



REPORT ON CONVERGENCE OF SUPERVISORY PRACTICES IN 2019

EBA-OP-2020-08 | 29 MAY 2020

EBA

EUROPEAN
BANKING
AUTHORITY

Contents

List of figures	4
Abbreviations	5
Executive summary	7
1. Supervisory convergence across the EU and EBA tools to promote it	10
2. Convergence in the supervisory review and evaluation process and in ongoing supervision	14
2.1 Status of the implementation of the SREP guidelines	14
Detailed observations on capital adequacy assessment	15
Link between the SREP, early intervention and determination of failing or likely to fail	16
Focus on a specific SREP element: business model analysis	17
2.2 Convergence in the application of P2R and P2G	18
2.3 Implementation of the 2019 convergence plan	26
2.3.1 Internal governance	27
2.3.2 ICT risks and operational resilience	35
2.3.3 Non-performing exposures	37
2.3.4 Use of benchmarking exercise for internal models	39
2.4 Supervisory convergence in other areas of ongoing supervision	39
2.4.1 Benchmarking exercise of internal models	40
2.4.2 Monitoring of the LCR implementation	42
2.4.3 Peer review on the RTS on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile	43
3. Convergence in the continuum between ongoing supervision, recovery and resolution	44
3.1 Interlinkages between recovery and resolution planning	44
3.2 Early intervention measures	45
4. Convergence in supervisory colleges	46
4.1 Monitoring of supervisory colleges in 2019	46
4.2 Quality of college interactions	48
4.3 Quality of college deliverables	51
Group risk/liquidity risk assessments	51
Joint decision on capital and liquidity	59
Joint decision on the assessment of GRP	63
4.4 EBA tools for supporting supervisory colleges	65
5. EBA policy work supporting supervisory convergence	67
5.1 Supervisory review and evaluation process	67

5.1.1	Guidelines on ICT and security risk management	67
5.1.2	Supervisory risk taxonomy	68
5.2	Ongoing supervision	69
5.2.1	Amended RTS and ITS on passport notifications	69
5.2.2	Draft ITS on the reporting of intra-group transactions and risk concentration for financial conglomerates	70
5.3	Internal governance	70
5.3.1	Guidelines on outsourcing	70
5.4	Roadmaps	72
5.4.1	IRB roadmap	72
5.4.2	Future work — roadmap for the delivery of the EBA mandates on Pillar 2	73
6.	Training as a convergence tool	75
7.	EBA 2020 convergence plan	77
8.	Key tasks for supervisory colleges in 2020	85
9.	Annex: 2020 list of supervisory colleges	88

List of figures

Figure 1 — Components of supervisory convergence	10
Figure 2 — SREP: link between ongoing supervision, early intervention and resolution	17
Figure 3 — Total capital requirements and P2G applied in a sample of banks	19
Figure 4 — Ranges of P2R applied in 2019	20
Figure 5 — Ranges of P2R applied in 2016	21
Figure 6 — P2R ranges by EBA business model classification	21
Figure 7 — P2R across risk categories and CAs (averages by main risk categories)	22
Figure 8 — P2G as communicated (across those jurisdictions that applied P2G in 2019)	23
Figure 9 — P2G as communicated (across those jurisdictions that applied P2G in 2016)	23
Figure 10 — Average capital demanded by CAs	24
Figure 11 — Average capital demand of overall SREP score ^(a)	25
Figure 12 — Average capital demand of SREP categories	26
Figure 13 — Type of college meeting	48
Figure 14 — Quality and depth of discussions	50
Figure 15 — College meeting discussions	50
Figure 16 — Identification of material ICT risks in supervisory colleges	52
Figure 17 — Institution's re-assessment of the individual and collective suitability of the members of the management body	54
Figure 18 — Resources allocated to internal control functions	55
Figure 19 — Draft group risk/liquidity risk assessment reports prepared and shared and respective dialogues conducted	57
Figure 20 — 2019 key topics discussed and embedded in college work	58
Figure 21 — Compliance with the 4-month requirement of the CRD for reaching a joint decision on capital	60
Figure 23 — Joint decisions on capital and liquidity shared and respective dialogues conducted	62
Figure 24 — Article 6 of the BRRD: 6 months and Article 8 of the BRRD: 4 months	64

Abbreviations

AML	anti-money laundering
BMA	business model analysis
BoS	Board of Supervisors
BRRD	Bank Recovery and Resolution Directive
CA	competent authority
CB	combined buffer
CCB	capital conservation buffer
CF	critical functions
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
DP	discussion paper
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Economic Area
EIM	early intervention measure
EIOPA	European Insurance and Occupational Pensions Authority
ESA	European supervisory authority
ESMA	European Securities and Markets Authority
EU	European Union
FOLTF	failing or likely to fail
GL	Guideline
GRP	group recovery plan
HDP	high default portfolios
HQLA	high-quality liquid asset
ICAAP	internal capital adequacy assessment process
ICT	information and communications technology

ILAAP	internal liquidity adequacy assessment process
IRB	internal ratings based
IRRBB	interest rate risk in the banking book
ISRB	Interactive Single Rulebook
IT	information technology
ITS	implementing technical standards
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
P2G	Pillar 2 guidance
P2R	Pillar 2 requirements
Q&A	questions and answers
RA	resolution authority
RAF	risk appetite framework
RTS	regulatory technical standards
RWA	risk-weighted asset
SA	standardised approach
SCOP	Standing Committee on Oversight and Practices
SCRePOL	Standing Committee on Regulation and Policy
SGOG	Sub-group on Ongoing Supervision
SEP	supervisory examination programme
SREP	supervisory review and evaluation process
TLAC	total loss absorbing capacity
TSCR	total SREP capital requirement
WCCA	written coordination and cooperation arrangements

Executive summary

In line with Article 107 of Directive 2013/36/EU (the Capital Requirements Directive — CRD), which mandates the EBA to report on the degree of convergence of supervisory practices to the European Parliament and the Council, this report summarises (i) the EBA’s observations on the convergence of supervisory practices across the EU in 2019 and (ii) the main activities undertaken by the EBA to enhance such convergence in 2019 and beyond.

The integrity of the single market and the level playing field in financial services requires that supervisory practices across the EU converge, in particular in the context of the supervisory review and evaluation process (SREP), which may entail the application of supervisory measures, qualitative and/or quantitative. The EBA’s role is particularly important in ensuring that relevant standards and guidelines are implemented consistently across the single market.

The EBA, in 2019, drove this process by establishing the 2019 convergence plan, which identified four key topics for heightened prudential supervisory attention, aimed at (i) informing competent authorities’ (CAs’) processes for selecting supervisory priorities for 2019 and (ii) drawing CAs’ attention to the consistent implementation of the related policy products. The four key topics identified for 2019 were (i) internal governance; (ii) information and communication technology (ICT) risk and operational resilience; (iii) non-performing exposures (NPEs); and (iv) the use of the benchmarking exercise for internal models. While the key element of the report is the stocktake of the degree of convergence of supervisory practices on the key topics, it also summarises the EBA’s observations on the implementation of a wider array of policy products. The EBA used various tools at its disposal, in particular desk-based reviews and peer reviews, college monitoring activity and follow-up on previous recommendations, and collected and analysed information on relevant supervisory practices; the outcomes of this work are summarised in this report.

Converging practices and methodologies contribute to achieving more consistency in SREP outcomes across the EU, which is indispensable in the context of cross-border banking groups. Therefore, colleges of supervisors are an important forum for driving such convergence through the sharing and discussing of supervisory assessments and outcomes.

Summary of the assessment of convergence of supervisory practices in 2019

The outcome of the assessment of the overall SREP practices is that a good degree of progress has been achieved by CAs in the implementation of the SREP guidelines (GLs) and most of the recommendations provided by the EBA have been addressed.

The EBA noted improvements and increasing consistency in the application of Pillar 2 requirements. While there are still some differences across CAs, primarily in the determination of these requirements and in some instances with regard to their legally binding nature, further convergence is expected as CAs continue to make progress with the adoption of EBA guidelines and

standards, as well as owing to the forthcoming implementation of CRD V and the revised Capital Requirements Regulation (CRR II).

Positive convergence effects were also observed in the setting of Pillar 2 guidance (P2G), which can be traced back to the introduction of the common framework for setting P2G in the revised SREP GLs. Again, convergence is expected to increase further in this area as experience with P2G matures, including the level of application, calculation methods and offsetting methods.

Overall, this report finds that the key topics for supervisory attention identified in the EBA 2019 convergence plan have been largely implemented in supervisory work across the EU, although to different degrees. Internal governance arrangements were well covered in supervisory activities, although, in connection with the management body, challenges were noted in relation to ongoing suitability assessments and ensuring diversity on boards. Institutions' approaches and processes for assessing and mitigating ICT risks were also reviewed by CAs in 2019. In this regard, credit institutions have more work to do to formalise their ICT risk appetite and implement it across the organisation. The requirement for the establishment of an NPE strategy and related operational plan was well implemented, particularly for institutions with relatively high NPE/non-performing loan levels. Refinement is expected, mainly in the quality of reduction plans, particularly for smaller and less complex institutions.

Supervisory colleges made considerable efforts in 2019 to conduct thorough group risk assessments, and the areas that received the most supervisory attention were operational risk, including ICT risk, and internal governance, which correspond to two of the 2019 key topics that the EBA put forward in its 2019 convergence plan. Further convergence is required in the assessment of interest rate risk in the banking book (IRRBB) in some colleges and in channelling the findings of the group recovery plan assessment and the money laundering/terrorist financing risk assessment into the SREP. In addition, colleges should make sure that a stand-alone group liquidity risk assessment report is prepared and shared, a lack of which hampers a thorough assessment of the main components of liquidity risk and is not in line with the legal requirements.

In 2019, the EBA performed one binding mediation related to recovery planning, in which the difference in views was successfully resolved by the amicable agreement of the parties involved during the conciliation stage.

EBA policy work supporting supervisory convergence in 2019 and training

Its role in assessing (emerging) risks in the EU banking sector allows the EBA to identify areas in which further strengthening of the EU prudential framework is necessary. In 2019, the EBA developed significant regulatory products to contribute to fostering supervisory convergence, many of which have cross-institutional and cross-sectoral relevance. Other products addressed the assessment and management of emerging risks identified by the EBA as key topics for supervisory attention, such as the EBA GLs on ICT and security risk management and the EBA GLs on outsourcing arrangement. The EBA is also committed to facilitating consistency of supervisory practices on the assessment of the IRB approach on an ongoing basis, and therefore it progressed towards completing its IRB roadmap in 2019.

Training is an important tool for the EBA in ensuring that the foundations for a common approach are widely shared. The 2019 training programme, which was prepared in cooperation with CAs, was aimed at promoting a common supervisory culture and fostering convergence of practices.

Further work in 2020

The EBA has continued with the practice of selecting key areas that warrant heightened supervisory attention and those are published together with this report. The coronavirus (COVID-19) pandemic entailed significant challenges to society and substantial uncertainties for the banking sector in 2020, therefore the key topics identified in the 2020 Convergence Plan are particularly relevant in the context of this crisis. Significant supervisory efforts and resources are and will be dedicated to monitoring crisis preparedness of institutions in 2020, as well as further implications of COVID-19 on credit institutions' operations and financial soundness, including policies implemented to protect the economy.

