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Board of Supervisors

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27 October 2021

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premises/teleconference

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# Board of Supervisors 27 October 2021 – Minutes

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## Agenda item 1: Welcome, approval of the agenda and Declaration of conflict of interest

1. The Chairperson welcomed the Members of the Board of Supervisors (BoS) to the first hybrid BoS meeting. He reminded the Members of the conflict of policy requirements and asked them whether any of them considered themselves as being in a conflict. No Member declared a conflict of interest.
2. The Chairperson informed about BoS membership changes and welcomed a new BoS Voting Member representing Lithuania - Mr Simonas Krepsta and his Alternate Ms Renata Bagdoniene.
3. The Chairperson asked the BoS whether there were any comments on the draft agenda. There were no comments on the agenda.
4. Finally, the Chairperson thanked the BoS for comments on the 16 September BoS Minutes submitted in written and ask if there were any further comments. No BoS Members raised any comments.

### Conclusion

5. The BoS approved the agenda of the meeting.
6. The BoS approved the Minutes of the 16 September 2021 BoS meeting.

## Agenda item 2: Update from the EBA Chairperson

7. The Chairperson updated the Members on three points. As a first point, he summarised the ECON hearing that took place on 14 October 2021 during which he presented the work of the Joint Committee and of the EBA during the last 12 months. The Chairperson noted that as part of the exchange of views, the questions put forward to the EBA related to the follow up to
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COVID-19 pandemic and impact on the banking sector; ESG and climate issues; digital finance, including on relation between banks and blockchain and on Brexit. He noted that the MEPs did not questioned organisational and finance-related topics.

8. As a second point, the Chairperson informed the Members that recently, the EBA received two calls for advice from the European Commission (EC). First one related to the Payment Services Directive (PSD2) and the published Retail Payment Strategy, for the aim to provide support to the EC in its revision of the PSD2, with the proposal for a PSD3 likely to be published at the end of 2022, or early 2023. The call for advice asked the EBA to help with the review and contained more than 30 questions on nearly all aspects of PSD2. The EBA was planning to start working on its response in December, with a view to submit a response by the deadline envisaged by the EC, which was 30 June 2022. Throughout that period, the EBA would also approach the BSG to provide updates and invite comments on the EBA's emerging views. The second call for advice was on the securitization framework. The advice was requested to the JC, although it was especially relevant for EIOPA and EBA, as it dealt with respectively the regulatory treatment of respectively Solvency II and CRR. The deadline for the response is on 01 September 2022.
9. Finally, the Chairperson informed the BoS that at its last meeting in September, the Management Board (MB) discussed lessons learnt from the cyber incident that affected the EBA earlier this year. This type of incident required full shut down of all email systems and the MB discussed alternative communication channels which could be used in similar situations. The EBA proposed to use Signal-based app with pre-defined groups, such as the BoS and MB. The MB Members were supportive of this initiative. The EBA keeps the List of contact details of EBA voting members, high-level alternates, observers, and other persons to contact in case of crisis. This List included, among other details, mobile phone numbers of the BoS/MB Members and Alternates and other persons, and was regularly updated. The mobile phone numbers were necessary for Signal, as an alternative communication channel, to allow the EBA to establish a group to which the EBA as an administrator could send relevant information. Therefore, the EBA was planning to approach the BoS to update all relevant details in the List for crisis situations in the coming weeks. As soon as the EBA collected all mobile phone numbers, the BoS Members would be asked to install Signal on their mobile phones to receive messages.

### Agenda item 3: Election of MB Members

10. The Chairperson informed the Members that on 01 October 2021, Ms. Martina Drvar stepped down from her MB as well as BoS positions. Furthermore, on 15 October 2021, the first term of Mr. Maarten Gelderman and the second term of Mr. Jesper Berg expired. Therefore, there were three vacant positions in the Management Board and the EBA sent a call for expression of interest on 01 October (open to BoS female members) and 12 October 2021 (opened to all BoS members) by means of written procedure. The Chairperson noted that Maarten expressed his interest to extend his term and by the end of the deadline, the EBA received an expression of interest from two candidates, Raimund Roeseler and Kamil Liberadzki. He concluded by

acknowledging the requirement set in the EBA Regulation related to MB Members representing non-participating countries and that at the moment, there was only one MB Member from a non-participating country.

11. The Members did not raise any concerns and approved all three candidates by consensus.

### Conclusion

12. The BoS approved Mr Maarten Gelderman, Mr Raimund Roeseler and Mr Kamil Liberadzki as MB Members as of 27 October 2021 by consensus.

