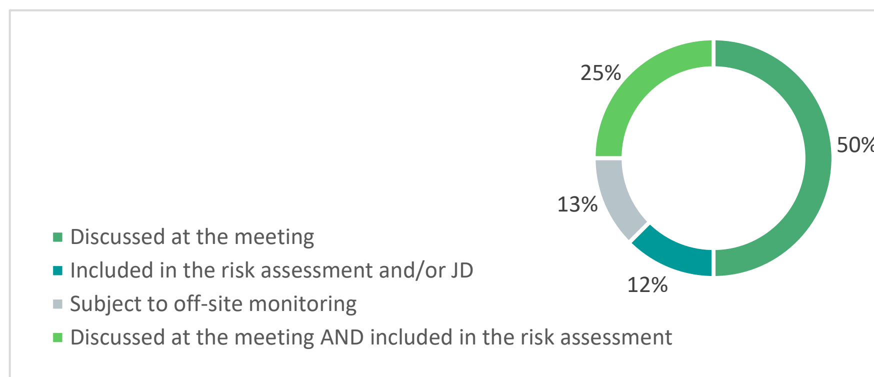
Area for further attention in closely monitored colleges:

- **The assessment of ICT requirements for third-party providers and cybersecurity preparedness should be better reflected in the group risk assessments.**

Profitability and business model

Supervisors in colleges discussed the ongoing efforts of banks to ensure profitable operation, and in particular concrete measures to improve profitability and sustainability, some of them also undertook some on-site and off-site activities in this regard. The EBA college-monitoring activity further supported the overall conclusion drawn in Chapter 1.2.3 that digital transformation could have been better incorporated into supervisory work in 2021, as only 37% of supervisory colleges assessed digitalisation and its impact on the business models and governance (including internal control implications) in the group risk assessment. Supervisors will thus be requested to continue implementing these objective elements as part of the 2022 ESEP.

Figure 16. Understanding the effects of digital transformation



Nevertheless, the EBA observed a good practice in one of the supervisory colleges where the bank was invited to the meeting to present their analysis of the efficiency impact of their digital

transformation (including indicators followed). In such a manner, the entire college could benefit from a detailed presentation of the group, which enhanced all college members' understanding of the main trends, including the various concrete matrices that the group monitors in the context of their digital transformation.

Good practice observed in closely monitored colleges:

- **The banking group presented the efficiency impact of their digital transformation at the college meeting (including indicators followed).**

Area for further attention in closely monitored colleges:

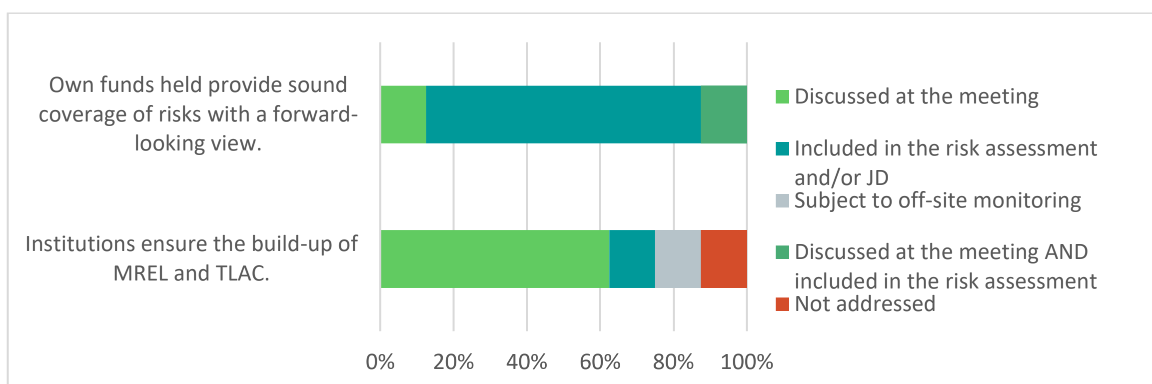
- **Digital transformation and its impact on the business model.**

Capital and liability management

All colleges kept capital management and planning in their focus for 2021, and assessed whether the own funds held, considering their quantity and quality, provide sound coverage of the risks to which the institution is or might be exposed. In 2021 an additional tool, the EBA EU-wide stress test supported supervisors in assessing if banks' capital buffers, which have been accumulated in recent years, would be sufficient to cover losses also in stressed times.

CAs were expected to engage with their RA counterparts on institutions' MREL plans to understand whether they have in place credible plans to meet the MREL requirements. In order to ensure the build-up of MREL and TLAC, CAs were also expected to engage with institutions on the viability of their funding plans to meet MREL, which is also relevant information in the context of the group risk assessment process. While all supervisory colleges addressed this topic in some ways, except one, it was covered mainly in college discussions. While the EBA acknowledges improvements compared to 2020 of how colleges addressed this topic, the EBA would argue that conclusions in this regard should feed into the group risk assessment in more and more supervisory colleges. The supervisory college which has not addressed the topic in any format, informed that no MREL has been implemented yet on the level of the banking group and local subsidiary for the group.

Figure 17. Capital and liability management (% of colleges)



Area for further attention in closely monitored colleges:

- **Conclusions on the viability of funding plans to meet MREL to be reflected in the group risk assessment.**

Topical task requiring supervisory attention in 2021

Supervisory colleges were expected to exchange views on some topical items, namely on the i) stress-test exercise; ii) on dividend arbitrage trading schemes in the context of the assessment of the internal governance framework; iii) on the cooperation and exchange of information with the AML/CFT college; and iv) on the terms of the UK's participation in the college, post-Brexit, where relevant.

All closely monitored colleges had effective communication in the context of the 2021 EU-wide stress-test exercise, both on process steps and milestones, as well as on the results and their inclusion in the banking group's SREP.

Colleges were expected to exchange views on dividend arbitrage trading schemes (Cumex) in line with the EBA's Action plan on dividend arbitrage trading schemes[51] and in connection with the assessment of the internal governance framework. CAs moved forward with addressing this topic, compared to 2020 when no discussions on this matter took place in any of the closely monitored colleges. In 2021, two thirds of the closely monitored colleges had either a thorough discussion on the topic or at least addressed some of the main areas under this item. A third of the colleges, all of which were selected for close monitoring in 2021, however, did not discuss the topic, mostly referring to the fact that the item is not relevant for the banking group considering its size and business model, including the services they offer.

Another aspect that the EBA followed in 2021 was the prudential colleges' cooperation with their AML/CFT counterparts. The cooperation and the exchange of information between the prudential and the AML/CFT colleges seemed to intensify over the course of 2021. Where the AML/CFT colleges have been established and provided input to the consolidating supervisor that were channelled to the college members subsequently. Nevertheless, for 44% of the closely monitored colleges, their AML/CFT counterparts are yet to be established in line with AML/CFT Colleges Guidelines[52].

Finally, with the UK's departure from the EU, supervisory colleges had to update their WCCAs, including the terms of the UK's participation in 2021 and onwards. Out of the 7 supervisory colleges, where this aspect was relevant, 5 updated their WCCAs already, while 2 were in the process of discussing and updating it at the end of the year.

2.3.2 Indirectly monitored colleges

The EBA releases the 2021 Convergence Plan to indirectly monitored colleges also in a bid to promote convergence efforts and assess the degree of convergence in supervisory practices. This

[51] See also the EBA Report on Competent Authorities' approaches to tackling market integrity risk associated with dividend arbitrage trading schemes.

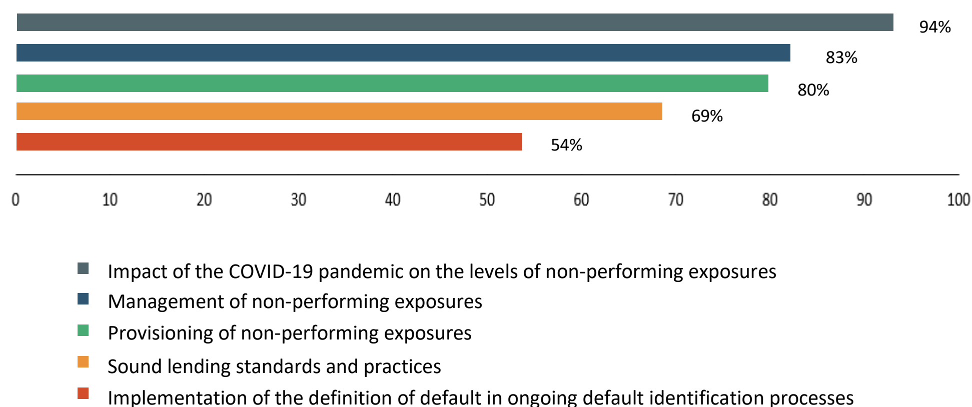
[52] AML/CFT Colleges Guidelines.

part of the report summarises how indirectly monitored colleges addressed the i) 2021 key topics selected for supervisory attention; and ii) the topical tasks for supervisory colleges.

Asset quality and credit risk management

Based on the outcomes of the self-assessment templates the EBA noted that indirectly monitored colleges made considerable efforts to set their annual college activities in accordance with the EBA's Convergence Plan priorities. 74% of them implemented all objective elements that were in the scope of the EBA's review, and the rest reported a partial implementation. Figure 18 depicts the level of implementation of the objective elements in focus.