The revision of the CRD and the CRR improves the clarity of the Pillar 2 framework, and thus is a step forward in enhancing the convergence of supervisory practices. The EBA published a roadmap for the delivery of the EBA mandates on Pillar 2 stemming from CRD V and CRR II¹. The Pillar 2 roadmap outlines the work planned for the review of the EBA SREP GLs, which is aimed at aligning the SREP GLs with CRD V and CRR II, and which will also ensure consistency with other EBA regulatory products that have been issued since its publication². Some of the most notable improvements address the incorporation of aspects related to anti-money laundering and countering the financing of terrorism, from a prudential perspective, into the supervisory assessment and the alignment of the provisions on Pillar 2 capital add-ons and P2G with CRD V, including the conditions for setting Pillar 2 capital requirements for institution-specific material risks or elements of risks not (sufficiently) covered under Pillar 1. In addition, and based on the observations of this report, the EBA intends to further investigate the use of supervisory measures under Pillar 2 and provide additional clarification in the update of the SREP GLs.

Further to its role in facilitating policy implementation, the EBA's new mandate to set union strategic supervisory priorities with forward-looking and strategic considerations, for the first time in 2020, complements the EBA's toolkit for driving a common supervisory culture and supervisory convergence.

¹ The Pillar 2 roadmap forms part of a set of roadmaps outlining the EBA's approach and timelines for delivering the mandates stemming from the risk reduction measures package, adopted by the Council of the EU and the European Parliament on 20 May 2019. The roadmaps are available on the EBA website: <https://eba.europa.eu/eba-publishes-its-roadmap-risk-reduction-measures-package>

² In particular, the EBA guidelines on the management of non-performing and forborne exposures, the EBA guidelines on loan origination and monitoring, and the revised EBA guidelines on outsourcing arrangements.

1. Supervisory convergence across the EU and EBA tools to promote it

In a broader sense, the European Banking Authority (EBA) is expected to contribute to the stability and effectiveness of the financial system and to improving the functioning of the internal market.

In a narrower sense, and in connection with supervisory convergence, the EBA is mandated by its founding regulation to actively foster supervisory convergence across the Union, with the aim of establishing a common supervisory culture. The EBA has to contribute to:

- a sound, effective and consistent level of regulation and supervision;
- strengthening international supervisory coordination;
- a consistent, efficient and effective application of the Union acts and fostering supervisory convergence.

The EBA's role in supervisory colleges also closely aligns with this mandate, because the EBA is mandated to streamline their functioning and foster convergence and consistency across colleges in the application of Union law.

The convergence mandate of the EBA, in connection with the supervisory review and evaluation process (SREP), has been further strengthened by the Capital Requirements Directive (CRD), Article 107, which requires the EBA:

- to develop common procedures and methodologies for the supervisory review;
- to report on the degree of convergence of supervisory practices annually to the European Parliament and the Council.

Based on these mandates, the EBA defines supervisory convergence with the following three components shown in Figure 1.

Figure 1 — Components of supervisory convergence



Supervisory convergence is a process whereby (i) common rules (Interactive Single Rulebook — ISRB) are applied and respected across the Union (*compliance*), and (ii) supervisory practices converge and are comparable as a result of the application of the common procedures and methodologies developed for the SREP purposes (*comparability*), which leads to consistent supervisory outcomes/measures (*consistency*).

The EBA has a number of tools to deliver the convergence mandate and effectively promote supervisory convergence across the Union.

Tools to promote supervisory convergence

1. Development of regulatory and policy products

The mandate to contribute to high-quality common regulatory and supervisory standards and practices is fulfilled through the policy development activities of the EBA, which are a powerful convergence tool. During the Capital Requirements Regulation (CRR) and CRD IV implementation cycle in 2013-2019, the EBA developed various Level 2 regulation and other policy products. This report, in Chapter 5, summarises the most important policy developments concerning the supervisory review and ongoing supervision.

A significant part of the Single Rulebook is addressed to competent authorities (CAs), covering various aspects of supervisory work. This is supported by the Single Rulebook questions and answers³ (Q&A) process and tool, as well as the Exchange Forum for CAs:

- a. **Q&A.** As a key element of the ISRB⁴, the Q&A provides guidance to help ensure the consistent application and implementation of the regulatory framework across the European Union (EU) single market, and thus also represents a powerful tool for the convergence of the practices of CAs in relation to those regulatory and policy products. Although aimed at all stakeholders, the issues raised and addressed in the Q&A are often relevant to the practical challenges that supervisors face when it comes to the application of the regulatory framework to banks' approaches. The Q&A tool's significance is reflected in the continuously high number of questions submitted. By 31 December 2019, approximately 5 070 questions (compared with 4 439 at the end of 2018) had been submitted through the Q&A tool. Its relevance as a tool for supervisory authorities is illustrated by the fact that about 25% of the questions have been submitted by CAs. The Q&A's contribution to the Single Rulebook is all the more remarkable when considering the fact that it has no binding force in law. Yet, its relevance is confirmed in practice by the findings of a

³ <https://eba.europa.eu/single-rule-book-qa>

⁴ The ISRB is a compendium of the key legislative frameworks within the EBA's remit: the CRR and CRD IV, the Bank Recovery and Resolution Directive (BRRD), the Deposit Guarantee Schemes Directive and, since 2018, the Payment Services Directive (PSD2). It allows stakeholders to consult the relevant legislative frameworks, with links from the articles of level 1 texts to associated technical standards (regulatory and implementing technical standards) developed by the EBA and adopted by the European Commission, as well as EBA guidelines and Q&As, relating to these legislative and regulatory texts. The ISRB is available at: <https://eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook>.

review of its implementation undertaken in 2018, when on a sample basis only a fairly low number of cases of non-application were identified⁵.

- b. **Exchange Forum for CAs.** Another internal resource that the EBA has been using since its inception that is more directly aimed at CAs and supervisory practices is the Exchange Forum for CAs. Its aim is to facilitate the exchange of experiences and day-to-day supervisory practices among authorities, and thus foster cooperation and ensure convergence in practices. It is being used on a regular basis for a variety of issues covering practices in areas within the EBA's remit.

2. Training

The EBA pursues the convergence mandate through training initiatives. The EBA policy experts involved in the development of policy products are well positioned to provide training to CAs, with the aim of assisting in the implementation of important policy products. The EBA prepares its training programme in cooperation with CAs; through this programme, good practices could also be shared among CAs. Chapter 6 of this report provides an overview of the 2019 training initiatives.

3. Monitoring and assessment

One of the most significant and practical tools among all the convergence tools available to the EBA is the monitoring and assessment of the implementation and application of Level 2 regulation and EBA policy products, including the SREP guidelines (GLs). The EBA completes this monitoring through various activities:

- a. **College monitoring.** The EBA, as member of supervisory colleges, promotes the effective, efficient and consistent functioning of these colleges. College monitoring activity ensures that the EBA is able to observe a wide array of supervisory practices across the supervisory cycle and in a cross-border context. It also allows, in the case of closely monitored colleges, direct contact with the consolidating supervisor and the relevant CAs participating in supervisory colleges and therefore a forum in which to discuss questions/issues that arise from the implementation of certain policy products or, in general, challenges with certain supervisory practices. Chapter 4 introduces the EBA's observations about the convergence of practices in the context of supervisory colleges.
- b. **Peer reviews.** In order to strengthen consistency in the implementation and application of Level 2 regulation and EBA policy products, as well as foster consistency in supervisory outcomes, the EBA regularly conducts peer reviews. A peer review is conducted with the coordination of the EBA Review Panel and involves EBA staff and experts from CAs. Section 2.4.3 of Chapter 2 summarises the outcome of the peer review conducted in 2019.

⁵ For further details, refer to the [feedback on the review of the use, usefulness and implementation of the EBA Single Rulebook Q&A](#).

- c. **Desk-based reviews.** The EBA conducted various desk-based reviews over the course of 2019 that incorporated an EBA stocktake exercise; the outcome of these were then discussed in the relevant subgroups and EBA standing committees⁶. The vast majority of the observations put forward in Chapter 2 rely on such desk-based reviews assessing the level of convergence in various areas and identifying potential inconsistencies in the implementation of policy products or divergences in supervisory practices or outcomes.
- d. **Bilateral convergence visits.** Bilateral convergence visits could supplement desk-based reviews or be used as a stand-alone convergence tool to assess the degree of convergence of supervisory practices. They are considered beneficial to both the EBA and CAs, because they allow the EBA to directly interact with CAs' staff and gain insights into their practices and application of the Single Rulebook. This also allows the occurrence of a feedback loop for policy development. In addition, CAs can have access to EBA experts and can raise issues and/or better understand relevant EBA policy products. As the bilateral visits are reviews that are rather resource intensive, it is not always possible to run such visits every year. The EBA conducted bilateral visits to CAs in 2016-2018 but did not undertake such visits over the course of 2019.

4. Union strategic supervisory priorities⁷

With the European supervisory authorities (ESAs) review published in the Official Journal on 18 December 2019, the EBA has been mandated to establish Union-wide strategic supervisory priorities going forward, which are an additional and important element of the EBA's toolkit for driving a common supervisory culture. The setting of the union strategic supervisory priorities complements the tools listed in this chapter aiming to facilitate policy implementation by establishing forward-looking, strategic considerations that reflect future developments and trends.

⁶ In particular in the Standing Committee on Oversight and Practices (SCOP) and in the Standing Committee on Regulation and Policy (SCRePOL).

⁷ Article 29a of the revised EBA regulation.

2. Convergence in the supervisory review and evaluation process and in ongoing supervision

2.1 Status of the implementation of the SREP guidelines

In 2019, a good degree of progress was made by CAs in the implementation of the SREP GLs. Most of the observations and recommendations made by the EBA during the 2016 and 2017 bilateral convergence visits have now been addressed.

These improvements addressed the regular monitoring of key financial and non-financial indicators and the alignment of data used in different supervisory processes to achieve a more comprehensive monitoring. In addition, some progress was observed in the implementation of the link between the SREP, early intervention and the determination of failing or likely to fail (FOLTF).

In connection with a specific SREP element, the business model analysis (BMA), progress was achieved in the identification and assessment of material business lines, product lines and entities, including refinement of the benchmarking with relevant peers.

There are, however, challenges remaining, primarily in the area of the determination of institution-specific additional own funds requirements. In some instances, the legally binding nature of Pillar 2 requirements (P2R) and the communication of the total SREP capital requirement (TSCR) as a legally binding requirement remain an issue.

The supervisory practices in the SREP form a key focus of the EBA's convergence monitoring and assessment work, as the SREP brings together outcomes of all supervisory activities within the ongoing supervision of institutions. The EBA has set out the comprehensive common European SREP framework in its GLs on common procedures and methodologies for the SREP (SREP GLs)⁸. The SREP GLs provide a common framework for the supervisory assessment of institutions' viability while focusing on an assessment of institutions' business models and strategy, internal governance and institution-wide controls, risks to capital and capital adequacy, risks to liquidity and funding, and liquidity adequacy. The GLs also set out the common approach to the determination and articulation of the TSCR and institution-specific liquidity requirements.