### Agenda item 4: Risks and vulnerabilities in the EU

13. The Director of Economic and Risk Analysis Department (ERA) presented the analysis of current risks and vulnerabilities in the EU banking sector with a focus on the topics identified as important during the last BoS meeting in September - real estate exposures, asset valuation and cyber risks. He informed that banks have initiated the Q3 2021 reporting and although only a few banks have reported their earnings, the preliminary results showed a presumably increasing trend for earnings as well as capital stability. On asset quality, the reported results showed a stable trend, without any material deterioration. With regard to the real estate exposures, the Director of ERA noted that residential and commercial real estate markets had different dynamics and considerations that needed to be taken into account in any analysis. Housing markets have been boosted by low interest rates, increasing savings due to lower consumption which have enabled borrowers to support down-payments for loans as well as lack of alternative investments, such as very low deposit rates/yields and risk premia. Additionally, the pandemic related need to spend more time at home have increased the demand for larger dwellings. On the supply side factors such as lack of investments in housing during the previous years and the increased cost of building materials have also contributed to the increase in housing prices. Commercial real estate markets however seem more problematic at the current juncture. Exposures of EU banks towards this segment was however lower than to housing (around EUR 1,3tn). In addition, commercial real estate segment experienced a more structural change driven by changes in workers and consumers' habits or behaviours (more teleworking, less leisure and travelling). The Director of ERA continued on the second topic - financial assets valuation and whether this formed a considerable risk for EU banks. He said that there were signs of overvaluation in some financial markets, increasing volatility driven by supply concerns and that sovereign spreads remained broadly stable despite the notable fiscal policy stimulus provided to counterbalance the negative impact of the pandemic. ESG funding has enjoyed increasing both demand and supply. Overall, there were no clear signs of overvaluations for either corporate or bank bonds. Finally, he focused on cyber risk where it was pointed out that the number of cyber incidents have been increasing. This suggested that banks were clearly more vulnerable to potential cyber-attacks than before. As a result, operational risks for EU banks have been increasing. He concluded by stressing the importance of banks having in place effective practices and governance control

frameworks to reduce cyber risk. This includes aligning with accepted industry standards and best practices, including frameworks to test the efficacy of cyber defenses.

14. A presentation by the Estonian BoS Member followed. He focused on digital services, cyber risks and cyber-attacks. He stressed that until now, cyber incidents were of limited impact but with increased sophistication of attackers, the main danger were incidents with long lasting business interruptions. He also summarised national approaches to cyber security and highlighted that cyber risk was more than a finance sector supervision issue, i.e., it was a matter of the national security.
15. The Members updated on their national developments. On cyber and ICT issues, many Members said that they had increased the number of staff dealing with these topics in the past years due to raising importance of these issues. Several Members suggested conducting a stress test to identify challenges in case of extensive cyber-attacks, in particular in relation to payments and information exchange. One Member mentioned that at the national level, they were considering setting up a network to exchange information given that this topic was relevant not only for the supervisory community but for wider audience. In this regard, one Member stressed that involvement of a larger and new set of stakeholders from both the private and public sector is an additional challenge that should be considered in preparation for bigger and more damaging cyber incidents.
16. With regard to the residential real estate, some Members noted that household debts were high, the market was vulnerable and that despite various special regulatory tightening measures implemented over the last decade, the house prices and debts had continued to grow. A number of Members confirmed increases in property prices but did not consider them as concerning and some said that the increase has recently slowed down. A few Members noted that lending standards were tightened during the COVID-19 pandemic and that in some cases, these were gradually being loosened now which indicated a return to more normal market conditions.
17. For commercial real estate, one Member noted that national data remained insufficient to support in-depth analysis of the factors underlying developments in this market. Other Members informed that macro- and microprudential requirements adopted in the past years helped during the pandemic but also suggested that there might still be room for more macroprudential measures if needed.
18. The ESRB representative reflected on the risks building on the residential real estate markets and informed that the ESRB has been conducting an EEA-wide analysis of residential real estate market to be presented during the General Board meeting on 02 December and of commercial real estate market to be ready by June 2022. Furthermore, the ESRB has prepared a report and a recommendation on cyber issues which were planned to be presented on 02 December as well together with a recommendation on money market funds.

19. The ECB SSM representative reminded the BoS that the ECB was collecting information about all cyber-attacks affecting significant institutions as part of its cyber incident database and that the ECB was planning to focus on growing digitalisation and exposure to the 3<sup>rd</sup> party provides in 2022. He also confirmed significant that they were increasingly focused on the residential real estate market.
20. The Chairperson concluded by noting that there were mixed views on how residential and commercial real estate markets were developing and that in some countries, the increase in prices become a concern for the supervisors. He also highlighted a need for collaboration with other players at the EU level in the area of the cyber security.