Figure 18. Level of implementation of the objective elements incorporated into the 'Asset Quality and Credit Risk Management' key topic



The impact of the COVID-19 pandemic on the levels of NPE was thoroughly assessed by 94% of these colleges. The main findings in this regard indicate that the impact from COVID-19 has been materialised to a limited extent (i.e. low impact on the levels of NPEs) and has been addressed by provisioning.

The coverage of the management and provisioning of non-performing exposures in supervisory activities and assessments was also good among these colleges, with 83% and 80% of colleges, respectively, covering these two key areas of asset quality management. As a result of their assessment, supervisor colleges have not identified major shortcomings in this regard, having identified areas for improvement such as timely identification of weak exposures and risk events. As regards the provisioning of NPEs, the replies indicate that the provision levels are deemed to be appropriate, i.e. fulfil the supervisory expectations.

While approximately two thirds (69%) of the supervisory colleges looked into whether institutions apply sound lending standards and practices, this objective element seemingly received less supervisory attention than the COVID-19 impact and in general the management and provisioning of NPEs.

The last aspect in scope of the EBA's review was the implementation of the DoD in ongoing default identification processes, where only 54% of the respondents has addressed this objective element under the scope of their SREP processes. It should also be noted that, around 46% of the colleges did not consider it relevant to assess the DoD in 2021 either because i) credit risk did not appear to

be a significant risk for the institution; or ii) because it will be addressed in the future through on-site inspections; or iii) it was considered in the risk assessments of previous years.

In view of this, the EBA stresses that the correct implementation of DoD is paramount to properly measure and assess the existing level of risk of a credit institution. With this practical caveat, CAs must be advised that referring to non-significance of credit risk, in general, does not seem to be appropriate reasoning for not addressing such a concern, even in cases where there are relatively low default rates and low NPL ratios.

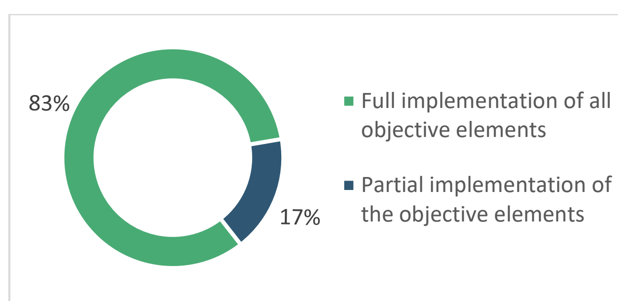
Area for further attention in indirectly monitored colleges:

- **CAs to continue to review lending standards and the implementation of the DoD.**

ICT and security risk, operational resilience

This key topic has been successfully implemented by 83% of the supervisory colleges, including the more detailed objective elements. The main outcome in this regard is that ICT and security risks are overall well governed, and banks have been demonstrating appropriate resilience.

Figure 19. Level of implementation of the *ICT and security risk, operational resilience* key topic



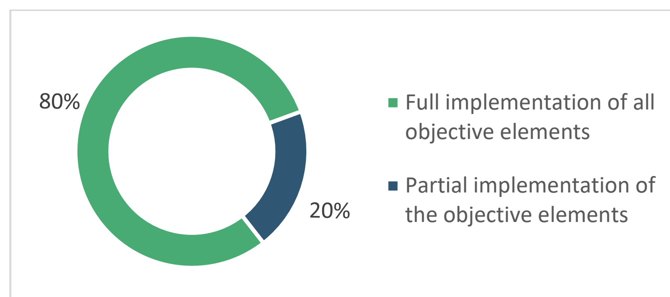
In the context of the security risk management and information security measures, roughly 83% of the replies indicate discussion on previous ICT inspections and ICT security risk management. Thus, supervisors rightly seem to be monitoring the ongoing remediation of the ICT deficiencies identified in previous inspections. Despite some shortcomings, the EBA acknowledged colleges' efforts to address this objective element via SREP reports.

Regarding cybersecurity preparedness, 74% of the respondents indicated that i) this aspect is included in their risk assessment reports; or ii) they are in the process of outlining deficiencies related to cybersecurity and information security management.

Profitability and business model

In this respect, 80% of supervisory colleges considered the topic in their supervisory work and reported no disagreements in the common assessment of the profitability and business model.

Figure 20. Level of implementation of the 'Profitability and business model' key topic



Roughly 83% of colleges scrutinised measures taken by the institution to improve profitability and sustainability, which included addressing potential implications of the COVID-19 pandemic, also in the context of the business plans, and improving sustainability overall.

According to the results of the self-assessments, 71% of colleges covered the increasingly important topic of digital transformation as part of their BMA assessment and included it in their risk assessment reports. The digitalisation strategy also gathered the attention of supervisors. Some assessments were ongoing at the time of the submission of the template, while a minority of colleges did devote considerable attention to digitalisation and noted that the topic is not relevant to some subsidiaries.

Capital and liability management

All 35 colleges that submitted their input, indicated they fully consider this aspect in order to ensure that the own funds held provide a sound coverage of risks. Overall, no particular concerns have been highlighted. The results show that 97% of colleges covered the setting of the P2R and P2G as part of their discussion to reach a joint decision, including the stress-test outcomes, where relevant.

Topical task requiring supervisory attention in 2021

Out of the four topical tasks, three were relatively well covered by indirectly monitored colleges, namely the stress-test exercise, the outcome of which was discussed and fed into the group risk assessments in all colleges, where relevant; as well as the cooperation and information exchange with the AML/CFT college, where 69% of the colleges discussed AML/CFT issues and reported effective exchange of information with AML/CFT authorities also in the context of the SREP. The colleges that did not address the issue referred to the fact that an AML/CFT college has yet to be put in place for the group.

The terms of the UK's participation in the college post-Brexit was discussed in 43% of the colleges where this was in fact relevant and materialised in the update and/or review of the written coordination and cooperation agreements. Colleges reported the least engagement (34%) on dividend arbitrage trading schemes, with the rest stressing informing that the topic is not a current issue to them.

2.4 Key deliverables of supervisory colleges

2.4.1 Group risk / liquidity risk assessment and joint decision on capital and liquidity

This chapter of the report summarises the EBA's observations from its college-monitoring activity for these three core college deliverables for 2021.

Group risk/liquidity risk assessments

Closely monitored colleges

According to Commission Implementing Regulation (EU) No 710/2014[53] on the joint decision process for institution-specific prudential requirements (ITS on the JD), one of the first steps of reaching a joint decision on capital and liquidity is the compilation of the group risk/liquidity risk assessment reports, for which both the consolidating supervisor and the relevant CAs conduct their respective assessments. Supervisory colleges are the forums where these draft group and individual risk / liquidity risk assessments are shared and discussed in order to reach a solid final group report that incorporates all supervisory views on the risks to which the group and its entities are exposed.

All colleges which were required to compile a draft group risk / liquidity risk assessment have done so in 2021 and had dedicated discussions in the college setting to exchange respective supervisory views. One of these colleges have not yet circulated the final group risk assessment report for the 2021 cycle due to the different timing of its SREP cycle, but in the rest of the colleges, the final group risk / liquidity risk assessment was circulated triggering the statutory timeframe[54] for reaching joint decisions in accordance with Article 113 of the CRD.

Two colleges had fallen short of completing the mandatory annexes of the group risk / liquidity risk assessment report as required by the ITS on the JD. More specifically, the risk-by-risk decomposition of the capital requirements at the consolidated / parent-entity level was not completed and shared in these colleges, even despite the EBA's intervention, meaning that the decomposition of the total SREP requirement at the consolidated / parent-entity level was not transparent enough in these colleges, thus not supporting the respective discussions on the risk assessment and joint decision. The rest of the colleges ensured that their group risk/liquidity risk assessment reports were complete in line with Article 6 (1)(4) of the ITS on the JD.

Area for further attention in closely monitored colleges:

- **distribution of the mandatory annexes as required by Regulation 710/2014, covering the risk-by-risk breakdown of capital requirements.**

Indirectly monitored colleges

Pursuant to Article 3 of the ITS on the JD, the consolidating supervisor and the relevant CAs, before the start of the joint decision process, shall agree on a joint decision timetable, which must be updated at least annually. Based on the results of the desk-based review of the self-assessment,

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[53] Commission Implementing Regulation (EU) No 710/2014.

[54] i.e., four months.

most of the indirectly monitored colleges (74%)[55] have agreed on a joint decision timetable, prepared the group risk/liquidity risk assessments and also discussed them in the college setting.

The same 74% have reported circulating the final group risk / liquidity risk assessment in the college as per Article 113(2) of the CRD and Article 8(3)(4) of the ITS on the JD, signalling the beginning of the 4-month period for reaching a joint decision. An additional 6% are in the process of finalising the group risk assessment. Moreover, these colleges used all the relevant mandatory annexes of the group risk / liquidity risk assessment report as per the ITS on the JD.

Joint decision on capital and liquidity

Closely monitored colleges

The EBA observed that in a number of colleges the cycle was not completed in 2021, but the final steps were extended to 2022. While in all colleges[56], except one[57], the draft capital and liquidity joint decisions for the 2021 cycle were shared, the finalisation of documents in many cases took place at the beginning of 2022, including the agreements between the consolidating supervisor and all relevant competent authorities. Such extension of the cycle was, to a certain extent, to accommodate the interaction between the SREP and the 2021 EU-wide stress-test exercise, in particular feeding the results into the capital adequacy assessment. Nevertheless, the 4-month legal deadline for reaching a joint decision was not respected in some colleges.