Although the SREP GLs provide a solid basis for all CAs to build their own assessment methodologies and practices, they also provide a common reference point for the EBA's assessment of

⁸ <https://eba.europa.eu/regulation-and-policy/supervisory-review-and-evaluation-srep-and-pillar-2/guidelines-for-common-procedures-and-methodologies-for-the-supervisory-review-and-evaluation-process-srep-and-supervisory-stress-testing>

convergence. For the 2016 and 2017 assessments, and for the follow-up in 2018, reference was made to the SREP GLs that were published in 2014⁹. At the same time, the outcomes of the convergence assessments fed into the revision of the SREP GLs, which was published in July 2018 for application as of 1 January 2019¹⁰.

Detailed observations on capital adequacy assessment

The regular monitoring of key financial and non-financial indicators

The regular monitoring of key financial and non-financial indicators forms an important element of the SREP process. It allows CAs to monitor changes in the financial conditions and risk profiles of institutions and identify the need for updates to the assessment of SREP elements, in light of new material information outside planned supervisory activities. Under the minimum engagement of the SREP GLs, CAs should monitor key financial and non-financial indicators, at least on a quarterly basis, for all institutions.

As noted in the 2018 convergence report, a number of authorities implemented new monitoring indicators and limit systems in the framework of the regular monitoring of changes in the financial conditions and risk profiles of institutions. The framework is usually rolled out as a risk dashboard, using a number of data sources, including common reporting (COREP)/financial reporting and market-based indicators that allow peer group comparisons and analytics. In 2019, we observed the inclusion of additional indicators for some of these monitoring systems, such as the addition of indicators related to minimum requirement for own funds and eligible liabilities (MREL).

Further progress was also observed in the alignment of data used in different supervisory processes to achieve a more comprehensive monitoring integrating key risk indicators and early warning signals. As part of the ongoing development of supervisory tools and systems, CAs are also looking at innovative options, such as data warehouse solutions and new technical solutions for distributing regulatory data and risk indicators.

Interplay between TSCR and restrictions on distributions

The role of TSCR and in particular the legally binding nature of P2R in the context of triggering and factoring into the calculation of maximum distributable amount (MDA) under Articles 141 and 142 of the CRD is explained in the EBA's opinion on MDA¹¹. In its 2016 convergence report, the EBA noted 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.

In 2019, it was observed that, in some instances, the legally binding nature of P2R and the communication of the TSCR as a legally binding requirement remained an issue; this was also true

⁹ <https://eba.europa.eu/documents/10180/935249/EBA-GL-2014-13+%28Guidelines+on+SREP+methodologies+and+processes%29.pdf/4b842c7e-3294-4947-94cd-ad7f94405d66>

¹⁰ <https://eba.europa.eu/documents/10180/2282666/Revised+Guidelines+on+SREP+%28EBA-GL-2018-03%29.pdf/6c2e3962-6b95-4753-a7dc-68070a5ba662>

¹¹ <https://eba.europa.eu/documents/10180/983359/EBA-Op-2015-24+Opinion+on+MDA.pdf>

if P2R were imposed as a legally binding measure, but the MDA framework did not take into account P2R for triggering the MDA calculation. Whereas the necessary legal changes to allow for the legally binding nature of P2R were completed in some of the jurisdictions involved, they are still pending in other jurisdictions, which does not facilitate a level playing field.

With the implementation of CRD V, authorities will need to set P2R as legally binding requirements to be taken into account for triggering the MDA calculation. As clarified in recital 14 and Article 141a, 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 relevant. This means that P2R will be legally binding in nature and will therefore be taken into account in the MDA calculation and its trigger.

The use of supervisory measures to address Pillar 2 concerns

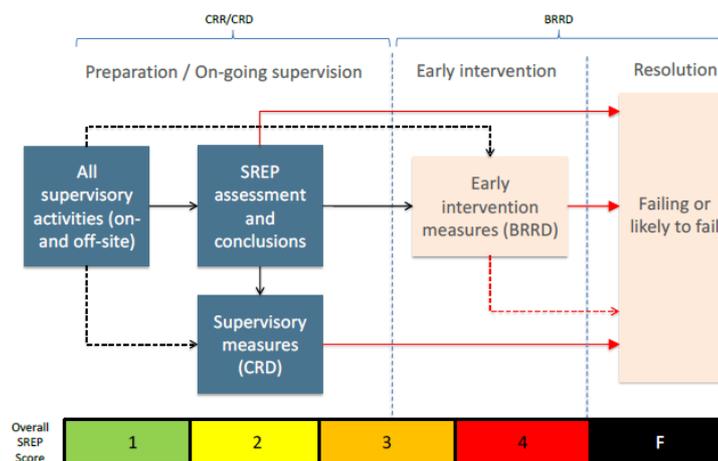
Regarding the supervisory measures applied under Pillar 2 for shortcomings in institutions' internal governance and BMA, supervisory practices range from the application of qualitative measures to requiring additional own funds in the form of P2R. Although an argument has also been made for setting Pillar 2 guidance (P2G) for shortcomings in internal governance, based on the reasoning that institutions with weak internal governance mechanisms are more likely to incur greater losses in times of stress, this reasoning does not seem to be in line with the current SREP GLs. The EBA intends to further investigate the use of supervisory measures under Pillar 2 and provide additional clarification of the common guidance in the upcoming revision of the SREP GLs.

Link between the SREP, early intervention and determination of failing or likely to fail

In 2019, the EBA observed further progress on supervisory practices in the continuum between ongoing supervision, recovery and resolution.

In particular, we observed some progress on the implementation of the link between the SREP, early intervention and the determination of FOLTF. One authority included quantitative triggers as part of its new risk model, establishing a link with the conditions for early intervention. Other authorities updated their internal guidance on using the outcome of the SREP as a potential trigger for the assessment of FOLTF, notwithstanding the possibility of implementing early intervention measures at an earlier stage if appropriate. In their methodology, CAs linked SREP scores to the assessment of the determination of FOLTF, without there being an automatic link between the SREP scores and such determination, and thus kept room for supervisory judgement.

Figure 2 — SREP: link between ongoing supervision, early intervention and resolution



Focus on a specific SREP element: business model analysis

Progress has been observed on the implementation of the business model analysis component of the common SREP framework.

The EBA SREP GLs introduced BMA as one of the main SREP elements requiring CAs to form supervisory views on business and strategic risks by assessing an institution's business model viability and sustainability. This component of the SREP is important for embedding a forward-looking perspective in supervisory work, linking together all the other components.

In the 2017 round of bilateral convergence visits, the EBA found that the CAs assessed had broadly implemented the common approach to BMA, as outlined in the SREP GLs and the Supervisory Handbook module on BMA, in their methodologies and practices. In some cases, the BMA was limited to only the consolidated level, and authorities did not take due account of the assessment of material business/product lines or the geographies in which institutions operate. Furthermore, the EBA observed, in some instances, a lack of a structured approach to the quantitative analysis, including the analysis of the institution's own financial forecasts, and the selection of peer groups for BMA purposes.

During the follow-up in 2019, progress was observed with regard to the identification and assessment of material business lines, product lines and entities as part of the preliminary analysis for the BMA, such as the further refinement of analytical tools to analyse and compare key ratios and profitability drivers across institutions for the purpose of this analysis. In terms of methodology, examples of more detailed supervisory guidance for the assessment of material subsidiaries and branches in the business model analysis were observed. Further progress was also made by authorities to document their BMA scoring approach, to provide supervisors with clear guidance and ensure consistency.

Improvement was observed in 2019 in the refinement of the system for benchmarking institutions with relevant peer groups, based on size, risk exposures, and business models. Such peer group

comparisons are used for the BMA under the SREP but can also be used for other purposes, such as the supervisory stress testing.

Some of the aspects that were identified in the convergence assessments will feed into the upcoming revision of the SREP GLs. The observations will lead, for example, to a further investigation into the use of supervisory measures under Pillar 2, including the setting of additional own funds requirements (P2R). The convergence work forms an important feedback loop for the Pillar 2 policy work in this respect.

During the revision, the SREP GLs will also be aligned with the revised CRD-CRR framework. The main changes to the Pillar 2 framework stemming from CRD V are explained in the Pillar 2 roadmap. Among the changes, the clarification of the conditions for applying additional own funds requirements under Pillar 2 (P2R) and the addition in the level 1 text of the possibility for CAs to set additional capital expectations in the form of P2G are particularly relevant in view of some of the observations stemming from the convergence work.

2.2 Convergence in the application of P2R and P2G

The EBA has analysed the actual P2R imposed by CAs, based on SREP outcomes in 2019, and, when possible, compared these with those imposed in 2017¹². All authorities in the sample have set P2R, and the EBA found a narrowing range of supervisory practices on setting P2R, contributing to a convergence in outcomes. However, some notable differences in supervisory practices remain across the authorities, which are explained by the different methodologies used, differences in the risk taxonomies and the use of P2R for macroprudential purposes (systemic risk add-on for P2R).

With regard to P2G, compared with the previous analysis of the setting of P2G and its drivers, positive convergence effects, which can be traced back to the introduction of the common framework for setting P2G in the revised SREP GLs, have been observed. The convergence is expected to continue as authorities build experience in setting P2G and make further progress with, in particular, the level of application, calculation methods and offsetting methods.

¹² The last survey of competent authorities on the setting of P2R and P2G was in 2017. No survey was carried out in 2018.

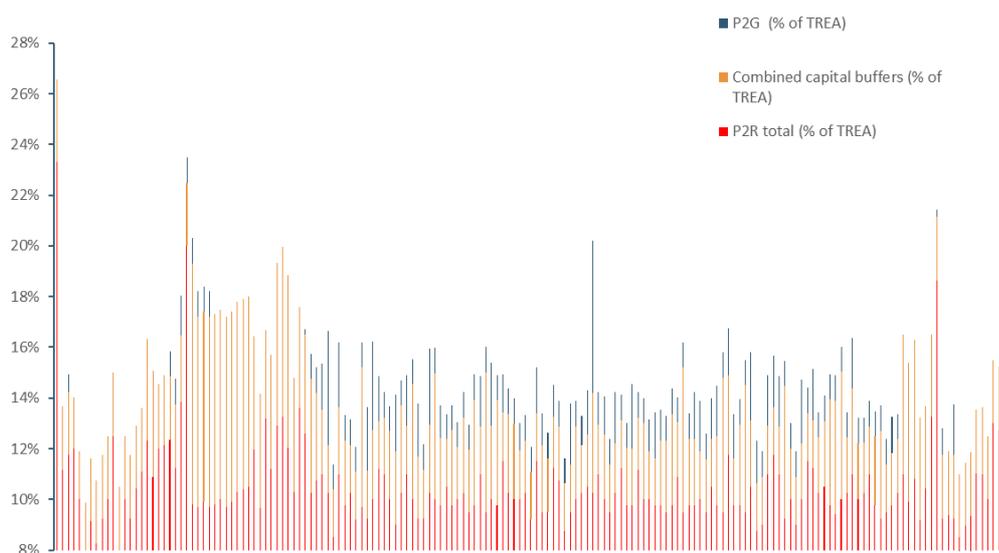
Analysis of aggregate P2R

The convergence in the application of SREP methodologies and thus the consistent application of supervisory measures across Member States is a key priority for the EBA, since it ensures consistent supervisory outcomes and a level playing field for banks in the EU.

As part of this work, the EBA analysed the supervisory measures applied by CAs, in particular the P2R applied across Member States, following the SREP cycle of 2019. The analysis of the 2019 convergence assessment is based on a sample of 22 authorities¹³ and 267 institutions¹⁴.