## Agenda item 5: EU-wide stress test

21. The Chairperson introduced the item by reminding the Members of the BoS discussion in April on the potential move to a hybrid approach for the EU-wide stress test, focusing on the changes to the framework that could be incorporated in the 2023 exercise, potentially serving as a first step for further enhancements in future stress tests.
22. The Director of ERA summarised the progress on the analysis of the availability, initial validation and further development of top-down models which could be used in the next stress test exercises. He noted that in line with the direction given by the BoS the Stress Test Task Force (STTF) had focused mainly on net interest income (NII) and net fee and commission income (NFCI) as areas where top-down models could be deployed. He pointed out that the task force had also considered the use of top-down credit risk models for non-material portfolios. Here however the recommendation to the BoS was to target the possible introduction of top-down credit risk models for the 2025 stress test. This recommendation reflects the conclusion by the STTF that the costs would outweigh the benefits for the 2023 stress test.
23. The Director also recalled that the revision of the existing stress test framework was triggered by a perceived need to increase the efficiency of the exercise but also to increase the realism of the stress test (for example, relaxing some of the methodological constraints), while still retaining its relevance and comparability. Increased reliance on top-down models combined with adjustments of methodologies should in principle help.
24. The Director of ERA then turned to the task force discussions on the governance surrounding the top-down models to potentially be used in the EU-wide stress test under a hybrid approach. The focus of this discussion in the task force had centered around the need for i) full transparency on data, model design, methodology, development, and implementation, ii) thorough validation of data and models and iii) Independence and mutualisation of deployed models. Particular reference was made to the level of transparency vis-à-vis workstream members should the hybrid approach be based on ECB developed models for NII and NFCI.

25. The BoS supported the work and agreed that the focus should be in introducing top-down models for net interest income (NII) and net fee and commission income (NFCI). Members also agreed to postpone the introduction of top-down credit risk models for immaterial exposures beyond the 2023 exercise. Several Members however indicated that in the longer-run they would welcome the broader introduction of top-down models for credit risk as well. Some Members raised concerns related to timelines and questioned whether it would be possible to introduce to-down models for the 2023 stress test. Several Members while supported exploring the use of top-down models expressed the need of these models to capture geographic and business model differences. A few Members questioned the benefits of introducing top-down models and expressed a clear preference for a continued bottom-up approach. Some Members also noted that an alternative could be to rely on benchmark models done at the national level given that there were differences mainly between Banking Union and Non-banking Union countries. One Member highlighted the importance of the information received from banks when discussing the stress test exercise.
26. The ECB Banking supervision representative supported the work pointing to the objective of increasing realism of the stress test. In this regard, he noted that his view is that the EBA should start working on top-down credit risk models to be prepared for the 2025 exercise. He also noted that this work would require additional resources. Regarding governance, he had preference for avoiding duplication of resources between the EBA workstream on Top-down models (WSTDM) and the FSC Working Group on Stress Test (WGST) hosted at the ECB.
27. On the governance of top-down models, several Members emphasized that a precondition for the top-down approach to work was the EBA ownership of the models and the importance of transparency in the design and validation of the models that should take place under the leadership of the EBA as, ultimately, the BoS would have to endorse the application of these models for the purpose of the stress test.
28. Members referred to the need to have good collaboration among all parties and indicated a willingness to build on the ECB models for the EU-wide stress test with a proper sharing of information (i.e. model documentation, data and codes). It was also clearly indicated by some Members during the discussion that without sufficient transparency and robust validation, they would prefer continuing with the current bottom-up approach. Several Members mentioned that they would need to explain the final outcomes when they discuss the stress test results with the banks in their jurisdictions – which required that they have sufficient information on the models to sustain this dialogue. According to some Members, the EBA should not only rely on the ECB, but also strengthen its own modelling capacities over the medium-term.
29. The Chairperson concluded that the BoS broadly supported efforts to introduce top-down models for NII and NFCI. He noted however that it was clear that the BoS has mixed views on the level of ambition and as to how top-down models would be developed further going forward. To this end, a long-term plan needed to be developed by the STTF in due course. On governance, the Chairperson noted that there was broad agreement that the BoS had to

approve any top-down models used for the stress test and that transparency was crucial in this regard. Finally, he said that at the next BoS in December 2021, the STTF should present a detailed proposal on the governance structure.