The available capital, including its quantity and quality, was assessed as adequate and it was concluded that the respective banking groups had capital headroom above the P2G, which was assessed as relatively low in some cases. The required level of own funds was articulated in line with the requirements of the SREP Guidelines in all joint decisions, including details on the quality of the P2R. In addition, CAs also set the P2G for the respective banking groups and their entities.

A shortcoming identified is that the joint decision documents failed to provide references to the combined buffer requirement, which is a requirement under Article 10(1)(j) of the ITS on the JD.

Colleges without Joint Decisions

Within the list of monitored colleges there are two colleges which incorporate only CAs of EEA-significant branches or CAs of EEA-significant branches and third-country subsidiaries. Such types of colleges were added to the list of monitored colleges for diversification purposes. The CAs of the home Member State and those of the members and observers shall exchange all information necessary to facilitate the effective supervision of the institution and its branches and third-country subsidiaries.

For these colleges, the extent and degree of interaction between the home supervisor and the host supervisors, as well as the number of college meetings organised varies and depends on the individual needs of the college. Such colleges are not legally required to perform a joint group risk / liquidity risk assessment and to reach joint decision on capital or liquidity as they are established in view of cooperation with host supervisors of (significant) cross-border branches and third-country authorities supervising subsidiaries.

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[55] Not all indirectly monitored colleges are required to reach joint decision on capital and liquidity.

[56] Which were required to reach a joint decision.

[57] The one which was in the process of finalising the group risk assessment report.

In general, the EBA staff observed a discussion on the risk assessment of the institution and its branches taking place within the college context. One of these colleges has a long-standing tradition of close cooperation among supervisors, which includes performing joint risk assessments, with the active involvement of a third-country authority, which is an excellent example of good supervisory cooperation that goes beyond the EU colleges context.

Also, for these colleges the WCCAs were being updated where necessary in view of Brexit and the relevant changes in the procedures for the participation of the UK supervisory authorities within the college. The colleges also ensured communication on the 2021 EU-wide stress-testing exercise according to the guidance and milestones provided by the EBA including the organisation of a college meeting to discuss the stress-test results.

Good practice observed in closely monitored colleges:

- **preparation of a group risk / liquidity risk assessment and respective discussion in colleges with significant branches and third-country subsidiaries only.**

Indirectly monitored colleges

Among the indirectly monitored colleges, 63% and 60% have reported circulating the draft joint decision on capital and liquidity, respectively, ahead of the college's discussion as per the joint decision timetable. In this sense, the EBA considers this to be an aspect for further attention and improvement.

While the EBA acknowledges the additional challenges that colleges might have faced in the context of the COVID-19 pandemic, the EBA finds it unsatisfactory that only 49% of the indirectly monitored colleges have complied with the 4-month legal deadline available for reaching the capital and liquidity joint decisions. Pursuant to Article 113(2)(a)(b) of the CRD, colleges must endeavour to ensure that the legal deadline available for reaching a joint decision is respected. It must be noted, however, that approximately 31% of the indirectly monitored colleges have reached informal agreements on the Joint Decisions which means that formal approvals in this regard were still outstanding at the time of the self-assessment.

Notwithstanding the efforts put forward by the colleges to ensure sufficient dialogue between the consolidating supervisor and the relevant CAs on the capital and liquidity joint decisions (80% and 77%, respectively), the EBA stresses that it is important that all colleges fulfil this requirement in accordance with Article 3(2)(i) of the ITS on colleges.

Area for further attention in supervisory colleges:

- **all colleges must respect the 4-month deadline available for reaching a joint decision.**

2.4.2 Group recovery plan assessment and joint decision

Closely monitored colleges

Supervisory colleges are also mandated by Article 8 of the BRRD[58] to review and assess the Group Recovery Plan (GRP) and they shall reach a joint decision on i) the assessment of the GRP; ii)

[58] Bank Recovery and Resolution Directive.

whether individual plans are to be requested; and on iii) the application of supervisory measures addressing material deficiencies.

In 2021, all closely monitored colleges, which were required to reach a joint decision have done so within 6 months of the submission of the plan by the institution, thus meeting the regulatory deadline specified in Article 6(2) of the BRRD.

Over the course of 2021, no material deficiencies have been identified in the GRPs of the closely monitored colleges. Therefore, as the GRPs were assessed as adequate, there was no need to consider the application of supervisory measures addressing material deficiencies in line with Article 6(6) of the BRRD.

In general, the interactions held within the colleges closely monitored by the EBA about their supervisory assessments of GRPs were assessed as good, however, in one particular college, the discussion was only driven by the EBA.

The college meetings discussing the assessments of the GRP explored various aspects of the assessment, some of the most common aspects being the i) the calibration of recovery indicators accounting for the current pandemic situation; the ii) inclusion of effective recovery options under the COVID-19 pandemic scenario; and, in some cases, the iii) integration of the former local plans into the GRP and potential further steps to improve the integration.

In terms of the supervisory assessments of GRPs, the EBA notes that comprehensive updates and improvements continued in this cycle and, all in all, the GRPs appeared to better cover the whole group in order to react to problems at subsidiary level. Additionally, the assessments often noted some progress in the menu of recovery options including institutions’ assessments of their feasibility for restoring the financial position of the group in stress scenarios. However, most of the supervisory assessments continued to highlight some persisting weaknesses and need for improvements in particular in the area of ORC and its calculation, governance for escalation, calibration of indicators and severity of recovery plan scenarios.

The EBA recognises the thorough efforts in regard to the general improvements on the recovery indicators framework with, for instance, the implementation of a net stable funding ratio (NSFR) indicator. The EBA expects that the quality of the recovery indicator framework will improve in next year’s assessment thanks to the new EBA GL on recovery plan indicators[59] that will include requirements for additional indicator types such as MREL and liquidity position, and also more detailed guidance on calibration of regulatory capital and liquidity indicators.

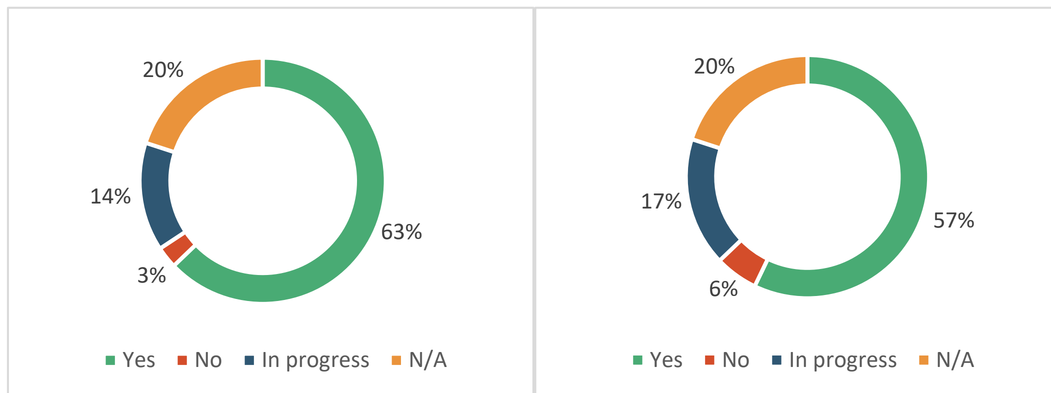
Indirectly monitored colleges

Substantial work has also been conducted in the indirectly monitored colleges to assess the GRPs. The large majority of the consolidating supervisors (80%) have circulated the recovery plan and the preliminary assessment to college members in a timely manner. However, the EBA flags that only 63% have reached an agreement on the GRP assessment in a timely manner; and only 57% have

[59] EBA/GL/2021/11.

reported reaching a joint decision within the 4-month legal deadline required by Article 8(2) of the BRRD.

Figure 21. Article 6 of the BRRD: 6 months and Article 8 of the BRRD: 4 months



On the whole, 23% of the colleges have reported that they requested banks to develop individual plans, while 14% have identified material deficiencies, which were promptly addressed, in line with Article 6(5) of the BRRD.

Area for further attention in indirectly monitored colleges:

- **All colleges must respect the 4-months deadline available for reaching a joint decision.**

2.5 EBA tools for supporting supervisory colleges

2.5.1 Guidance to CAs on the 2021 EU-wide stress test

The EBA is mandated to initiate and coordinate an EU-wide stress test as per Article 21 of its founding regulation[60] and promote the effective and efficient supervisory activities including evaluating the risks to which the financial institutions are or might be exposed as determined under the SREP. According to the same article, the EBA shall ensure the consistent functioning of supervisory colleges[61].

In light of the above, the EBA issued a guidance to CAs in the context of the 2021 EU-wide stress test, focusing on i) the organisation of communication in colleges; as well as ii) on the integration of results in the SREP and joint decision.

The consolidating supervisor and the relevant members of the college had to exchange all process-related information, both at the individual and consolidated level to facilitate the SREP, as well as the results of the supervisory stress tests performed pursuant to Article 100 of Directive

[60] Regulation (EU) No 1093/2010 of the European Parliament and of the Council.

[61] Please note that, while the guidance provided by the EBA envisages the interaction among European supervisors in the college context, it could also be considered to interact with third-country supervisors.

2013/36/EU[62]. Accordingly, CAs were requested to apply the stress-test results as an input to the SREP in line with the SREP Guidelines.