Figure 3 depicts the total capital requirements and P2G applied in the sample. It illustrates that capital requirements can differ noticeably across banks. In part, this variation is reflective of differences in the risk profile of banks, such as differences in inherent risk exposure, the quality of risk management and control, business models and a bank's contribution to systemic risk in a Member State. Differences in capital requirements that are driven by such inherent factors are genuine and reflect the risk-based approach of prudential supervision. At the same time, part of the variation may be driven by other factors, such as differences in supervisory practices and methods that lead to undue variations in the capital requirement across banks. These factors can affect the level playing field for banks and hamper the integrity and integration of EU financial markets.

Figure 3 — Total capital requirements and P2G applied in a sample of banks



¹³ The 22 competent authorities in the sample are those of Austria, Belgium, Croatia, Cyprus, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Luxembourg, the Netherlands, Norway, Poland, Portugal, Romania, Spain, Sweden, Slovakia, Slovenia and the single supervisory mechanism.

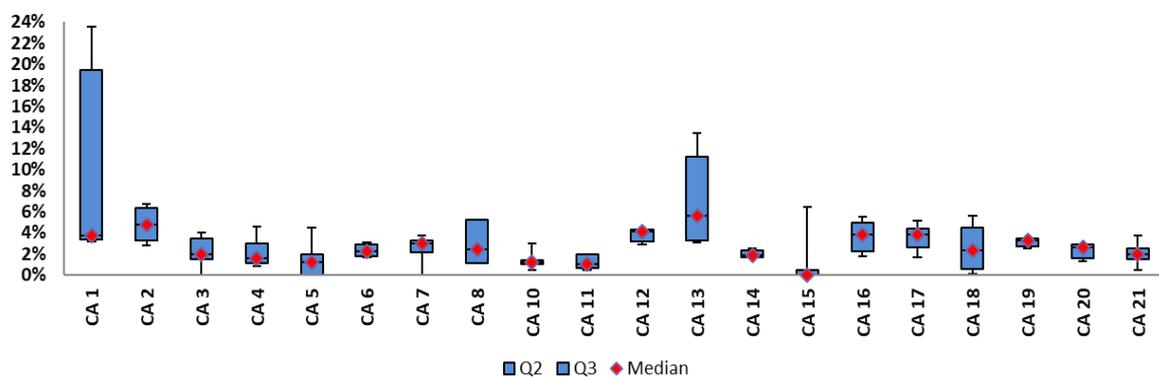
¹⁴ Data were submitted on both a solo level and a consolidated level, which resulted in the sample size of 267 institutions. Overall, 169 institutions were given on a consolidated level.

Overall, progress has been achieved in the application of P2R compared with 2017, and the EBA sees greater consistency in the ranges of P2R across the authorities. In particular, while in 2017 some authorities chose not to apply P2R as an institution-specific measure at all, relying instead on macroprudential capital measures, the EBA has noted that all the CAs in the sample applied P2R as an institution-specific measure.

Despite the positive convergence effects, the ranges of P2R applied in 2019 still vary across jurisdictions, sometimes substantially. As different samples were used in the 2017 survey, no direct comparison can be made between the P2R ranges applied in 2017 and those applied in 2019.

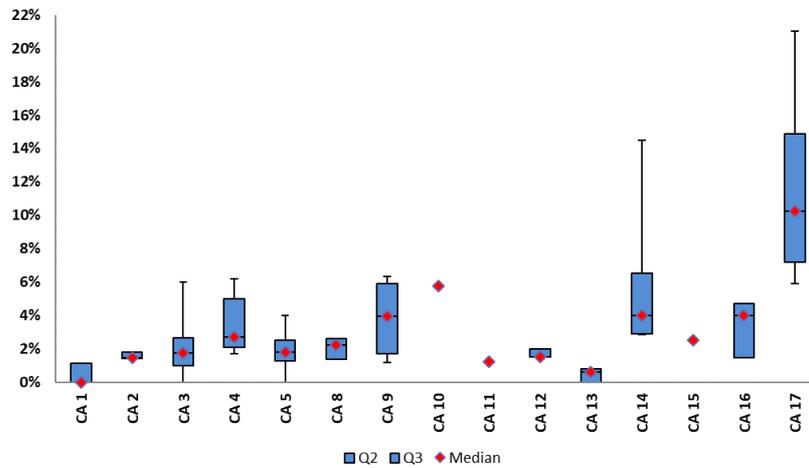
While the data do not allow for a more detailed investigation of the underlying drivers of variability, it is noted that the cross-country dispersion seems to have narrowed somewhat, compared with 2017. In addition, it can be observed that the variability of P2R across banks *within* a member jurisdiction (see e.g. CA 1 and CA 13) can exceed the typical level of variability observed *across* member jurisdictions. This suggests that the current variability observed across Member States does not appear to be extraordinary and may be broadly in line with the range of outcomes that would be expected from a CA that applies its supervisory methods in a consistent manner.

Figure 4 — Ranges of P2R applied in 2019¹⁵



¹⁵ CA 9 and CA 22 have been removed from Figure 4 owing to the small sample size.

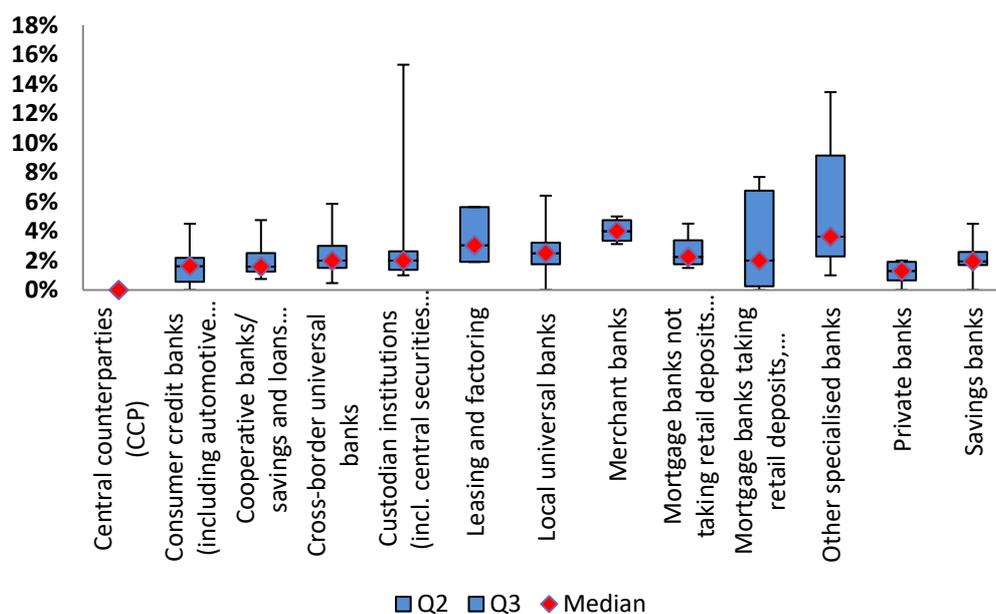
Figure 5 — Ranges of P2R applied in 2016



Still, the methodologies used for the application of P2R vary across CAs. For example, some jurisdictions determine P2R through a holistic assessment, with a decomposition of capital requirements into individual risk categories taking place *ex post* or not at all, which are both not in line with the EBA SREP GLs.

There is also considerable variability in P2R ranges in certain business models, the justification of which should be further explored. According to Figure 6, considerable variations occur for mortgage banks taking retail deposits, other specialised banks and the business model of leasing and factoring.

Figure 6 — P2R ranges by EBA business model classification

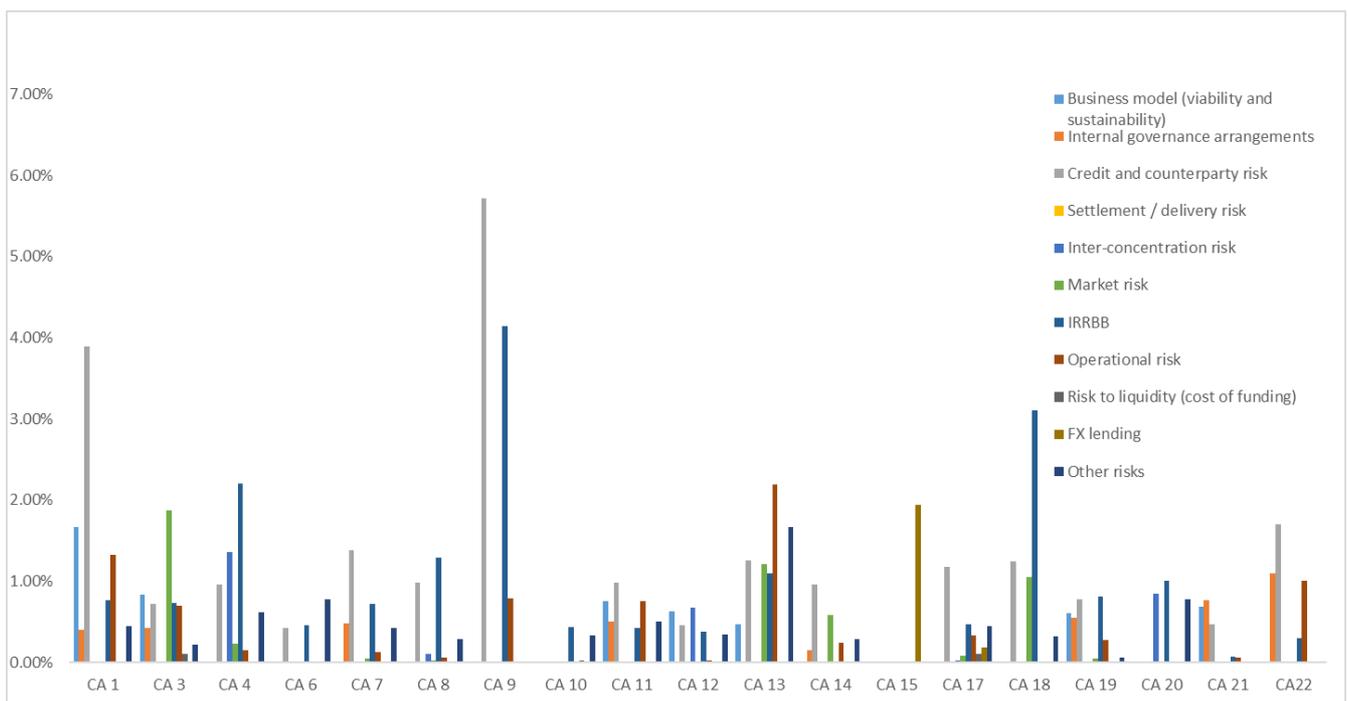


In addition, the EBA has observed that the type and definition of risk category employed by the CAs vary widely. In the data analysis, the 22 CAs provided 45 different risk categories.

Moreover, as can be observed in Figure 7, the average sizes of the P2R add-ons within the same risk category vary across the CAs. Credit risk, market risk, operational risk and interest rate risk in the banking book (IRRBB) are the risk categories to which the P2R add-ons are applied across most CAs.

Overall, the EBA sees room for further convergence, which would help achieve a consistent treatment of risks and support a level playing field across all Member States. The completion of the supervisory risk taxonomy would provide a common language for supervisors, support CAs with the design of their SREP processes, and support the risk-by-risk analysis and the structured dialogue that CAs need to have with credit institutions (CIs). It would also help potential benchmarking of institutions against peers.