## Agenda item 6: Status of implementation of the ECA AML report recommendations

30. The Chairperson introduced the item by briefly summarising that in June 2020, the European Court of Auditors (ECA) issued a report on how the EC, EEAS, ECB and EBA have carried out our respective tasks relating to AML/CFT. The report contained a number of recommendations for the EBA to follow-up on with deadlines of the end of 2021 and Q1 2022.
31. The Head of LC summarised that the report made five recommendations. Three concerned adoption of guidelines, where ECA's deadlines were aligned with the EBA's planned timelines for consultation periods and BoS adoption. The EBA was progressing the implementation of these recommendations without any delays to the timelines. The recommendation regarding avoiding undue delays in decision making in breach of Union law (BUL) cases was largely to be delivered in practice, but the existing internal SLA for responding to BUL requests could be upgraded to include it within the BUL rules of procedure. However, there was a final recommendation which expected the EBA to "put in place rules to prevent other BoS members from seeking to influence panel members during their deliberations". The Head of LC explained that the proposal was to take a broad approach to implementing the recommendation in order to secure the independence of members of the panels, BoS and other committees that contribute to BUL decision-making. He concluded by noting that during its meeting on 28 September 2021 the MB supported the approach proposed.
32. The majority of the Members supported the approach as proposed by the EBA. Several Members questioned whether panel members, regardless whether it was for BUL or mediation, could exchange views on the issue with experts from their organisation and noted that in many cases, the experts could bring necessary knowledge. One Member suggested to discuss with the other ESAs as this topic was relevant for them as well. Some Members were of the view that, in addition to the general prohibition on influencing the panel, in order to directly address the ECA's recommendation the proposed rules could also include specific provision to avoid influence from BoS members on the panel members. One Member stressed the importance of the right to be heard for authorities under investigation and the possibility that members of the BUL-panel or the EBA could also be subject to external pressure, including political pressure as shown by statements on the recent BUL case, in order to draw certain conclusions from their investigation. Another Member considered that the BoS did not discuss proposed policy options enough in the past before proposing the changes. She said that the ECA might not consider the proposals as relevant as expected and queried whether provision also needed to be made for earlier phases of the mediation process. In this regard, one Member said that the amended wording on deadlines for assessing cases could be redrafted. Another member noted that investigations under Article 22 of the EBA's founding regulation

also required panels, and that it would be prudent to establish rules of procedure for such investigations.

33. One Member highlighted that changes to the EBA procedures were crucial to avoid any political pressure on the EBA. Another Member queried whether the changes would provide enough time to give effect to the “right to be heard” principle, as this was an issue in past cases.
34. The EC representative supported the work and noted that all the issues in the ECA recommendations were important for MEPs and with proposed changes, the EBA processes would become more robust and the EBA’s position would be stronger. He also noted that the right to be heard was well preserved in the Rules of Procedure.
35. In his response, the Head of LC said that part of idea of having a more flexible composition since the ESAs Review changes made in January 2020, was that the panel had relevant expertise and therefore, the main discussions should take place there rather than relying on additional experts, also in order to maintain confidentiality of the process. However, the Rules of Procedures were not banning consultations with domestic experts and the EBA would consider further clarification in the drafting in this regard although the expectation should be that this is used carefully. He clarified that in case of mediation, the panel was to be set up only if no solution was found between the parties during the initial conciliation facilitated by EBA staff, and that the proposed changes to the Rules of Procedure only applied when the panel was set up. He also mentioned that the EBA liaised with the other ESAs regarding the proposed changes. On the deadlines for assessing requests for investigations, he explained that the drafting was designed to allow some flexibility. Finally, in relation to Article 22 investigations, the Head of LC agreed that establishing rules of procedure would be useful, noting that EIOPA had done this, and EBA staff would consider bringing forward proposals at a later stage.
36. The Chairperson concluded by noting the broad support by the BoS and asked the Members to send their written comments until 2 November. The final draft of the Rules of Procedures would be sent to the BoS for approval in written procedure.

## Conclusion

37. The BoS supported the amendments of the BUL and mediation Rules of Procedures.

## Agenda item 7: Consultation papers on SREP Guidelines under IFD and RTS on Pillar 2 adds-on IFD

38. The Chairperson introduced the item by clarifying that the two tabled consultation papers were closely interrelated and that while the draft guidelines set out the procedures and methodologies for SREP, the draft RTS further clarified the measurement of risks, based on their SREP assessment.