Throughout the stress-testing process, consolidating supervisors were invited to plan college discussions at specific milestones to ensure smooth information sharing throughout the exercise and allow CAs preparedness ahead of the public disclosure of the results.

Integration of results in SREP and joint decision

The 2021 EU-wide stress test, together with additional relevant information from related stress tests, was a crucial piece of information in the 2021 SREP. The results of the stress test allowed CAs to assess banks' ability to meet applicable minimum and additional own-funds requirements under stressed scenarios based on a common methodology and assumptions.

The process for reflecting the stress-test outcome in the SREP had to be undertaken in close cooperation between the CAs responsible for supervising cross-border EEA institutions and had to be conducted in line with the relevant provisions of the EBA SREP GLs. Furthermore, the EBA noted that, where possible, the SREP and joint decision were to be finalised only after the publication of the stress-test results, so that CAs were able to factor in the stress-test results.

The EBA expressed that when incorporating the results of the EU-wide stress tests into the SREP assessments, CAs were to use the qualitative results to inform the assessment of risks to capital, internal governance, and institution-wide controls; and the quantitative results of the stress test (impact on own funds) to assess banks' ability to meet own-funds requirements over the economic cycle. They were also requested to discuss the impact of the stress test with the credit institution and understand the extent to which credible management actions may offset some of the impact of the adverse scenario and analyse outcomes, including the relevance of supervisory stress testing considering the institution's strategy, financial plans and business model[63].

All relevant information regarding the determination of the P2G had to be shared and discussed in supervisory colleges as part of the joint decision process, including the approach to establishing the P2G at solo level where no data from the supervisory stress test is available. Where the P2G was set, that had to be subject to a joint decision in the supervisory college as per Article 113(1)(c) of the CRD V and thus included in the joint decision document.

In the context of the COVID-19 situation, CAs were invited to share information and exchange views on situations where the banking group or any of its entities had fallen or were expected to fall below the level of its P2G in reaction to the exceptional supervisory measures taken in 2020 on the use of capital buffers. In this respect, CAs were advised to coordinate their respective supervisory responses, as far as possible and practicable, in the supervisory college framework.

2.5.2 EBA college platform

[62] Article 10(2)(h) of the Commission Delegated Regulation 2016/98 on the general conditions for the functioning of colleges of supervisors.

[63] As per paragraph 394(d) of the SREP GLs.

In line with the EBA role in the efficient functioning of colleges, the EBA maintains an EBA Colleges platform that is used to facilitate a secure and user-friendly way for continuous exchange of information and collaboration between the authorities.

The EBA continues its work on enhancements of the platform pulling resources and efforts in creating the European supervisory, resolution and AML/CFT platform accessible to all colleges and relevant authorities. In November 2021 a great achievement and step forward to retrofit the EBA college platform to use modern cloud-based identities, with strong multi-factor authentication that removes hard tokens. Introducing the soft token will improve the user experience and is expected to give a boost to usage of the EBA college platform.

The EBA invites the colleges that are still relying on secured email for exchanging confidential information to start using the updated EBA college platform.

2.5.3 EBA equivalence assessments of non-EU authorities for participants in supervisory colleges

According to Article 116(6) of the CRD, third-country supervisory authorities may participate in EEA supervisory colleges, provided that their confidentiality regime has been assessed as being equivalent to the requirements laid down in the CRD. To facilitate and support the work of colleges and in particular the participation of third-country supervisory authorities in the EEA supervisory colleges as an ongoing activity, on a continuing basis, the EBA assesses the equivalence of the professional secrecy and confidentiality regimes of such authorities.

To that end, in 2021, the EBA continued its work on the third-country equivalence and — with the support of the EBA Network on Equivalence — conducted specific assessments of third-country authorities on confidentiality and professional secrecy, including participation in the supervisory colleges. The outcome of this work has been channelled into the EBA Guidelines on the equivalence of confidentiality and professional secrecy regimes.

3. EBA policy work supporting supervisory convergence

The EBA worked on various policy products over the course of 2021 to drive further convergence in particular in the cooperation between AML/CFT supervisors and FIUs, and in procedures of establishing IPUs. Additionally, the EBA has updated its internal-governance-related guidelines in line with CRD V to foster diversity and ensure equal opportunities. The EBA also facilitated consistency of supervisory practices in i) the management and supervision of ESG risks; ii) the treatment of 'legacy instruments' by institutions across the EU; iii) the mapping of incoming third-country branches; and in iv) recovery planning.

3.1 Ongoing supervision

3.1.1 Final Guidelines on cooperation and information exchange between prudential supervisors, AML/CFT supervisors and financial intelligence units

In December 2021, the EBA published its final Guidelines on the cooperation and information exchange between competent authorities, AML/CFT supervisors[64] and FIUs[65] ('AML/CFT Cooperation Guidelines')[66]. In accordance with Article 117(5) CRD, competent authorities, AML/CFT supervisors and FIUs must cooperate closely within their respective competencies and provide each other with information relevant to their respective tasks. The AML/CFT Cooperation Guidelines were developed under Article 117(6) CRD to specify the manner of this cooperation and information exchange both at the level of Member States and in a cross-border context.

While each authority has its own roles and responsibilities in the fight against ML/TF, there are areas where their tasks complement each other and therefore effective cooperation and information exchange is essential to identify, address and mitigate ML/TF risks.

The guidelines set out general provisions and practical methods for timely sharing of information, both for information shared upon request and on own-initiative basis. The guidelines cover regular as well as ad hoc information exchange between authorities.

The guidelines provide common guidance on which information needs to be exchanged with whom and at what stage throughout the supervisory life cycle. The guidelines cover the information exchange in the context of authorisations of new institutions, ongoing supervision including the risk assessment and SREP, and where relevant, the imposition of supervisory measures and sanctions,

[64] AML/CFT supervisor means a competent authority as defined in point (2)(iii) of Article 4 of Regulation (EU) No 1093/2010.

[65] Financial Intelligence Unit (FIU) means an entity set up in accordance with Article 32(1) Directive (EU) 2015/849 (AMLD).

[66] EBA/GL/2021/15.

including the withdrawal of the authorisation on grounds of serious breaches of the applicable AML/CFT laws.

For on- and off-site supervisory activities, the guidelines set out the procedures for coordinated supervisory activities if areas of mutual interest are identified between competent authorities and AML/CFT supervisors.

3.1.2 Final Guidelines on the monitoring of the IPU threshold

In July 2021 the EBA published its final Guidelines on the monitoring of the threshold and other procedural aspects on the establishment of intermediate EU parent undertakings (IPU) under Article 21b CRD. These guidelines were developed on the EBA's own initiative with a view to establishing consistent, efficient and effective supervisory practices and to ensuring the common, uniform and consistent application of Union law.

The guidelines apply in the context of the new requirement introduced by CRD V in Article 21b for third-country groups with a total value of assets in the EU of at least EUR 40 billion (IPU threshold) to have an IPU. This threshold includes the assets of credit institutions and investment firms belonging to third-country groups, as well as branches of third-country institutions. The groups may have two IPUs where there is a mandatory requirement for separation of activities imposed by the third country or if this would render resolvability more efficient. The requirement is applicable from 29 December 2020[67], subject to transposition of CRD V into national legislation.

The guidelines set out a common approach and methodology for the calculation of the IPU threshold. To account for the fluctuation in the value of assets it was specified that for the application of the IPU requirement, the total value of assets in the EU of the third-country group should be calculated as an average over the last four quarters. This value should be monitored on a quarterly basis and reported to the relevant competent authorities.

In addition, given that establishing an IPU may be a lengthy process, institutions belonging to third-country groups must apply a forward-looking approach to be able to meet the IPU requirement in a timely manner. The guidelines specify that they should assess at least annually whether the threshold is expected to be reached within the 3-year horizon, based on the strategic planning of the third-country group and the forecast of assets.

Furthermore, the guidelines clarify some procedural aspects including exchange of information between the institutions, third-country branches and competent authorities, as well as appropriate timelines for the establishment of an IPU. Guidance is also provided to competent authorities regarding notifications to the EBA.

[67] Third-country groups operating through more than one institution in the EU and with a total value of assets equal to or greater than EUR 40 billion on 27 June 2019 shall have an intermediate EU parent undertaking or two intermediate EU parent undertakings by 30 December 2023.

3.1.3 Revised Guidelines on internal governance

Following the amendment of Directive 2013/36/EU by Directive 2019/878/EU (CRD V) and the publication of the EBA's 10-point action plan on dividend arbitrage trading schemes, the EBA updated its guidelines on internal governance issued on 26 September 2017. The update also considers further changes to Directive 2013/36/EU that are included in Directive 2019/2034/EU (IFD)[68]. The revised Guidelines aim to ensure sound governance arrangements and are applicable as of 31 December 2021.

The main revisions of the Guidelines under CRD V, concern requirements that foster diversity and ensure equal opportunities for both genders, specific expectations regarding loans to members of the management body and their related parties and provisions to tackle risks in the context of money laundering and terrorist financing.

The revised Guidelines further specify and improve the framework regarding loans to members of the management body and their related parties. Those loans may constitute a specific source of actual or potential conflict of interest and, therefore, specific provisions have been explicitly included in the CRD. In the same way, other transactions with members of the management body and their related parties have the potential to create conflicts of interest and, therefore, the EBA is providing guidance on how to properly manage them. Decision-making on loans or transactions should be objective and not be influenced by conflicts of interest. The arm's length principle safeguards independent and objective decision-making and ensures appropriate conditions for such loans or transactions.