Figure 7 — P2R across risk categories and CAs (averages by main risk categories)



Analysis of aggregate P2G

Compared with the previous P2G aggregate analysis in 2017, when most CAs applied P2G for the first time, positive convergence effects have been observed, with 13 out of 22 CAs having set P2G, compared with 5 out of 17 in the previous analysis. Overall, 9 CAs out of the 22 CAs have not yet applied P2G.

There is still a high level of dispersion with regard to the CAs’ approaches to setting P2G. Out of the 13 CAs that set P2G, 2 have not based it on the stress test outcomes. In addition, as can be seen in the Figures 8 and 9, the ranges of P2G have improved only slightly, compared with the previous assessment.

The EBA has noted differences with respect to the level of application. Of the CAs applying P2G, most have applied it to banks on both a consolidated level and a solo level, whereas some CAs have applied P2G to banks on only a solo level or a consolidated level.

Figure 8 — P2G as communicated (across those jurisdictions that applied P2G in 2019)

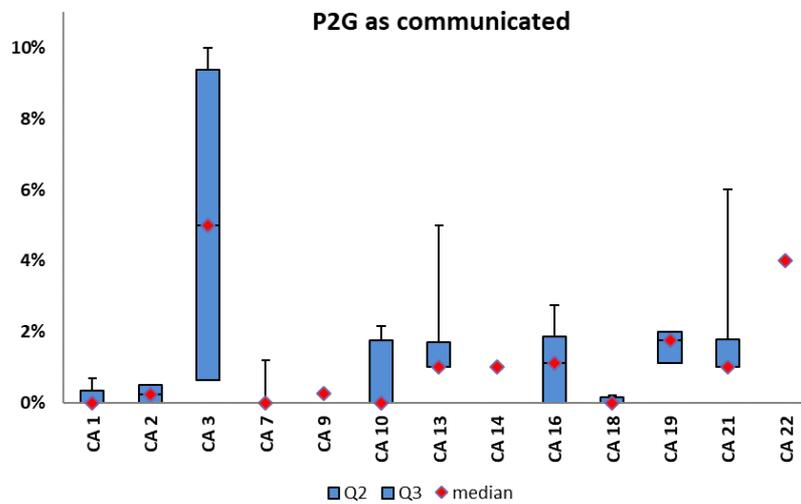
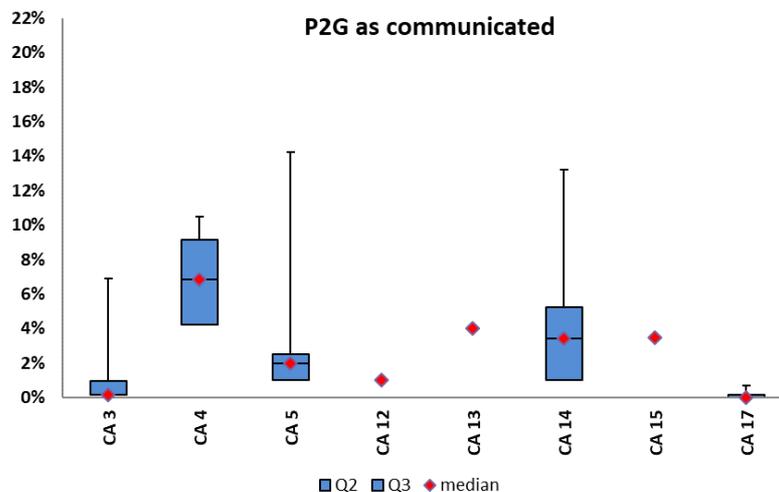


Figure 9 — P2G as communicated (across those jurisdictions that applied P2G in 2016)

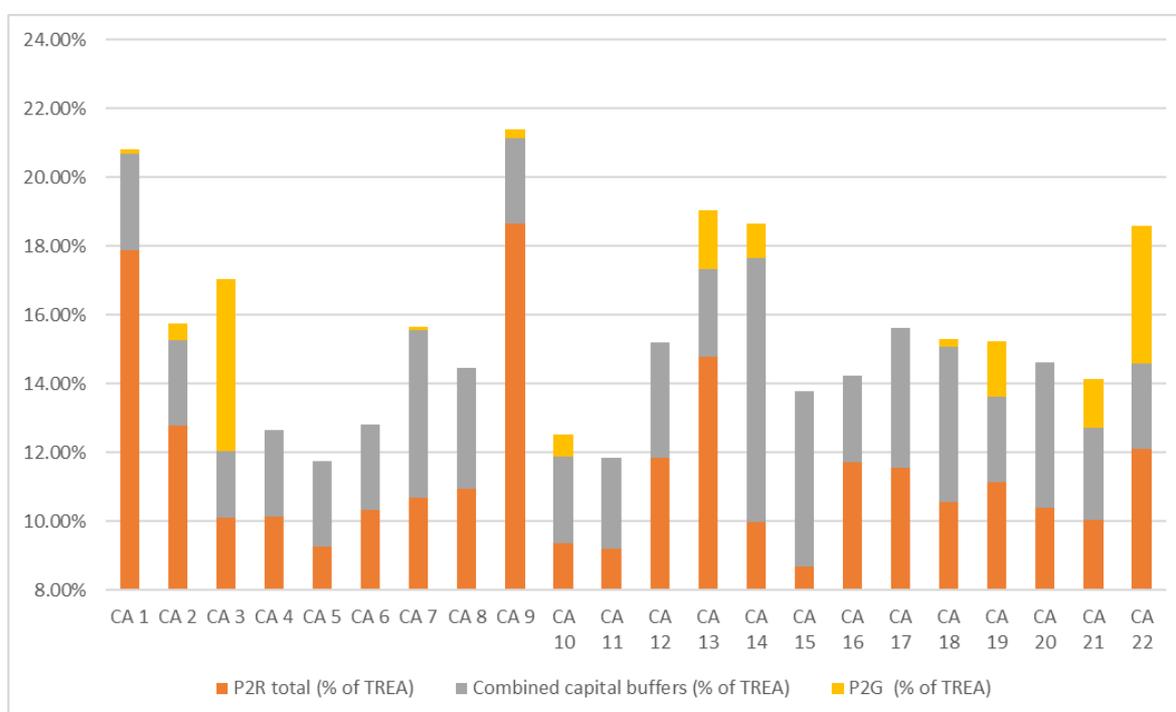


In addition, the EBA has observed differences in the methodologies used for determining P2G. In particular, different calculation methods were noted, and differences were seen in the adjustments used for offsetting and the combined buffer elements used for offsetting.

With the revision of the EBA SREP GLs¹⁶, which introduced P2G and supervisory stress testing, diverging practices will likely decrease in the future.

The EBA did not observe specific tendencies regarding the interplay between P2R and P2G. Some CAs applied high P2R coupled with low P2G and vice versa, whereas other CAs have set P2R and P2G at comparable levels, as can be seen in Figure 10.

Figure 10 — Average capital demanded by CAs



Institutions in the sample have also been grouped according to the allocated overall SREP score as well as their SREP categorisation. Figures 11 and 12 depict the outcome of these analyses and provide a picture of the links with the P2R and P2G levels, as well as the capital conservation buffer and the combined buffer (CB) requirement.

Figure 11 illustrates that P2R typically increase when the SREP score deteriorates, which may reflect the increased exposure to risks. It should be noted, however, that, according to the EBA SREP GLs, there is no direct link between the overall SREP score and P2R¹⁷.

¹⁶ Applicable from 1 January 2019.

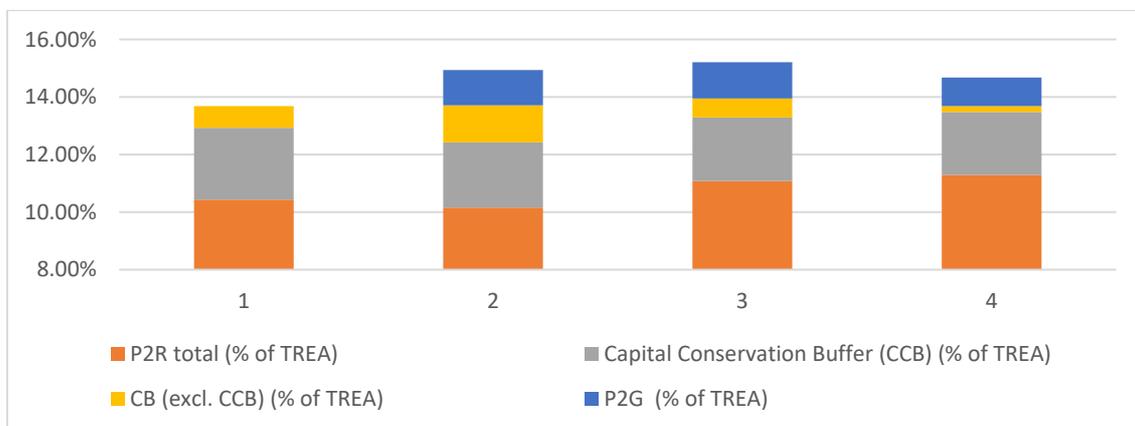
¹⁷ The overall SREP score relates to the overall risk to the viability of the bank. The P2R add-on reflects material risks not covered or not sufficiently covered by the own funds requirements under Pillar 1.

At the same time, the countercyclical capital buffer is typically somewhat lower for these banks, which may illustrate that the SREP score also partly reflects local economic conditions. Furthermore, P2G appears to be somewhat lower for banks with a SREP score of 4. As P2G is based on a supervisory stress test, the effect of the stress test may be lower for banks that already find themselves in financial duress, which explains the reduced P2G figures.

Similarly, Figure 12 illustrates the outcome of the analysis based on the institution's SREP categorisation. In general, no significant discrepancies are given for the capital demand based on the EBA SREP categories. However, for category 4 banks, which are defined as small, non-complex domestic institutions, the CB requirements are the lowest, which can be explained by the fact that the CB requirements cover macroprudential risks, such as the global systematically important institution and other systematically important institution buffer, a systemic risk buffer and an institution-specific countercyclical capital buffer.

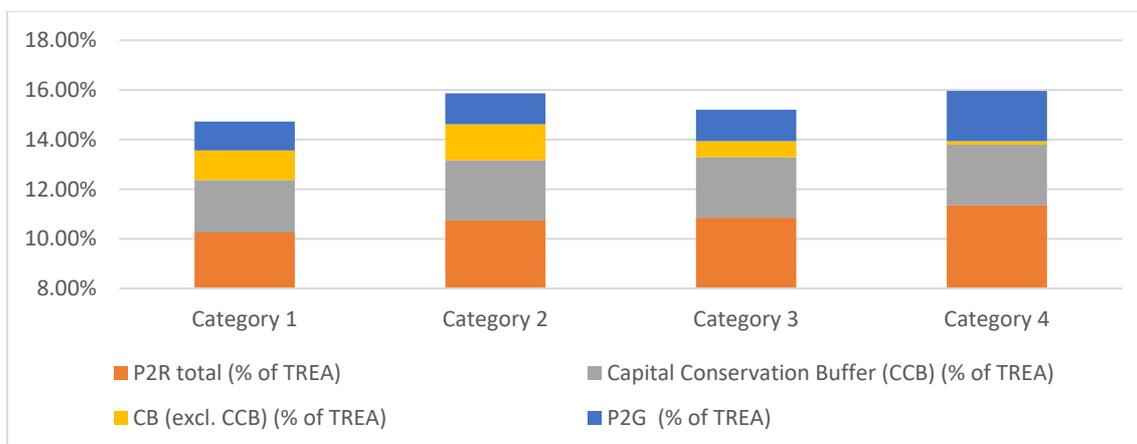
Finally, the sample sizes of the different SREP categories vary significantly; thus, generating concrete conclusions is challenging. In addition, the figures do not include whether the capital additions imposed by the CAs are determined in a 'holistic' manner or whether they are determined on a risk-by-risk basis, which could also be an indicator of the differences in the additional levels of capital imposed.