39. The EBA Head of Supervisory Review, Recovery and Resolution (SRRR) continued by explaining that the guidelines have been developed jointly with ESMA and that they specified common procedures and methodologies for the supervisory review and evaluation process and the assessment of the treatment of risks. They introduced requirements appropriate to the size, the structure and internal organisation of investment firms and the nature, scope, and complexity of their activities. The draft RTS have been developed in consultation with ESMA and they specified how the risks and elements of risks were to be measured, including those that are explicitly excluded from Pillar 1. They included indicative qualitative metrics for the amounts of additional own funds considering the range of different business models, legal forms, and proportionality. The Head of SRRR summarised the main assumptions of the SREP guidelines – consistency with existing SREP guidelines for credit institutions and the principle of proportionality, and the list of indicative qualitative metrics under the RTS. He concluded by mentioning that the deadline for the publication of the final SREP guidelines and RTS was June 2022.
40. The BoS supported the work. Two Members welcomed the extra proportionality and flexibility for category 3 investment firms proposed in the consultation papers. They also suggested expressing the P2G requirement in percentage of Pillar 1 requirements rather than an absolute amount. One Member was concerned that the requirements were still demanding for category 3 firms and questioned the adequacy of prudential regime for firms that do not hold customer's money. This Member also proposed allowing flexibility for CAs regarding requirements for small companies. Another Member pointed out potential difficulties in setting P2R and P2G for investment firms and noticed that the feedback from consultations would be important.
41. The Head of SRRR responded that a question could be added to the consultation paper to reflect the proposal by the BoS Members to reflect P2G as a percentage of Pillar 1 requirements.
42. The Chairperson concluded by noting the Members' support for the publication and said that the question on the P2G would be added.

### Conclusion

43. The BoS supported the publication of the consultation paper on SREP guidelines under IFD and the consultation paper on the draft RTS on Pillar 2 add-ons under IFD for the three months consultation period.

### Agenda item 8: EBA 2022 European Supervisory examination Programme (ESEP)

44. The Chairperson reminded the BoS of the EBA's mandate to contribute to enhancing supervisory convergence and to build a common supervisory culture and consistent supervisory practices throughout the Union. With this purpose, the EBA has developed the

2022 European Supervisory Examination Programme (ESEP) with material contributions from CAs that put forward priority areas for supervisory attention for 2022 and aimed at shaping CAs supervisory practices concerning the selected topics.

45. The Head of SRRR clarified that the ESEP replaced convergence plans from previous years. He summarised the key topics and focus areas for 2022 – impact of the COVID-19 pandemic on asset quality and adequate provisioning; ICT security risk and ICT outsourcing risk, risk data aggregation; digital transformation and FinTech players; ESG risk, and AML/CFT. He also mentioned that the CAs were expected to consider these key topics when developing their 2022 priorities and embed them in their supervisory examination programme (SEP) and reflect them in supervisory activities for the credit institutions that they supervised throughout the year. Furthermore, the colleges of supervisors should implement these key items through the sharing and discussing of relevant supervisory assessments and outcomes. He concluded by outlining next steps which included development of objective elements/attention points for each topic by the EBA relevant working group in November 2021; implementation of the key topics by the CAs throughout 2022 and the assessment of approaches applied by the CAs by the EBA at the end of 2022.
46. The BoS supported the work. Some Members proposed introducing a caveat in relation to proportionality to allow the CAs some flexibility on implementing the key topics, in particular related to the ESG risks for small firms. Other Member suggested to merge ICT and digital key topic and add a topic on market risk. In this regard, one Member raised concerns on the increased number of the key topics compared to previous years. One Member questioned how the EBA would assess the compliance with the ESEP and how the CAs implemented the key topics.
47. The SRB representative appreciated the key topics and noted that some flexibility was introduced also in the European Resolution Examination Programme.
48. The Head of SRRR clarified that the language used in the ESEP provided already some flexibility for the CAs to address specificities and implement proportionality and also made reference to the future involvement of technical subgroup in shaping the way the monitoring of the implementation of the ESEP would happen.
49. The Chairperson also considered that the language used in the ESEP was already able to ensure the needed proportionality and concluded by noting the support of the BoS. He agreed that the number of topics should not inflate over time.