Combating money laundering and terrorist financing is crucial for maintaining stability and integrity in the financial system. Therefore, uncovering any involvement of credit institutions and investment firms in money laundering and terrorist financing can have a detrimental impact on the institution's viability and on trust in the financial system. In this context, these Guidelines clarify that identifying, managing and mitigating money laundering and terrorist financing (ML/TF) risk is part of sound internal governance arrangements and credit institutions' risk management framework.

In line with the requirement to have a gender-neutral remuneration policy, the revised Guidelines provide new guidance on the code of conduct to ensure that credit institutions take all necessary measures to guarantee equal opportunities to staff of both genders and to avoid any form of discrimination.

3.1.4 Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders

The EBA and the ESMA have updated the joint Guidelines on the assessment of the suitability of members of the management body and key function holders. These Guidelines take into account the amendments introduced by the revised CRD V and the Investment Firms Directive (IFD), and their effect on the assessment of the suitability of members of the management body, in particular

[68] Directive 2019/2034/EU.

with regard to ML/TF risks and gender diversity. Both credit institutions and investment firms will be subject to the revised Guidelines which apply from 31 December 2021.

In order to ensure robust governance arrangements, it is of utmost importance that the members of the management body and the key function holders within an institution be suitable for their position. The management body has the overall responsibility for the institution and therefore its collective composition must be appropriate and reflect an adequately broad range of experience. Institutions should take into account the diversity (e.g. gender, age, professional and educational background) in the composition of the management body, as a more diverse management body reduces the phenomena of 'group think' and 'herd behaviour' and facilitates good and balanced decision-making. In particular, a gender-balanced composition of the management body is of particular importance. Institutions should respect the principle of equal opportunities for any gender and take measures to improve a more gender-balanced composition of staff in management positions so as to ensure a more gender-balanced pool of candidates for positions within the management body.

The revised Guidelines also aim to further harmonise the assessment of suitability within the EU banking and securities sector, in particular, with regard to the assessment of suitability in the context of existing ML/TF risks. Where CAs have reasonable grounds to suspect that money laundering or terrorist financing is being or has been committed or attempted, or if there is an increased risk of such actions in connection with an institution, CRD V requires that the suitability assessments take account of those facts. The management body must have a high level of competence and relevant experience in this area to be able to ensure that there are strong controls that ensure compliance with the requirements under the Anti-Money Laundering Directive[69] in light of the additional exposure of the institution, as the anti-money laundering aspect is relevant for the suitability assessment of all members of the management body in all institutions. The guidelines also aim to ensure that tax offences, including those committed through dividend arbitrage schemes, are considered in the assessment.

3.1.5 Guidelines on sound remuneration policies

Following the amendment of Directive 2013/36/EU by Directive 2019/878/EU (CRD V), the EBA updated its guidelines on sound remuneration policies, issued on 21 December 2015. The update also considers further changes to Directive 2013/36/EU that are included in Directive 2019/2034/EU (IFD). This update is in relation to institutions' sound remuneration policies and, in particular, the requirement that remuneration policies should be gender neutral. The final Guidelines, applicable since 31 December 2021, also consider supervisory practices and clarify some aspects of retention bonuses and severance pays.

The remuneration provisions under CRD V, after the implementation of the IFD in June 2021, only apply to institutions that are subject to the CRD, while a new prudential framework has been established for investment firms.

[69] Anti-Money Laundering Directive.

The main amendments introduced by the CRD V in the area of remuneration mainly concern the requirement to have remuneration policies that are gender neutral[70], the introduction of waivers for the application of deferral and pay out in instruments, the possibility of using share linked instruments also in listed companies and the application of the requirement in a group context, in particular, with regard to firms that are subject to a specific remuneration framework. Furthermore, the sections on severance payments and retention bonuses have been clarified, taking into account supervisory experience, in order to ensure a more harmonised application of the requirements.

The final Guidelines also clarify how the remuneration framework applies on a consolidated basis to financial institutions that are subject to a specific remuneration framework (for example, firms subject to the IFD, the Undertakings for Collective Investment in Transferable Securities Directive (UCITS) or the Alternative Investment Fund Managers Directive (AIFMD)).

3.1.6 Report on management and supervision of ESG risks for credit institutions and investment firms

ESG risks are becoming more important in the EU banking sector, as institutions may financially suffer the consequences of such risks drivers. In this context, and addressing the mandate given to the EBA under Article 98(8) of CRD, the EBA published in July 2021 its report on ESG risks management and supervision[71], providing recommendations for both institutions and competent authorities to incorporate ESG risk-related considerations into their assessments.

The objective of this work, which is part of a broader roadmap on sustainable finance[72], is to ensure preparedness for and resilience of the banking sector to ESG risks. The report emphasises the importance for institutions to incorporate ESG risk-related considerations in their strategies, objectives, and governance structures, capturing potential impact in the short, medium, and longer-term. In that context, competent authorities are expected to evaluate progressively and proportionately, the ability of institutions to identify, address and oversee these risks within their strategies, governance arrangements and risk management frameworks. The assessment should over time be expanded to include a long-term view of the financial risks that can arise beyond standards business planning horizons.

Lack of data and methodologies to evaluate the quantitative impact of ESG risks on financial risks remain a key challenge for competent authorities justifying a gradual incorporation of ESG issues into the assessment of risks to capital and ultimately into the assessment of institutions' capital and liquidity adequacy. Such proportionate and progressive incorporation of ESG risks into the SREP should foster supervisory convergence and ensure a level playing field, while the EBA, together with other authorities will continue to assess ESG-related developments and risks in the banking sector to further enhance the applicable supervisory framework.

[70] In line with Article 157 of the Treaty on the Functioning of the European Union (TFEU) which lays down the principle of equal pay for male and female workers for equal work or work of equal value.

[71] EBA publishes its Report on management and supervision of ESG risks for credit institutions and investment firms | European Banking Authority (europa.eu).

[72] EBA Action Plan on Sustainable Finance.

3.1.7 Follow-up of the EBA Opinion on legacy instruments and considerations on ESG capital bonds

In October 2020, the EBA published its Opinion on the prudential treatment of legacy instruments[73]. When reviewing EU institutions' legacy instruments and examining the clauses that led to their grandfathering, the EBA identified two main issues which could create what is known as infection risk, i.e. the risk of other layers of own funds or eligible liabilities instruments being disqualified. The first issue relates to the flexibility of distribution payments principle, while the second involves clauses that might contradict the eligibility criterion of subordination.

In 2021, and as alluded to, at the time of the publication of its guidance, the EBA kicked off the monitoring of actions taken by institutions regarding legacy instruments, placing particular focus on the use of the proposed options across and within jurisdictions with a view to ensuring consistent application. Shortly after the publication of the Opinion, competent authorities intensified the discussions with institutions to identify the legacy instruments that might pose an infection risk and the planned actions to address this risk. Several rounds of surveys collecting input from competent authorities in a coordinated way were organised by the EBA in the course of 2021. In addition, the EBA considered the transposition of specific provisions of Directive 2014/59/EU (BRRD, in particular Article 48(7)) into national legislation, looking at how this might alleviate concerns about the existence of infection risk linked to subordination aspects. Furthermore, when publishing its last updated version of the AT1 report in June 2021, the EBA complemented the initial guidance with additional clarifications following questions received from institutions[74].

Transparency on the implementation of the options envisaged in the Opinion by institutions and competent authorities will be ensured in 2022 by the EBA with the publication of its final observations and overview on the treatment of legacy instruments by institutions across the EU.

In addition, due to the recent market trend to issue own funds or eligible liabilities instruments with ESG features linked to ESG labels, the above-mentioned AT1 report included a chapter dedicated to guidance in the field of ESG capital bonds. The purpose of this guidance is to: i) give an overview on the identified risks; ii) comment on identified differences of clauses; and iii) provide policy observations and guidance on how the clauses used for ESG issuances and the eligibility criteria for own funds and eligible liabilities instruments interact. The aim is to identify best practices or practices/clauses that should be avoided.

Following the publication of the guidance, the EBA continued to monitor the issuance of recent ESG instruments in order to assess the reaction of issuers to the recommendations in 2021. In particular, the EBA assessed their prospectuses and final terms with particular focus on the following topics: no segregation of assets and liabilities; clear description of the status of notes; and no link between performance or use of assets and notes. As a result of this assessment, the EBA's preliminary

[73] EBA issues Opinion to address possible infection risk stemming from legacy instruments | European Banking Authority (europa.eu).

[74] EBA updates on monitoring of Additional Tier 1 instruments and issues recommendations for ESG-linked capital issuances | European Banking Authority (europa.eu).

conclusion is that the recommendations on ESG are being integrated into the documentation of recent issuances (with various degrees of completeness depending on the issuer).

In terms of next steps, the EBA will continue to look at the ESG features (including ESG targets and KPIs) of some new own funds and eligible liability issuances.

3.1.8 Report on incoming third-country branches

In fulfilment of the mandate set out in Article 21(b)(10) CRD, in June 2021 the EBA published a Report addressed to the European Parliament, the Council and the Commission, on the treatment of incoming third-country branches under the national law of Member States[75].