Figure 11 — Average capital demand of overall SREP score ^(a)



^(a)Only one bank has an overall SREP score of '1'.

Figure 12 — Average capital demand of SREP categories



2.3 Implementation of the 2019 convergence plan

The EBA established a convergence plan for 2019, with the aim of fostering supervisory convergence across the Union. The convergence plan, which identified key topics for heightened prudential supervisory attention, was aimed at informing CAs' processes for selecting supervisory priorities for 2019, as well as drawing CAs' attention to the consistent implementation of certain policy products affecting supervisory practices.

The objective of the convergence plan was to assess the degree of convergence in supervisory practices through the key topics. For the follow-up on the 2019 convergence plan, the EBA conducted a desk-based review that collected information from CAs in the relevant subgroup¹⁸ of the Standing Committee on Oversight and Practices (SCOP) as well as relied on its college monitoring activity.

In order to support CAs in focusing their attention in relation to each key topic and promote a common approach in supervising these topics, the EBA has identified objective elements for each of the key topics. The set of objective elements was aimed at influencing the supervisory practices of CAs on the selected topics and, at the same time, allowed for a structured follow-up on whether the supervision of the key topics has been consistent across the EU.

Overall, this report finds that CAs took into account the key topics for supervisory attention identified in the EBA 2019 convergence plan in their supervisory work, although to different degrees.

In particular, the governance arrangements of CIs, including the periodic assessment of the effectiveness of the internal governance framework and the assessment of the three lines of defence, were well covered in supervisory activities. The ongoing assessment of the individual and collective suitability of the members of the management bodies will require further

¹⁸ Subgroup on ongoing supervision.

attention. Supervisors should also ensure that all CIs have implemented diversity policy, including targets for the under-represented gender.

Institutions' approaches to and processes for assessing and mitigating information and communication technology (ICT) risks were reviewed by CAs in 2019. While the existence of an ICT strategy and the coverage of ICT risk in the internal capital adequacy assessment process (ICAAP) were well reviewed, a further focus on the formalisation of the ICT risk appetite and how it cascades down the organisation is needed.

The requirement for the establishment of a non-performing exposure (NPE) strategy and implementation plan was well implemented across the EU, in particular for institutions with relatively high NPE/non-performing loan (NPL) levels. Further attention needs to be given to the quality of reduction plans, in particular their reliability and consistency with the operational plans for smaller and less complex institutions.

CAs have increasing experience of conducting the annual assessment of the benchmarking of internal models that is supported by the EBA benchmarking exercise.

2.3.1 Internal governance

CAs were expected to ensure that their supervision of institutions' internal governance arrangements takes into account the revised EBA GLs on internal governance (EBA/GL/2017/11) and the EBA-European Securities and Markets Authority (ESMA) joint GLs on the assessment of the suitability of members of the management bodies and key function holders (EBA/GL/2017/12), both of which entered into force on 30 June 2018.

EBA guidelines on internal governance

The EBA's follow-up focused on the following aspects of the GLs:

- the periodic assessment of the effectiveness of the internal governance framework by the management body in its supervisory function;
- the level of details of the minutes of the management body in its supervisory function;
- organisational arrangements of the three lines of defence;
- resources allocated to the internal control functions;
- the implementation of a risk culture across organisations.

This report finds that CAs had a good coverage of the governance arrangements of credit institutions in 2019, in particular areas such as the periodic assessment of the effectiveness of the internal governance framework by the management body in its supervisory function, the assessment of the three lines of defence and the resources allocated to the internal control functions.

Supervisory practices in 2019

CAs assessed the internal governance framework as part of their SREP assessment and ongoing supervision. Many CAs performed the assessment through both on-site and off-site supervisory

activities, while some relied mainly on off-site (desk-based) reviews. The effectiveness of the internal governance framework and the functioning of the three lines of defence were the central elements of CAs' governance review in 2019, which was verified mainly through:

- regular periodic meetings with members of the management/supervisory bodies, their committees and key function holders, including staff members of the second and third line of defence;
- a regular evaluation of the reports submitted by the external auditor, the management bodies' committees or the internal control function on the assessment of the effectiveness of the requirements imposed by law and any measures taken to tackle shortcomings;
- an analysis of the of the ICAAP/internal liquidity adequacy assessment process (ILAAP) reports, in particular the internal governance sections and the organisational aspects;
- a self-assessment and completed questionnaires submitted by institutions;
- on-site inspections and/or thematic reviews.

While the majority of CAs applied a combination of the mentioned activities to verify the effective oversight by the supervisory function of the management body, a handful of them reported that they mainly relied on the evaluation of the reports received from internal or external auditors and/or the self-assessment received from the management body, particularly for smaller and less complex institutions.

More authorities reported that the topic has been high on their agenda in the past 2 to 3 years. Some CAs noted that the 'internal governance and institution wide controls' form part of the agenda of their comprehensive on-site inspection, including an assessment of the duties and responsibilities of the management body and the internal control framework.

Other CAs launched dedicated governance thematic reviews in 2019, some of which were conducted using questionnaires, to address the effective functioning of the management body in its supervisory and executive functions and the assessment of the risk appetite.

It can be concluded that supervisors in 2019 looked into the supervisory board's assessment of the management board's activities and the existence of structures and mechanisms to perform their self-assessment. Supervisors also examined whether the management body and senior management conducted assessments of how the institution's core values and risk appetite framework (RAF) are understood and cascade down the organisation, and how they are embedded in decision-making and operations.

In order to substantiate that the management body operates effectively and that the collective decision-making process is of sufficient quality, the vast majority of CAs checked the minutes of board and committee meetings. In general, the assessments concern the level of detail, the quality of discussions and member's involvement in the decision-making process.

The majority of the CAs reported that institutions are required to send the minutes of board and relevant committee meetings on an ongoing basis, which are reviewed by the supervisory team as

part of the ongoing supervision. Other CAs requested the submission of the minutes as part of the SREP review, while two authorities requested them on an ad-hoc basis, according to a risk-based approach. Only one CA reported that the assessment of the management body's activity in its challenging function, through a review of the minutes, was not planned for 2019, highlighting that this is, nevertheless, a mandatory item to be checked during an on-site inspection.

Overall, 68% of all reporting authorities have confirmed that, during on-site inspections/visits, the minutes of the meetings of the management bodies are deeply analysed.

The assessment of the three lines of defence is an area that has been and is receiving considerable attention from all prudential supervisors across the EU. The assessment focused on how institutions' organisational structure, including the three lines of defence, is designed, their independence and the main reporting lines. In most Members States, either local law or regulation/recommendation issued by the CA provides a strong legal basis.

The resources allocated to the internal control functions, in terms of both financial and human resources, seem to always form part of the CAs' review of the internal control functions. An assessment of the three lines of defence was carried out mostly through off-site supervision and verified during on-site examinations. The compliance function, as an element of the second line of defence, received dedicated attention in 2019, according to some CAs.

Slightly more than 50% of CAs reported that they review whether institutions follow high ethical and professional standards and implement a 'code of conduct' to ensure risk awareness through a strong risk culture as part of the yearly SREP assessment. In total, 20% noted that this aspect is checked during on-site inspections.

Main outcomes of the supervisory review of the internal governance arrangements

When weaknesses were detected, CAs mainly requested mitigation actions, but occasionally a Pillar 2 quantitative requirement was also imposed in the SREP. In the most serious cases, CAs issued sanctions and requested immediate actions from credit institutions. In other cases, shortcomings were communicated in an official letter and remedial actions were requested. If needed, meetings were organised with the bank to ensure that the findings were being addressed in the shortest possible timeframe.

CAs have revealed some common weaknesses in connection with the oversight function of the management body in its supervisory function, in particular in terms of the regularity of the assessment by the supervisory body of the internal control framework, the lack of adequate segregation of duties and responsibilities or the structure and efficiency of the committees.

CAs have noted the following improvements: (i) the large majority of institutions that were targeted in 2019 have improved their internal control framework, and (ii) the awareness of the importance and significance of the internal governance framework in general has been raised.

In connection with the minutes of the management body in its supervisory function, the supervisory views were fairly balanced between 'improvements noted' and 'improvements needed', with an

increase in the quality of board discussions and their respective minutes on the one hand, and a lack of minutes or a lack of details and content in the minutes on the other hand. On very few occasions, the minutes revealed the inadequate and ineffective supervision of the board. When the level of details was insufficient to reflect the content of the discussions and debates, banks were requested to elaborate further in the minutes.

The supervisory conclusion regarding the three lines of defence is that the independence of the second and the third lines of defence and the direct access of the internal control functions to the management body in its supervisory function is ensured by a large majority of institutions. Although some improvements were noted, some common weaknesses were still identified, particularly in smaller institutions, in connection with the resources dedicated to the control functions, resulting in substandard controls and a lack of independence of the internal control functions.

While the resources allocated to the internal control functions are generally commensurate with the size and complexity of institutions, more than half of the CAs identified a strain on resources in several institutions, in particular in smaller institutions. A few CAs reported a lack of adequately qualified staff in the internal control areas, and ICT risk was mentioned as an example of where better coverage by auditors is vital.

The level of risk awareness of staff across the organisation overall seems to be adequate in the EU, but at the individual institution's level the poor management of conflict of interest by the management board or the lack of an institution-wide risk culture framework were noted.

In connection with risk culture and risk awareness, supervisors noted that combating financial crime was the focus of supervisory attention in 2019, with relevant training initiatives (e.g. anti-money laundering — AML) gaining importance.

GOOD PRACTICES

- Issuance of further guidance on requirements and assessment practices connected to internal governance: some CAs highlighted that they issued notices specifying minimum expectations for the content of reports¹⁹ to be sent by institutions. One CA noted that the expectations are updated and published on a yearly basis.
- Occasional supervisory presence at board meetings: in order to supplement the desk-based review of the meeting minutes, line supervisors at a few CAs participated in board meetings on an ad-hoc basis or as part of on-site inspections, which allowed further insights into the board's dynamics.
- The benchmarking of resources allocated to the control functions (full-time equivalents) across institutions took place; thus, discrepancies could be spotted more easily.

¹⁹ Mainly internal control reports.

- Whistleblowing policies and procedures were assessed as part of the 2019 SREPs by some CAs.
- Promotion of risk culture/awareness in supervisory conferences and on an ongoing basis at regular meetings with CIs.

EBA-ESMA joint guidelines on the assessment of the suitability of the members of management bodies and key function holders

The EBA's follow-up focused on the following aspects of the GLs:

- implementation of policies/procedures for the induction/training of the members of the management body;
- existence of a matrix or an equivalent appropriate methodology for the assessment of the collective suitability of the management body;
- institutions' reassessment of the individual and collective suitability of the members of the management bodies;
- publication of supervisory procedures applied to the suitability assessment;
- existence of a diversity policy promoting diversity within the management body;
- targets defined for the representation of the underrepresented gender in the management bodies.