## Conclusion

50. The BoS approved the 2022 European Supervisory Examination Programme and supported the envisaged next steps.

## Agenda item 9: Opinion on treatment of client funds under DGSD

51. The Chairperson introduced the item by mentioning that the tabled Opinion stemmed from EBA's previous work on the review of the implementation of the DGSD across the EU, and a subsequent EC's Call for Advice (CfA) on Digital Finance. More specifically, that CfA included a request to provide further advice on the treatment of client funds from a deposit protection perspective.
52. The EBA Head of Conduct, Payments and Consumers (COPAC) reminded the BoS that the CfA asked the EBA to provide interim results to the EC by the end of July, which following BoS' agreement, the EBA delivered on time. The CfA then asked for policy recommendations by the end of October, in consultation with ESMA in relation to the treatment of client funds deposited by investment firms. Based on the interim findings, the EBA and its taskforce on deposit guarantee schemes developed five recommendations addressed to the EC which the Head of COPAC briefly summarised.
53. The BoS supported the work. One Member suggested developing additional technical specifications related to recommendation 5 which aimed at ensuring that those client funds deposited with credit institutions (CIs) were taken into account when calculating contributions to DGS funds. Two Members were of the view that the data collected in support of the EBA's work, in particular on micropayments, was not robust enough to make policy recommendations and therefore, the EBA should ask, as part of its response to the EC, for a mandate to further collect relevant data. Finally, one Member noted a minor technical inconsistency related to their national feedback they had provided.
54. In his response to the last comment, the Head of COPAC thanked the Member for the specific inconsistency identified and confirmed that it would be corrected before the submission of the Opinion to the EC. In response to the first comment, he confirmed that the EBA would further elaborate on some technical specifications in the separate EBA Guidelines on contributions to DGSs, which the EBA has started to review and would be revising in the first half of 2022. Finally, in response to the comment about the robustness of the data, he confirmed that, for the purpose of the Opinion, the data quality was sufficient and mentioned the recommendation acknowledged that additional data analysis would be required before actual requirements could be articulated.
55. The Chairperson concluded by noting the comments and the BoS' broad support for the work and asked for the aforementioned inconsistency rectified before publication and submission.

## Conclusion

56. The BoS agreed with the submission of the Opinion on the treatment of client funds under DGSD to the EC.

## Agenda item 10: IFRS 9 monitoring report

57. The Chairperson reminded the BoS that the EBA has been continuing to scrutinise the effective implementation of IFRS 9 in the EU, focusing, in particular on the COVID-19 implications on

IFRS 9 ECL models. In this context, the tabled report summarised the findings arising from the EBA's investigations since the publication of its last report in December 2018.

58. The EBA Head of Liquidity, Leverage, Loss Absorbency and Capital Unit (LILLAC) presented the main takeaways from the report. She said that banks have made significant efforts to implement and adapt their systems to the IFRS 9 requirements. However, the high level of judgment embedded in the standard left a wide variety of practices open at this stage. On the other hand, no single practice turned out to be a strong driver of the ultimate levels of provisioning. Nevertheless, the limited experience and history to date, as well as the rapid modelling adjustments introduced during the pandemic reinforced the need for close monitoring and investigations from regulators and supervisors. The Head of LILLAC also said that final observations confirmed the preliminary ones presented to the BoS in February 2021, in particular that the limited use of a SICR collective assessment remained an area of attention for supervisors, given its potential impact on Stage 2 transfers; the COVID-19 pushed IFRS 9 models outside their boundaries, thereby increasing the use of overlays, and the IFRS 9 12M PD estimates and variability generally increased during the pandemic, as a result of the incorporation of forward-looking information and the more point in time nature of the IFRS 9 estimates, while the IRB PDs remained comparatively relatively stable. Furthermore, there was a need for supervisors to further investigate the approaches used for incorporating forward-looking information. She informed that the EBA observed some discrepancies in the classification and measurement/de-recognition of financial assets that would deserve further attention. Finally, she mentioned that only one third of institutions made use of the IFRS 9 transitional arrangements as of December 2020. The Head of LILLAC concluded by noting the next steps, in particular the integration of HDP in the ITS on supervisory benchmarking and current development of analytical tool to help supervisors in using the ITS data for supervisory benchmarking (same as for credit risk).
59. The BoS supported the publication of the report. Several Members stressed the importance and value of the report as well as the envisaged next steps. One Member was of the view that the EBA should continue having an open dialogue with auditors who were looking for guidance in the area of IFRS9.
60. The EC representative appreciated the work on the report and questioned whether, as a result, the EBA was considering reviewing 2017 Guidelines on accounting for ECL.
61. The Head of LILLAC informed that the EBA has been developing a communication programme around the report which included roundtables as well as bilateral meetings with auditors. During these meetings, the EBA was planning to point out some of the issues that the auditors should focus their investigations on. On the Guidelines on ECL, she mentioned that such revision was not identified as necessary or urgent as this stage.
62. The Chairperson concluded by noting a broad support by the BoS as well as very didactic aspects of the report which he appreciated.