The Report contains a mapping of incoming third-country branches (TCBs) currently established in the EU and illustrates the diversified national legislation and practices across the EU.

The mapping of the TCBs established in the EU shows an increase in their presence and activity in the EU from 31 December 2019 to 31 December 2020[76]. While the Report acknowledged that the situation was still subject to changes due to the post-Brexit reorganisation of TCGs' presence in the EU and the implementation of the IPU framework, the comparison identified a growing trend in the use of branches by TCGs as a form of accessing and operating in the EU market. Against this background, the stocktaking exercise on applicable national laws and practices carried out to develop the Report, brought to the fore varied regulatory and supervisory approaches across the EU, and the consequent divergent treatment of third countries in different MSs.

In light of these findings, the Report underscores the need to lay down a minimum EU harmonisation framework in order to ensure equal treatment of third-country undertakings across the EU and soundness and safety of management. To that end, it puts forward 14 high-level recommendations to address national regulatory differences and prevent arbitrage opportunities. The recommendations also aim to balance the openness of access to the EU market by TCBs and enable the conduct of significant financing business, with the need to preserve financial stability.

For these purposes, they focus on various aspects ranging from market access and international cooperation, AML requirements and supervision, governance ad suitability requirements of branch managers, prudential requirements (capital endowment and liquidity), reporting and transparency obligations, ongoing supervision, and the consideration of a mechanism to require the third-country entity to apply for authorisation as a credit institution when certain quantitative and qualitative conditions are met. This mechanism is envisaged to ensure that CAs are duly empowered to preserve the sound and prudent management, and to prevent TCBs from posing financial stability risks taking into account their volume of business and interconnectedness.

[75] See EBA/REP/2021/20.

[76] Based on data as of 31 December 2020, there are 106 TCBs, established in 17 MSs, holding total assets aggregate amount of EUR 510.23 bn, of which 86% is concentrated in four MSs. Compared to data as of 31 December 2019, this picture represents + 14 TCBs, equal to an increase of 15%; +3 MSs in which TCBs are established; + EUR 120.52 bn in total assets held by TCBs, representing an increase of 30.93%. See EBA Report on Treatment of incoming third-country branches.

Based on the Report, a new framework applicable to TCBs has been introduced by the Commission in the Proposal for the review of Directive 2013/36/EU ('CRD VI review') which relies to a significant extent on the findings and high-level recommendation if the EBA Report.

3.2 Recovery planning

3.2.1 Guidelines on recovery plan indicators

In November 2021 the EBA published its final guidelines on recovery plan indicators[77]. These guidelines have been developed on the basis of the legal mandate included in Article 9(2) of the BRRD in order to provide to institutions and competent authorities in a single set of guidelines the essential elements to be followed when developing the recovery plan indicator framework. The EBA first issued guidelines on recovery plan indicators in 2015 and decided to amend them based on practical experience acquired in recovery planning.

These revised guidelines provide additional guidance on practical aspects such as the calibration of thresholds of recovery indicators to ensure that recovery options are implemented early enough. The guidelines provided institutions with a set of general principles to follow in setting the thresholds of recovery plan indicators, focusing on the treatment of recovery plan indicators in a crisis, in particular in the case of the application of supervisory relief measures. On the latter point, the guidelines clarify that, in a systemic crisis, there should not be automatic recalibration of recovery plan indicators due to supervisory relief measures, unless in duly justified cases and agreed with the competent authority.

The Guidelines also emphasise the importance of constant monitoring of recovery indicators and timely notification of their breaches to supervisors. Lastly, the Guidelines specify the minimum list of categories of recovery plan indicators that should be covered, and they also include a minimum list of recovery indicators. In the revised guidelines the minimum list of indicators includes three new additional recovery indicators (MREL/TLAC, asset encumbrance and liquidity position) to the minimum list of recovery indicators and one of them (cost of wholesale funding) has been removed.

The Guidelines provide a common EU approach for the recovery plan indicators to ensure they can promptly signal a stressed situation and enable the institution to consider timely and effective recovery actions. In this respect, the guidelines ultimately aim to strengthen the quality of recovery indicators framework and contribute to effective crisis preparedness of institutions.

[77] EBA/GL/2021/11.

4. Ongoing and future policy work

The EBA has updated the SREP Guidelines in order to provide additional guidance to supervisors in conducting the common SREP. The updates not only incorporate alignment with CRD V provisions, but also incorporate practical experiences with the implementation of the SREP framework. The EBA has also been committed to fostering a comprehensive Supervisory Risk Taxonomy as a complement to the SREP GLs.

In 2021, the EBA has launched a peer review of the supervision of NPE management in an effort to understand the readiness of the CAs and the institutions most affected by the NPEs, in the context of the COVID-19 economic conjuncture.

4.1 Supervisory review and evaluation process

4.1.1 Update of the SREP GLs

In line with its roadmap for the risk reduction measures package[78], the EBA updated the SREP Guidelines and published the final revised SREP Guidelines[79] on 18 March 2022 in order to reflect regulatory and supervisory developments that took place since their first revision in 2017. In particular this second review carried out in 2021 aims to align the SREP Guidelines with the requirements of Directive (EU) 2019/878 amending Directive 2013/36/EU (CRD) and with the requirements of Regulation (EU) 2019/876 amending Regulation (EU) No 575/2013 (CRR), as well as with other relevant guidelines and technical standards published by the EBA. Furthermore, this review aims to enhance the guidance based on observations from the ongoing monitoring and assessment of convergence of supervisory practices. The changes introduced to the SREP Guidelines do not significantly alter the overall structure of the SREP framework but update and provide additional guidance to strengthen a common set of rules that are fit for purpose for the day-to-day work of supervisors.

The main areas of the SREP Guidelines impacted by the refinement are the following:

- **Proportionality:** the application of proportionality principle in SREP is driven by both the categorisation of institutions and the minimum engagement level, as well as targeted flexibility allowing for adjusted granularity of assessments. The revised framework updates the categorisation criteria, considering both the size and risk profile of institutions. Moreover, the minimum engagement model is revisited, graduating the frequency of assessment depending on the category, while providing simple alternatives for smaller and less-complex institutions. Finally, additional clarification is provided on the application of the proportionality principle in the granularity of assessment.

[78] EBA risk reduction package roadmaps.

[79] Final Report on revised Guidelines on common procedures and methodologies for SREP and supervisory stress testing.

- **AML/CFT**: considering the potential detrimental effect of ML/TF risks on the institutions' financial soundness, the revised framework proposes an integrated approach to consider ML/TF risks from a prudential perspective in the relevant SREP areas and to foster cooperation between AML/CFT and prudential authorities, while avoiding duplications or interference between supervisory measures. Such a framework has been set up to enhance the overall supervisory view on institutions, their viability and risks.

- **Risk of excessive leverage:** in line with the revised CRR / CRD package the risk of excessive leverage is now isolated into a separate stack of own-funds requirements, including the potential P2R and P2G to address this risk. This regulatory change has been reflected in the revised SREP Guidelines, facilitating competent authorities' assessment of the risk of excessive leverage, and providing guidance on the determination of the level and composition of additional own-funds requirements. The guidance aims to foster convergence of supervisory practices and a level playing field between institutions.

- **Determination of P2R:** to align with the revised and extended requirements of the CRD, the revised SREP Guidelines clarify the determination of the quantity and composition of P2R, further emphasising the institution-specific nature of such a requirement. Clarifications are provided on the assessment and supervisory use of the ICAAP, considered as a key supervisory tool, while ensuring an appropriate degree of prudence in setting additional own-funds requirements.

- **Communication of additional own-funds requirements:** in line with the extended CDR requirements, the revised SREP Guidelines enhance the supervisory dialogue by clarifying the minimum scope of information and justification of the results of the SREP to be provided to institutions. Separate communication is expected for the leverage ratio capital layer and the risk-based capital layer.

- **Methodology for setting P2G**: in line with the CRD requirements, the revised SREP Guidelines clarify the setting of the P2G, encompassing both the use of the results of supervisory stress tests and possible adjustments, depending on institution-specific circumstances. While flexibility is granted regarding the P2G methodology for ensuring sufficient proportionality, the revised framework introduces the bucketing approach that supervisors may use to determine the P2G in a consistent manner across institutions. In addition, a separate determination of the P2G for the risk of excessive leverage is expected in line with CRD requirements.

- **Sustainable finance**: in line with the EBA report on ESG risk management and supervision published in July 2021, the EBA decided to implement a progressive approach, starting with the inclusion of ESG risk into the supervisory business model and internal governance analysis. Given the complexity of the area of ESG risks and the need for institutions and supervisors to build up data and tools to develop quantification approaches to increase the scope of the supervisory analysis, more detailed guidance will be provided in further revisions of the SREP Guidelines.

The other areas that have been under review include the assessment of governance and institution-wide controls, and the assessment of risks, including credit risk, operational risk, market risk, IRRBB and CSRBB, as well as liquidity and funding risks.

4.1.2 Supervisory risk taxonomy

When the final EBA SREP GLs were approved by the EBA BoS it was concluded that they should be complemented with a comprehensive Supervisory Risk Taxonomy to ensure the common understanding of risks and their respective categorisation, with the aim of facilitating and strengthening convergence in the identification and assessment of risks, leading to consistency in the applied supervisory measures, in particular, in the determination of additional own-funds requirements.