Overall, this report finds that the supervisory procedures applicable to the suitability assessment of the members of the management bodies of institutions are in place and publicly available for all reporting CAs. Furthermore, the initial assessment of the individual and collective suitability of the members of the management bodies is subject to major scrutiny by all reporting CAs. However, the ongoing suitability assessment will require further attention from CAs, together with the ongoing training initiatives, to ensure that the knowledge of the members of the management bodies is up to date. Supervisors should also take further steps to understand whether diversity policy has been implemented by all CIs on an ongoing basis, including targets for the underrepresented gender.

Supervisory practices in 2019

All CAs pay attention to the initial assessment of the individual suitability of a prospective member of the management body, based on the fit and proper process. Collective suitability is generally reassessed from notifications required under the authorisation process.

A quarter of the reporting CAs consider the existence of a matrix in CIs a must, to ensure that there is an appropriate skills mix across board members and to assess the collective suitability of the members of the management bodies against this matrix. Other approaches include the requirement of having a skills matrix for a subset of institutions (e.g. higher impact CIs), while other CAs promote the use of the suitability matrix developed by the EBA.

The vast majority of CAs reported that the existence and appropriateness of training for the members of the management body, as part of the induction programme, was considered in

connection with their nomination in the framework of the fit and proper process. However, only very few authorities reported that they followed up on ongoing training initiatives.

According to the GLs, 'ongoing training should aim to improve and keep up to date the qualifications of members of the management body so that at all times the management body collectively meets or exceeds the level that is expected. Ongoing training is a necessity to ensure sufficient knowledge of changes in the relevant legal and regulatory requirements, markets and products, and the institution's structure, business model and risk profile.'

Overall, 20% of the CAs reported that the requirements for institutions to devote adequate human and financial resources to the induction and training of the management board and supervisory board members are stated either in national law or in published supervisory notices/guidance.

The assessment of the individual and collective suitability of the members of the management bodies should be performed on an ongoing basis by CAs, as part of their ongoing supervisory activity. CAs should ensure that the necessary reassessments are conducted by institutions.

Based on CAs' responses, the reassessment of the individual and collective suitability of the members of the management bodies is predominantly performed through off-site supervisory activities, including the review of SREP questionnaires, and internal or external audit reports. More CAs perform the assessment only as part of the authorisation procedure. One CA reported that a thematic review that considered the assessment of individual and collective suitability of members of the management body in 2019 was performed on the fit and proper processes.

Directly linking the assessment to new nominations and the connecting fit and proper procedures means that supervisors may have no insight into whether the individual and collective knowledge and skill set of the members of the management body have been met on an ongoing basis, according to the CRD IV requirements and EBA GLs.

The level of detail of the information that CAs received and/or requested seems to differ across jurisdictions, with some receiving the institution's reassessment policy or regular reassessment reports of the individual and collective suitability of the members of the management body, and others relying on an external auditor's report on the institution's shortcomings or evaluating this aspect using the SREP questionnaire.

It was less apparent if all CAs had received information that was detailed enough to form a view of whether a sound assessment process is in place in institutions, which would ensure that events affecting the required knowledge and skills experience of the management body would lead to the reassessment of the suitability of the members.

According to the GLs, CAs should ensure that their supervisory procedures allow them to address cases of non-compliance in a timely manner. All reporting CAs confirmed that the supervisory procedures applicable to the suitability assessment of the members of the management bodies of institutions are publicly available, mainly on CAs' websites. These often take the form of governors' acts, circulars, handbooks, legal opinions or other guidance documents.

In order to ensure a broad set of qualities and competences of the members of the management bodies of institutions, and to avoid the groupthink phenomenon and foster challenges within the boards, in more than half of the responding Member States, either local law or the CA's policy documents outline the requirements for the existence of a diversity policy. While a handful of authorities noted that they verify at a minimum that institutions have established a policy promoting diversity in the management body, primarily in connection with the fit and proper process, it was not identifiable from the rest of the CAs' responses that they would have conducted such a supervisory assessment. Two CAs highlighted that an assessment of diversity in the management body was subject to thematic inspection or work.

According to the GLs, the diversity policy for significant institutions should include a quantitative target for the representation of the underrepresented gender in the management body, and for all other institutions, in particular those with a management body that has fewer than five members, the target may be expressed in a qualitative way.

The supervisory actions taken by authorities differ: a few regulators have set quantitative quotas or targets and assessed the achievement of these targets in the context of the SREP cycle, while more authorities have not included the review of this topic in their 2019 supervisory plans. More CAs referred to the regular EBA diversity benchmarking exercise and noted that they assess if CIs have defined targets for the representation of the underrepresented gender, based on the outcome of the exercise.

[Main outcomes of the supervisory review on the assessment of suitability](#)

The use of a matrix or an equivalent appropriate methodology for the assessment of the collective suitability of the management body varies across CAs and institutions, but in general, there are ongoing efforts to develop one if it is missing. CAs noted the lack of experience of institutions of the reassessment of the individual and collective suitability in general, but more CAs noted issues with the initial assessment itself. For example, some institutions have not yet systematically formalised the appointment process and/or an objective assessment methodology was missing. When suitability requirements are not met, CAs evaluate the necessity to challenge the board's composition and ask for substitutions or the enhancement of knowledge of the member in question through substantial training initiatives.

Few CAs noticed a higher awareness of various institutions of the training needs of new appointees in general, and individual weaknesses were identified in the appointment process for members of the management body. The very few CAs that looked into whether an ongoing training initiative existed for the members of the management body concluded that such plans had not been put in place.

The CAs that undertook the assessment identified issues in all cases, with many institutions not having policies promoting diversity within the management body in place, particularly the small and less complex institutions. Others noted the limited scope of the diversity policies, the wide divergence in approaches in terms of whether diversity targets were in place and their definitions,

and the missed achievement of the set targets. Other CAs highlighted the overall lack of diversity at management body level.

In the limited cases in which an assessment was carried out by CAs, it was concluded that many institutions, in particular small and less complex institutions, did not define targets, neither qualitative nor quantitative, for the representation of the underrepresented gender.

GOOD PRACTICE

- Q&A section made available on a CA's website to provide additional clarity on filling in forms for the appointment or renewal of members of a management body;
- off-site review of board members' knowledge of ICT risk for institutions that are actively adopting new technologies;
- minutes of the board meeting that discussed the suitability assessment and its outcome, including the underlying reasoning being submitted to the supervisor;
- supervisory questionnaire on diversity policy, which also covered how diversity targets have been met;
- supervisory engagement with targets identified for the representation of underrepresented gender and diversity overall.

AREAS FOR CAS' ATTENTION

- CAs should extend their scope to the ongoing training initiatives for the members of the management bodies, to ensure that the members understand the relevant changes in the legal and economic environment, and in markets and products, and their effect on the institution.
- All CAs should conduct regular checks, whether or not institutions meet the requirements of the GLs, periodically reassess²⁰ the collective suitability of the management bodies and link this assessment to the nomination processes. In particular, CAs should reassess the individual or collective suitability of the members of the management bodies, whenever significant new facts or evidence are unveiled during the course of ongoing supervision.
- CAs are encouraged to discuss, with supervised institutions, in the context of supervisory dialogues, how to assess the materiality of new facts and when these should trigger a re-assessment of the suitability of the members of the management bodies or key function holders.

²⁰ Significant institutions at least annually and non-significant institutions at least every 2 years.

- CAs should verify whether all institutions have a policy promoting diversity in the management body and whether it has been implemented to promote a diverse pool of members, in accordance with Article 91(10) of Directive 2013/36/EU.
- CAs are invited not to exclusively rely on the EBA benchmarking exercise but make their own assessments of diversity policies.
- CAs should ensure that all institutions establish targets for the representation of the underrepresented gender in the management body; for significant institutions these should be quantitative in nature, and for all other institutions these can be expressed in a qualitative manner.

2.3.2 ICT risks and operational resilience

EBA guidelines on ICT risk assessment under the SREP

The EBA issued these GLs to assist CAs in their assessment of ICT risks, as part of the SREP, in light of the increasing complexity and growing importance of ICT risks within the banking industry and individual institutions.

The EBA's follow-up focused on the following aspects of the GLs:

- existence of approved ICT strategy and related implementation plan;
- ICT risks under the RAF and ICAAP;
- identification of material ICT risks;
- approved risk management policy, including guidance on the management and mitigation of ICT risks.

It can be concluded that, in line with the growing importance and increasing complexity of ICT risks in the banking sector, institutions' approach and efforts during the identification, monitoring, assessment and mitigation of ICT risks were reviewed by CAs in 2019. While the existence of an ICT strategy and the coverage of ICT risks in ICAAP were well reflected in supervisory activities, a further focus on the formalisation of the ICT risk appetite and how it cascades down the organisation, as well as ICT risk governance and controls, is needed.

Supervisory practices in 2019

Risk management frameworks, including ICT risk policies, together with the identification of material ICT risks, are considered by all CAs in the regular SREP process and feed into the operational risk and/or internal governance SREP elements. However, more transparency on how the ICT SREP scores feed into the final SREP score would be welcomed.

When CAs performed the assessment of ICT risks, the existence of an ICT strategy, that is one that is adequately governed and in line with the institution's business strategy, was their focus, together with the identification of material ICT risks. CAs in general assessed the identification, monitoring, assessment and mitigation of the ICT risks by institutions and looked into the related governance arrangements that support the implementation of an ICT strategy.

The depth, detail and intensity of the assessment corresponds to the requirements of the SREP minimum engagement model. More than half of the CAs applied questionnaires that captured the institution's self-assessment, either as part of the SREP questionnaire or as a dedicated ICT risk questionnaire.

Around 35% of the responding CAs informed that on-site audits looked into the ICT risk strategy and its implementation, as well as the identification of material ICT risks, in 2019 or in general; these areas are reviewed on-site during periodic inspections. Not only the on-site inspections but also the self-assessments of the institutions resulted in considerable findings.

While all authorities in their review of the ICAAP documentation verify whether the ICT risks are adequately covered and when warranted internal capital is allocated, only less than half of the CAs noted that they confirmed whether ICT risk appetite had been formalised and approved by the management body.

Main outcomes of the supervisory review of ICT risks

The outcomes of on-site visits vary across CAs and institutions, with some having reported that all supervised banks have some form of ICT strategy, including the identification of strategic priorities, and that ICT strategy requirements are adequately covered. However considerable shortcomings were also identified, in particular the fact that the ICT strategy was too generic and not updated regularly, that measures for implementation were not specified, that funds for strategy implementation were not allocated, or, more generally, that there was a lack of a clear connection with the business strategy.

Deficiencies identified in risk management frameworks concerned the incomplete risk identification and assessment, the timely implementation of controls, the lack of policy updates and change management and finally employee awareness.

The large and complex institutions in general covered ICT risks in their risk appetite and ICAAP, although for a number of institutions some material ICT risk elements were not included or the granularity of risk metrics for ICT risks was not satisfactory. However, a large number of institutions, mainly small and less complex institutions, does not sufficiently consider ICT risk in the context of ICAAP and for the determination of internal capital.