## Conclusion

63. The BoS supported the publication of the IFRS9 monitoring report.

## Agenda item 11: Consultation paper on draft RTS on IMMV

64. The Chairperson introduced the item by referring to the EMIR amendments from 2019 based on which the EBA had a mandate to complement the RTS, jointly developed by the ESAs, concerning the exchange of margins for non-centrally cleared OTC derivatives.
65. The EBA Head of Risk-based Metrics (RBM) Unit clarified that these RTS were meant to complement the ESAs' RTS on uncleared OTC derivatives which established that counterparties, within the scope of EMIR, must exchange Initial Margins (IM) when they enter into an OTC derivatives transaction not cleared by a CCP. In accordance with the ESAs RTS on uncleared OTC derivatives, the exchange of IM can be based on the Standardised Grid or IM model. He summarized the main aspects of the RTS and said that the RTS were addressing the fact that there was variety of subjects that needed validation of their model and their different capacities to sustain a validation process; the model applied so far, without validation, is an industry-wide model (i.e., not bank-specific) for the computation of IM (SIMM Model). The Head of RBM also said that the RTS addressed the diversity in the counterparties pragmatically by developing a proportionate approach and that the proposal in the consultation paper contained two distinctive processes: a standard and a simplified one. The criteria to discriminate the subjects rely mainly on a quantitative assessment. Most significant institutions would be identified by the volumes of their OTC derivative activity and would have to follow a standardised process of validation of the IM model. The rest of the institutions shall go through a simplified form of validation. He concluded by mentioning a transitional phase of two years after the application of the RTS for counterparties already applying the model before the application of these RTS. Hence, by the time the RTS would apply, the use of any existing IM models should be allowed to continue for a limited period, and sufficient time would be provided to the CAs to complete the first wave of the validation processes. In addition to the two-year temporary provision for models already in use, the RTS provided a phase-in of a one-year delayed implementation for counterparties in the scope of the Standardised Validation procedure, and two to three years (depending on the AANA of OTC derivatives exchanged – Euro 50bn threshold) for counterparties in the remit of the Simplified validation procedure.
66. The BoS supported the work. One Member suggested amending the wording on page 48 of the consultation paper with regard to the collection of initial margins and disruptions of industry practice on this matter.
67. The ECB Banking supervision representative suggested prolonging the timelines for major banks and having two years phase-in delay in the application of the rule.
68. In his response, the Head of RBM said that the wording on page 48 could be amended and clarified that the wording on the transitional phase (two years of transition) apply to all

subjects in scope, and that the phase-in length would be object of specific question in the consultation paper and could be rediscussed after the publication.

69. The Chairperson concluded by noting the BoS' support with the publication of the consultation paper, subject to the changes agreed during the meeting].

## Conclusion

70. The BoS supported the publication of the Consultation paper on draft RTS on IMMV.

## Agenda item 12: Discussion paper on machine learning for IRB models

71. The Chairperson introduced the item by stressing that the increased use of machine learning techniques in banks has been accompanied by a limited use in the IRB space. In addition, there were also supervisory concerns which needed to be considered.
72. The Head of RBM summarised that the machine learning models could be very useful to improve predictive power and were not new to internal models used for credit approval process. However, they have not been incorporated in banks' IRB models as rapidly as in other areas and the reasons for this have been less explored so far. One explanation could be that it has been seen as prohibitively difficult to fulfil the regulatory requirements requesting regulatory models to be intuitive, plausible, and based on economic theory. Therefore, the tabled discussion paper acknowledged these issues and aimed at engaging the industry and the supervisory community to discuss the use of machine learning in credit risk and, in particular, as IRB models. The Head of RBM also clarified that the discussion paper focused on the more complex models and provided characteristics to evaluate the complexity of a model. It also included analysis of the challenges and the benefits which institutions may face in using machine learning to develop CRR-compliant IRB models as well as a set of principle-based recommendations that should ensure a prudent use of models in the context of the IRB framework.
73. The BoS supported the work. Several Members asked for an explicit clarification that regardless of the models, the individuals in the institutions were responsible for compliance with the regulatory framework. One Member questioned the impact of the models on the governance perspective. One Member noted that the EBA should consider communication requirements given that these models and their outcomes were not always intuitive. Another Member underlined that the main challenge is the capacity to explain such models given that they needed a lot of information to become stable. Many Members highlighted that it was crucial to start the discussion with the industry on the machine learning and that the industry was expecting the discussion. They also asked for active engagement of the regulators in these discussions. A few Members asked for balanced drafting and one Member stressed that the discussion paper should not be based primarily on negative point of view.