A significant amount of work has been conducted since the call from the BoS, in particular, a stocktaking exercise of supervisory practices on risk taxonomies and their practical applications and the development of the draft Supervisory Risk Taxonomy that was shared with the supervisory community for testing with two rounds of feedback collections (end 2017 and in 2018). The testing and the feedback collection confirmed that supervisors and risk experts used the Supervisory Risk Taxonomy in a wide array of supervisory activities.

In 2020 the EBA had mapped each risk category of the Supervisory Risk Taxonomy with the corresponding coverage in terms of legal references (CRD V/CRR II) and regulatory references under Pillar 1 and Pillar 2. This deliverable is an important underlying element of the revision of the SREP Guidelines. The SREP Guidelines point out that the observable effect of their adoption should be that institutions with similar risk profiles, business models and geographic exposures are reviewed and assessed by competent authorities consistently; and be subject to broadly consistent supervisory expectations and actions/measures, including institution-specific prudential requirements. The Supervisory Risk Taxonomy aims to enhance and support this process and ultimately improve the quality and consistency of SREP practices and their outcomes.

In 2021, the EBA mapped each risk category of the Supervisory Risk Taxonomy with a list of FINREP/COREP reporting references which takes into account the ITS[80] on reporting as amended to reflect the main changes brought about by the CRR II and the Prudential Backstop Regulation. Data collected under COREP and FINREP reporting may enable quantifying the various risk categories as listed under the Supervisory Risk Taxonomy at the various steps of the SREP process. The EBA Supervisory Risk Taxonomy is now relatively stable, while it remains a living document and will therefore continue to be adapted to legislative and policy developments.

[80] Commission Implementing Regulation (EU) 2021/451 of 17 December 2020 laying down implementing technical standards for the application of Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to supervisory reporting of institutions.

4.2 Ongoing supervision

4.2.1 Peer review on supervision of NPE management

With the concerns of the impact of the COVID-19 pandemic on the quality of banks' credit portfolios and longer-term implications for the level of non-performing exposures (NPE) in the EU financial sector, in 2021, the EBA launched a peer review of the supervision of NPE management by institutions. The review focuses on the assessment of competent authorities' supervisory approach on the management of NPEs by the institutions, including supervisory approaches to incorporating consumer-protection objectives, having regard to implementation by CAs of the EBA Guidelines on management of non-performing and forborne exposures (EBA/GL/2018/06[81]). The peer review will also look into understanding the readiness of the CAs and the institutions most affected by the NPEs for dealing with the increased level of NPEs in the post-COVID-19 economic environment.

Since the topic of NPE management and its supervision is of importance both from prudential and consumer-protection perspectives, and considering that the Guidelines on management of non-performing and forborne exposures also incorporate consumer-protection obligations, the peer review covers both prudential and consumer-protection authorities and looks, *inter alia*, at the interaction between the two authorities (or two functions in the case of the integrated supervisors) when dealing with supervision of NPE management by institutions.

[81] EBA/GL/2018/06.

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5. Training as a convergence tool

In 2021, the EBA's training team delivered 20 training activities to 3 647 representatives from all the European countries. Participants and external speakers alike expressed great interest in the topics offered, which was reflected in the feedback received.

Figure 22. Overview of the Training events the EBA provided to EU Competent Authorities in 2021

No.	Title	Date	Format	Attendees
1	Updated crypto-assets for supervisors	continuous basis	e-learning	339
2	Outsourcing to the cloud	continuous basis	e-learning	86
3	Breach of union law investigation	continuous basis	e-learning	66
4	Introductory training to AML/CFT	15 February 2021	webinar	587
5	EBA workshop on mystery s(*only for SCConFin members NCAs*)	23 March 2021	webinar	60
6	EBA/BIS virtual webinar on sustainable finance in the EU	13 and 15 April 2021	webinar	168
7	EBA workshop on guidelines on remuneration of sales staff	14 April 2021	webinar	38
8	ESE/EBA seminar on current and best practices in recovery plan assessment	29 - 30 April 2021	webinar	65
9	Workshop on AML/CFT colleges	4 – 5 May 2021	webinar	247
10	Supervisory reporting – COREP & FINREP	31 May – 7 June 2021	e-learning	213
11	Loss-absorbing capacity: MREL /TLAC	21 – 30 June 2021	e-learning	144
12	EBA Workshop for banks- improving reporting practices and data reporting	21 – 30 June 2021	webinar	448
13	EBA training on countering the financing of terrorism	6 July 2021	webinar	240
14	EBA mandates under the Investment Firms Directive and Regulation	3 September 2021	webinar	102
15	ESAs' Workshop on digital finance	10 September 2021	webinar	379
16	EBA/SSM workshop on colleges	23 September 2021	webinar	59
17	EBA training on investment firms	4 October 2021	webinar	164
18	EBA/ESE Current and best practices in recovery plan assessment	15 – 16 November 2021	webinar	62
19	Cross-sector training: The use of data and Sup Tech	29 – 30 November 2021	webinar	185
20	Mystery shopping	14 December 2021	webinar	30
Total				**3 647**

Virtual seminars

On 15 February 2021, the EBA held its first external training activity of the year on 'Introduction to AML/CFT'. It was a successful training activity with 587 participants from 37 CAs and public bodies in Europe. The EBA policy experts together with high-profile speakers from the EC, Europol, the Egmont Group, the ECB, the FATF and the ACPR provided participants with a basic understanding of AML/CFT in the financial services sector. The training was very well received by participants, eager to obtain all materials made available on the EBA Learning Hub. An additional AML training, 'Workshop on AML/CFT Colleges', was delivered from 4–5 May 2021 to assist competent authorities to set up colleges in accordance with the EBA guidelines.

A second training on colleges delivered on 23 September 2021 was the 'EBA/SSM workshop on Colleges', solely for the staff of the SSM who are involved in college related work. Pre-requisite material in the form of an e-learning course was made available to the participants to complete before the workshop. The workshop brought together supervisors working with colleges and facilitated an effective way to share supervisory experiences and best practices in implementing the various policy products, thus ultimately promoting a common supervisory culture and converging supervisory practices.

The EBA delivered its first ever training on 'Mystery Shopping' on 23 March 2021 with a follow-up workshop on 14 December 2021. The objective of the training session was achieved through an interactive exercise including workable scenarios. Introducing a case study in the training also helped participants to familiarise themselves with the relevant decisions when designing mystery shopping scenarios for a specific goal.

The annual EBA/BIS training on 'Sustainable Finance in the European Union' held from 13–15 April welcomed 114 participants from 31 institutions and 26 countries. Participants were particularly appreciative of the presentations from the private sector on climate and environmental risks which one participant described as 'very illuminating'. Panel discussions further revolved around risk management and supervision of the climate and environmental risks. Additional joint training activities delivered were EBA/ESE 'Current and best practices in Recovery Plan Assessment' held from 29–30 April 2021 with 103 candidates which was rerun from 15–16 November 2021. The training was limited to 65 participants from 21 countries in order to render the training session more interactive; waitlisted candidates from the April 2021 session were prioritised. This was done by integrating poll questions into the training to further engage the audience. The EBA's e-learning course on 'Recovery Planning' was also made available on the EBA Learning Hub, as an optional pre-training material for participants. There were 27 participants enrolled in the course, of which half completed it. The feedback received was overwhelmingly good.

The EBA's 'Workshop for banks- improving reporting practices and data reporting' held on 29 June 2021 raised significant interest with 448 representatives from 42 countries in attendance. The workshop was opportune in complimenting the cross-sector training on the 'Use of data and Sup Tech' held jointly with EIOPA from 29–30 November 2021. While the training on data reporting focused on the policy aspects of data reporting, the EBA presentations at the training on Sup Tech, concentrated on the use of data and SupTech. Both workshops were positively received, reflected in the high number of questions posed.

The EBA training on Countering the Financing of Terrorism (CFT) was held on 6 July 2021 following the EBA 2021 Opinion of ML/TF risk which identified the common concerns about the financial institutions' CFT systems and controls across almost all sectors. The training attracted 240 participants from 42 countries who gained a complete overview of the key components of CFT and an insightful understanding of the TF risks in the EU including mechanisms to improve the detection and mitigation of TF risk. Participants agreed that the training brought together experts in the field of CFT whose discussions focused on real life examples and strategies which competent authorities can apply in practice. Following the training, the recordings and training materials were made available on the EBA Learning Hub for further training purposes.

The two training activities on 'EBA mandates under the Investment Firms Directive and Regulation' held on 3 September 2021 and 'EBA webinar on Investment Firms Prudential Framework and the EBA mandates' held on 4 October 2021, attracted 102 and 164 participants respectively from over 30 countries. Based on the feedback received, participants agreed that the workshops gave them a good overview of the new regulatory regime in IFD/IFR and hence deeper knowledge of key developments in data management. Further, the interactive manner in which EBA policy experts summarised the most complex requirements and presented them was praised by numerous participants. Suggestions in the Q&A session included requests for more practical examples for each topic for better understanding.

E-learning courses

In 2021, the EBA continued to offer training activities on its training platform accessible for over 700 registered members from competent authorities, EBA staff and other public bodies, demonstrating an all-time high since the platform's set up in 2017. In 2022, the training team expects a further growth, thanks to the delivery of new courses on 'Breach of Union Law (BUL)' and 'Supervisory Reporting in May 2021'.