74. The EBA Executive Director added that the Basel Committee had recently discussed similar issues and that it agreed that the responsibility should be with the institutions to ensure that they stay within the risk appetite and that there was already a number of governance provisions which may address this. Furthermore, there should not be an analogy between the machine learning models and internal models given that the set of data and algorithms used for the first ones were constantly evolving, which made validation much more challenging. Finally, this topic had not only micro- but also macroprudential aspects, in particular, related to consumer protection and the possible exclusion of some groups of clients.
75. The Chairperson concluded by noting the broad support by the BoS. He highlighted that the use of machine learning models could not be an excuse not to comply with the regulation and that relevant individuals within the institutions had to be responsible for the outcome of these models as well as being able to explain how they function. He asked the BoS for drafting suggestions by 4 November 2021.

### **Conclusion**

76. The BoS supported the publication of the discussion paper on machine learning in IRB models.

### **Agenda item 13: AOB**

77. The Chairperson informed the BoS that the EBA has been discussing the format of the BoS meetings in 2022 and that the BoS would be informed in the coming weeks on the meeting planning, in particular which meetings would be held at the EBA premises as physical meetings.
78. No Members raised any comments or questions.
79. The Chairperson thanked the BoS for their contributions and concluded the meeting.

## Participants of the Board of Supervisors' hybrid meeting 27 October 2021<sup>1</sup>

**Chairperson:** Jose Manuel Campa

<u>Country</u>	<u>Voting Member/High-Level Alternate</u>	<u>National/Central Bank</u>
1. Austria	Helmut Ettl	Karin Turner-Hrdlicka
2. Belgium	Jo Swyngedouw	
3. Bulgaria	Stoyan Manolov	
4. Croatia	Sanja Petrinic Turkovic	
5. Cyprus	Constantinos Trikoupis	
6. Czech Republic	Zuzana Silberová	
7. Denmark	Jesper Berg/Thomas W. Andersen	
8. Estonia	Andres Kurgpold	Timo Kosenko
9. Finland	Marko Myller	Katja Taipalus
10. France	Dominique Laboureix/Emmanuelle Assouan	
11. Germany	Peter Lutz	Karlheinz Walch
12. Greece	Heather Gibson/Kyriaki Flesiopoulou	
13. Hungary	Gergely Gabler	
14. Ireland	Gerry Cross	
15. Italy	Andrea Pilati	
16. Latvia	Santa Purgaile/Ludmila Vojevoda	Andris Vilks
17. Lithuania	Simonas Krepska/Renata Bagdoniene	
18. Luxembourg	Claude Wampach	Christian Friedrich
19. Malta	Joseph Gavin/Pierre Paul Gauci	Oliver Bonello
20. Netherlands	Maarten Gelderman/Sandra Wesseling	
21. Poland	Kamil Liberadzki	Olga Szczepańska
22. Portugal	Ana Paula Serra	
23. Romania	Cătălin Davidescu	
24. Slovakia	Tatiana Dubinova/Linda Simkovicova	
25. Slovenia	Primoz Dolenc/Damjana Iglic	
26. Spain	Angel Estrada/Alberto Rios Blanco	
27. Sweden	Karin Lundberg	David Forsman

<u>EFTA Countries</u>	<u>Member</u>
1. Iceland	Unnur Gunnarsdottir
2. Liechtenstein	Markus Meier
3. Norway	Morten Baltzersen

<u>Observer</u>	<u>Representative</u>
1. SRB	Sebastiano Laviola

<u>Other Non-voting Members</u>	<u>Representative</u>
1. ECB/SSM	Stefan Walter
2. European Commission	Martin Merlin

<sup>1</sup> Liga Kleinberga (Financial and Capital Market Commission); Jose Rosas (Banco de Portugal); Kurt Van Raemdonck (NBB); Luca Serafini (Banca d'Italia); Brita Hrenovica (Finanstilsynet); Morgan Allen, Eida Mullins (Central Bank of Ireland); Pawel Gąsiorowski (Narodowy Bank Polski); Vincent Woyames Dreher (ECB); Pascal Hartmann (FMA); Marek Sokol (CNB); Liza Lunstroo, Carljin Elemans (DNB)





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|--------------------------------|----------------------------|
| 3. EIOPA                       | Kai Kosik                  |
| 4. ESMA                        | Tomas Borovsky             |
| 5. EFTA Surveillance Authority | Marta Margret Rúnarsdóttir |
| 6. ESRB                        | Tuomas Peltonen            |

**EBA Directors**

Executive Director	Francois-Louis Michaud
Economic and Risk Analysis	Jacob Gyntelberg
Director of Prudential Regulation and Supervisory Policy	Isabelle Vaillant

**EBA staff**

Philippe Allard; Jonathan Overett Somnier; Francesco Mauro; Angel Monzon; Dirk Haubrich; Tea Eger; Delphine Reymondon; Lars Overby

For the Board of Supervisors

Done at Paris on 07 December 2021

José Manuel Campa

EBA Chairperson