The e-learning course on 'Supervisory Reporting' from 31 May–7 June 2021 provided the 213 participants from 20 authorities with a good overview of the supervisory reporting requirements for EU credit institutions, focused on the current supervisory reporting package (2.10). Feedback was very positive, in particular participants' comments on the balance of theory and practice achieved through exercises and case studies including the complimentary live sessions which encouraged much interaction between participants and trainers.

On 8 June 2021, the training team launched the online training on 'Breach of Union Law'. The course is a completely self-paced course offered on a continuous basis on the EBA's online training platform. The training focuses on the possible scenarios of a potential Breach of Union Law investigation, from the moment a complaint is filed to its closure.

A fully updated course on 'Loss Absorption Capacity - MREL/TLAC' was delivered to NCAs from 21–30 June 2021.The training activity was fully updated to reflect changes stemming from the new banking package (CRR2/BRRD2). One hundred and seven participants from 33 authorities participated, with more than 80% qualifying for a certificate of completion.

As the EBA's online courses remain in high demand, re-runs of COREP/FINREP and MREL/TLAC courses are scheduled to take place in 2022, to accommodate more participants.

6. The implementation of the Union Strategic Supervisory Priorities and their interaction with the EBA 2021 Convergence Plan

The first cycle of the USSPs is about to conclude with the assessment of supervisory activities and actions conducted under its umbrella. Based on its implementation, the USSPs prove to be a valuable point of entry to allow for discussions on future supervisory developments and long-term trends. From that starting point, the concrete supervisory activities and actions as well as specific points of attention tend to be enacted via the Convergence Plan. The interplay and sequencing of the USSPs and the Convergence Plan[82] may allow for a strategic debate on the supervisory priorities for the next 3-year cycle followed by the refinement and operationalisation of supervisory activities and actions under these priorities.

Going forward, USSPs should help to ensure continuity of discussions in the area of supervisory convergence. Nonetheless, the addition of the USSPs to the supervisory toolkit needs to be further institutionalised and incorporated into existing processes and practices.

6.1 Implementation of the USSPs

The revised EBA Regulation[83] stipulates that according to Article 29 (a) the EBA shall identify, at least every 3 years, by 31 March, up to two USSPs which shall reflect future developments and trends.

The first 3-year cycle of USSPs was launched in the year 2020. For its first 3-year cycle of USSPs, the EBA identified the priorities of 'business model sustainability and adequate governance structures' in light of the COVID-19 pandemic. In a next step, CAs agreed to integrate those priorities into their 2021 work programmes. As such, the USSPs build a first layer of supervisory attention in the Union-wide supervisory convergence work. The high-level USSPs have subsequently been reflected in the key topics which were selected for the 2021 Convergence Plan.

Accordingly, CAs have put in place their own set of supervisory activities and actions which are equally in line with the USSPs and the 2021 Supervisory Convergence Plan. CAs considered the USSPs of business model sustainability and adequate governance as part of their regular

[82] The Supervisory Convergence Plan will become the ESEP in 2022.

[83] OJ L 331 15.12.2010, p. 12.

supervisory activities, namely SREP assessment, thematic analyses, meetings with banks or on-site inspections.

The focus of activities and actions diverged slightly with regard to the risk-based assessment based on the USSPs and the 2021 selected key topics in the Convergence Plan. Some CAs stressed that they had been reworking supervisory scenarios as well as adjusted on-site visits and dialogues as part of looking at the USSP of business model sustainability in the context of COVID-19. As a follow-up to the setting of USSPs, some CAs also highlighted the expansion of their analysis and monitoring in the area of asset quality and credit risk management. They stressed that the context of the pandemic has made this exercise even more relevant. Other specific projects reported under the priority of business model sustainability are, for example, the launch of a new strategic project on the risk management function and additional communication guidance and dedicated thematic reviews.

As a key follow-up to the USSP of adequate governance standards, the CAs reported on the integration of the new regulatory requirements with subsequent evaluation of banks' ability to adjust to new regulation. In addition, some CAs noted their increased level of engagement, additional thematic investigations, as well as closer networking with conduct supervision and on targeted inspections.

Some CAs have complemented their supervisory activities under the USSPs with additional focus on digitalisation, ICT risks and outsourcing. Others have paid increased supervisory attention to the impact of the low-rate environment and profitability. These specifications fall into line with the 2021 selected topics of the Convergence Plan, namely topics number 2 and 3 which are *ICT and security risk, operational resilience* as well as *profitability and business model*. Together, the USSPs and the implementation of the Convergence Plan have been a lever for some CAs to push banks to convey more evidence on long-term sustainability and to push for more proactive strategic planning and decision-making by banks' boards and senior management. The follow-up to those priorities took often place as part of the SREP exercise.

With the end of the first cycle of USSPs approaching, most CAs reported on the full or high degree of completion of supervisory actions and activities falling under the USSPs. Any delays have been mainly due to operational disruptions caused by the pandemic and the accompanying sanitary measures. CAs also reported on diverse, but constant monitoring of the completion of those activities and actions in-house. For some, the USSPs have been incorporated into existing review processes, while other USSPs are being monitored in parallel to any dedicated review of the national supervisory strategy.

Despite the completion of most CAs' planned actions and activities under the USSPs, most CAs emphasised that those priorities continue to remain points of high attention beyond the first cycle of USSPs. Some CAs had already proactively incorporated those priorities in a multi-year plan for supervisory attention.

Best practices and lessons learnt from the first cycle

The USSPs are a new part of the supervisory convergence toolkit. The conclusion of the first cycle of USSPs provides lessons learnt, best practices and take-aways for the next cycle, which would be launched in 2023.

First, the USSPs proved a valuable entry point to a discussion on future supervisory convergence developments and trends. As a relatively new addition, the USSPs have been implemented alongside the longer-established work streams of the CAs and the EBA in the area of supervisory convergence. The first cycle of USSPs was carried out as an additional strategic layer to the supervisory convergence discussions, which was then complemented by the EBA 2021 Convergence Plan. The latter offers refinement of those USSPs in terms of supervisory activities and actions. CAs' feedback on this implementation was positive as it offers room for strategic discussion on supervisory convergence as well as enough flexibility to accommodate for specificities in the national implementation. Feedback conveyed that closer monitoring should not happen at the level of USSPs themselves, but rather as part of the well-established supervisory convergence work streams.

Going forward, the USSPs will be further incorporated into the existing supervisory convergence work streams. This may make it possible to better institutionalise and operationalise planning and reporting, while avoiding any duplication. Additionally, links and synergies may be explored with the supervisory priorities in the context of CAs thematic work.

Second, CAs underlined the need for continuity from one USSP cycle to the next. There is consensus that business model sustainability, as well as adequate governance, will remain of heightened supervisory attention beyond the first3-year cycle. In that regard, some CAs informed that they already proactively decided to uphold these priorities for supervisory activity in 2022. When launching the second USSP cycle, this request for continuity is to be considered.

Finally, while business model sustainability and adequate governance are pertinent trends to be followed through in the upcoming USSP cycle, some CAs also underlined that some further nuances to the USSPs would merit consideration. In particular, CAs highlighted the growing importance of the sustainable and digital transformation and their impact on strategy, transformation and profitability. Other proposals related to the topics of cyber security, ICT risks and data quality as well as exposures towards COVID-19 vulnerable sectors and prevention of unmitigated risks in the area of leveraged finance. While most of these elements are incorporated into the EBA's 2022 ESEP, whether to incorporate this emphasis more explicitly into the next set of USSPs would represent the valid starting point for the next USSP cycle.

Annex: 2022 list of supervisory colleges established in the EEA

EEA home country	Name of EEA cross-border banking group
AT	Addiko Bank
AT	Bausparkasse Wüstenrot
AT	Erste Group
AT	Porsche Bank Group
AT	Raiffeisen Bank International AG
BE	KBC
BE	FinAx Group
CZ	J&T Finance Group
DE	Deutsche Bank
DE	Clearstream Financial Holding Group
DE	Commerzbank AG
DE	DZ Bank AG Deutsche Zentral-Genossenschaftsbank
DE	ProCredit Group
DK	Danske Bank
DK	Saxo Bank A/S
EL	Alpha Bank, S.A.
ES	BBVA
ES	Grupo Santander
ES	Banco de Sabadell, S.A.
FI	Nordea

EEA home country	Name of EEA cross-border banking group
FR	BNP Paribas
FR	Société Générale
FR	Crédit Agricole S.A.
FR	ODDO ET CIE
FR	RCI Banque SA
FR	Dexia Group
HU	OTP Bank Nyrt
IE	Allied Irish Banks plc
IE	Bank of Ireland Group plc
IT	UniCredit Group
IT	Intesa Sanpaolo SPA
LI	Liechtensteinische Landesbank Group
LI	VPB Group
LU	Havilland S.A.
LU	Precision Capital S.A.
LU	Quilvest Wealth Management S.A.
NL	ING Groep N.V.
NO	DNB ASA Group
PT	Banco Comercial Português, SA
SE	Skandinaviska Enskilda Banken (SEB)
SE	Handelsbanken
SE	Swedbank
SI	Nova Ljubljanska Banka (NLB)
43	**Total number of colleges for EEA banking groups**

Name of third-country banking groups with supervisory college established in the EEA
Citibank
EFG Bank
2 colleges for third-country banking groups

EUROPEAN BANKING AUTHORITY

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