In general, institutions identify their material ICT risks, even if the categorisation is expected to be improved in some smaller entities. Most CAs noted ICT availability/continuity and ICT outsourcing risks as the main risks for the entities under their supervision. ICT outsourcing seems to be the area raising most concerns; therefore, the EBA intends to broaden the scope to the wider context of operational resilience and make it a key topic for supervisory attention for 2020²¹ with leveraging on the EBA GL on outsourcing.

GOOD PRACTICES

²¹ Please refer to Chapter 7 for information on the topics identified for supervisory attention for 2020.

- In the framework of the off-site monitoring, the CA requests the institutions' ICT strategy, together with a description of how the institution ensures that ICT operations are conducted according to the institution's ICT strategy and process and internal rules.
- An ICT risk scorecard was developed by a CA that incorporated a SWOT (strengths, weaknesses, opportunities and threats) analysis to capture more qualitative information for small and less complex institutions' ICT risk framework.

AREAS FOR CAS' ATTENTION

- All CAs should ensure that an institution's ICT risk appetite has been formalised and approved by the management body.
- The SREP ICT risk assessment needs to pass to its 'second' phase, with supervisors scrutinising the ICT risk governance, risks controls and mitigation plans more, by taking into account the heightened importance of ICT risk management and appropriate control of ICT risks.

2.3.3 Non-performing exposures

As part of the continued efforts to improve the asset quality of European banks and also drive the convergence of supervisory practices in this respect, the EBA included, in its 2019 convergence plan, the assessment and monitoring of the reduction in NPLs in institutions' balance sheet as a key topic for supervisory attention. The GLs on the management of non-performing and forborne exposures, which were addressed to CIs and CAs, were applicable from 30 June 2019.

The EBA followed up on the monitoring of key asset quality indicators as well as focused its assessment on the following aspects of the GLs:

- existence of an approved NPE strategy, with time-bound reduction targets;
- existence of an NPE operational plan and appropriate organisational arrangements to implement the NPE strategy.

The EBA's review concluded that the requirement for the establishment of an NPE strategy and operational plan was well implemented across the EU, in particular in Members States with relatively high NPE/NPL levels. Further attention needs to be given to the quality of NPL reduction plans, in particular their reliability and consistency with the operational plans.

All CAs continuously monitored NPE levels, inflows and their coverage, through both on-site and off-site supervisory activities, and have a considerable amount of data at their disposal to conduct such an assessment relying on supervisory reporting. More authorities emphasised the role of dedicated on-site inspections in the assessment of the related risk reduction policies and processes. Some of the on-site visits in 2019 addressed smaller and non-complex institutions in SREP categories 3 and 4.

The analysis of the submitted data not only fed into each bank's supervisory assessment report but was also used for peer reviews, sectoral analysis and stress testing. The data were verified by on-site inspections and were also used in supervisory dialogues with the institutions.

More authorities reported that they had issued recommendations or formalised their expectations in other forms, in line with the EBA GLs, and published them on their website.

All Member States where CIs were predominantly affected by high levels of NPLs reported that all or the vast majority of institutions were systematically asked to submit NPE strategies, which were followed up by supervisors. The average time horizon of the strategies is 3 years, and it is updated on an annual basis. Some CAs also highlighted that they have checked whether the interest of customers was respected, in line with the GLs, and that banks offer effective and viable long-term solutions to borrowers with financial difficulties.

One Member State with a low level of NPE-NPL ratios in the banking sector reported that they intended to fully comply with the EBA GLs on management of non-performing and forborne exposure by end of 2020, and another reported that the 2019 internal control report, including the element on the NPE strategy, will be submitted by the institutions in early 2020.

Institutions are required to present an operational plan to show how the objectives of the NPE strategy will be achieved. The NPE operational plan, submitted in conjunction with the NPE strategy and detailing the operational approach of delivering the NPE strategy, is used for feasibility assessment. Supervisors follow up on the detailed requirements, in terms of both organisational aspects, e.g. separate NPL resolution units, and the establishment of early warning system and its appropriate information technology (IT) support.

When CIs have a gross NPL ratio below the 5% level but have a high share or material amount of NPEs in an individual portfolio(s) or in a geographical region, an economic sector or a group of connected clients, CAs may require CIs to submit an NPL strategy and a related implementation plan. It was, however, not apparent from the exercise that CAs apply this provision of the GLs to individual portfolios.

Main outcome of the supervisory review

Supervisory experience in 2019 was that the banks' strategies varied greatly, in relation to both the amount of planned recoveries and sales, and how prudent the plans' assumptions were. Not all strategies, in particular those of smaller and less complex institutions, offered a realistic but sufficiently ambitious time horizon for NPL reductions, while others were not accurate or were inconsistent with the implementation plan. Some banks have not taken sufficient account in their assumptions of the recent decline in economic growth prospects.

At the aggregate level, the NPL reduction achieved by the less significant institutions so far is in line with the targets, while on an individual basis some misalignments were identified.

AREAS FOR CAS' ATTENTION²²

- All CAs implement the provision of the GLs in their supervisory practices.
- CAs should consider requesting an NPL strategy and a related operational plan for selected portfolios, even if the gross level of the NPL ratio of an institution does not exceed 5%. This will ensure that the institution is effectively tackling the reduction in NPLs in the affected portfolio and ensure timely reduction.

2.3.4 Use of benchmarking exercise for internal models

The benchmarking of internal models, as per Article 78 of the CRD, is a crucial element of supervising CIs with approved internal models²³. Supervisors check, on a yearly basis, whether institutions use well-developed and up-to-date internal model techniques and verify that regulatory requirements are met.

The supervisory benchmarking exercise involves both complex and small and less complex institutions using internal models for the calculation of own funds requirements. Based on the information provided by CAs, they rely on the EBA bank-specific exercise as an input to the supervisory assessment of banks' internal model approaches. Outliers from the EBA benchmarking exercise are followed up with the institution for further insight and/or explanation and integrated into the ongoing monitoring. Systemic underestimation of risk parameters in a portfolio could warrant a detailed review.

CAs reported that, for smaller and less significant institutions, the exercise is less relevant, because only a limited number of these institutions were authorised to adopt internal models for calculating own funds requirements for credit or market risk.

Monitoring activities are often conducted in a thematic way in order to ensure consistent treatment of identified model weaknesses across institutions involved in specific portfolios.

Main outcome of the supervisory review

Significant progress has been observed as a result of the actions undertaken in recent years at both regulatory (inter alia, regulatory technical standards — RTS — and GLs provided by the EBA) and supervisory levels. Institutions' internal validations and CAs' monitoring activities are increasingly picking up on internal ratings-based (IRB) model deficiencies identified by the EBA exercise.

2.4 Supervisory convergence in other areas of ongoing supervision

The 2019 EU-wide benchmarking exercise for market risk shows a substantial reduction in the dispersion in the initial market valuation and some reduction risk measures, especially for the

²² These points should be read together with the [EBA statement on actions to mitigate the impact of COVID-19 on the EU banking sector](#), in particular the fact that there is the flexibility in the implementation of the EBA GLs on management of non-performing and forborne exposures and that the EBA calls for a close dialogue between supervisors and banks, on non-performing exposure strategies, on a case-by-case basis.

²³ Further information about the technicalities of the exercise is included in the next section (Section 2.4).

aggregated portfolios, compared with previous exercises. For credit risk, the usual metrics on the variability are relatively stable when calculated using a common sample of institutions.

The EBA monitored the practical implementation of the liquidity coverage ratio (LCR) in 2019, and in its LCR monitoring report it highlighted areas in which further guidance was deemed useful for banks and supervisors to foster a common understanding and harmonisation of the application of the liquidity standard. In addition, the EBA has identified areas that may need further attention from supervisors in their ongoing supervision of liquidity risks.

The peer review that the EBA has conducted regarding the application of RTS on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile shows that, within the European Economic Area (EEA), CAs have properly applied the RTS during the reference period. The review panel identified a number of best practices and weaknesses from CAs.

2.4.1 Benchmarking exercise of internal models

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 that (ii) the EBA produces reports to assist CAs in this assessment.

This benchmarking exercise is a regular EU-wide supervisory tool, covering the entire population of institutions authorised to use internal models for calculating own funds requirements²⁴. 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 from 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 year²⁵ (Regulation (EU) No 2016/2070).

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.

Market risk benchmarking — report on the 2019 exercise

With respect to market risk, the 2019 exercise represents the first exercise with the new set of hypothetical instruments and portfolios. The new set of instruments, which is fairly more extensive in terms of the number of instruments to model than the three previous exercises, is made up of almost all vanilla instruments. The 2019 analysis shows a substantial reduction in the dispersion in the initial market valuation and some reduction risk measures, especially for the aggregated portfolios, compared with the previous exercises. This improvement was expected and is likely due to the simplification in the market risk benchmark portfolio. Nonetheless, some dispersion still exists; however, the fact that this is the first exercise with new instruments, and that banks usually need time to get familiar with new instruments, has to be taken into consideration.

²⁴ More than 130 institutions at the highest level of consolidation.

²⁵ In July 2019, the EBA published an updated ITS for the 2020 data collection.

A major part of dispersion has been examined and justified by the banks and the CAs. A minor part of the outlier observations remains unexplained and is expected to be part of the ongoing supervision activities of supervisors, who are expected to monitor and investigate the situation.

The quantitative analysis, which has been extended with respect to the previous exercises, was also complemented by a questionnaire for CAs. As for the past exercise, the questionnaire was used to collect CAs' assessments of the over- and underestimation of RWAs. In most cases, CAs were aware of and able to explain the causes of the majority of the deviations. Although the majority of the causes were identified and actions were put in place to reduce the unwanted variability of the hypothetical RWAs, the effectiveness of these actions can only be evaluated through an ongoing analysis.

Credit risk benchmarking — report on the 2019 exercise

With respect to credit risk, the report uses a mix of qualitative and quantitative analysis to measure variability. Since 2018, the reports have presented the outcomes of the analyses on benchmarks for both low default portfolios (LDPs) and high default portfolios (HDPs).

On the quantitative side, the usual metrics on variability are relatively stable when calculated using a common sample of institutions: around 50% of the variability observed is explained by simple risk drivers ('top down analysis'), the fact that the risk weight deviation on LDPs is limited to 10 percentage points and the fact that the estimates on HDPs are generally on the conservative side when compared with empirical default and loss rates. Furthermore, this year was the first year that a comparison with the standardised approach (SA) could be performed on HDPs. While the overall variability observed under the SA is at a similar level to that of the IRB observed previously, it is worth noting that, within a single exposure class, the variability under the IRB approach follows, in a conservative manner, the empirical variability of risk (observed through default rates), while the variability of RWAs in the SA is not as linked to the empirical risk variability.

The quantitative analysis is complemented with a qualitative one. This is because, while the quantitative analysis provides a measurement of the variability, a qualitative assessment is necessary to understand the cause of this variability. It is composed of three different parts.

- A questionnaire filled in by CAs, which ensures that the benchmarking figures are analysed in a harmonised manner. Supervisory benchmarking is a key tool in the supervisory cycle.
- Interviews with institutions for which the highest number of outlier observations were spotted. In general, the interviews were useful, because they allowed a number of points to be clarified and a thorough understanding of the deviation observed from the benchmarks. They confirmed the known peculiarities of calibration for LDP, stemming from the lack of default observations. This seems to support the reduction in the scope of modelling agreed in the final Basel III framework²⁶ and also recommended by the EBA in a set of recommendations, as an answer to the call for advice of the European Commission²⁷.
- A survey to delve deep into a specific topic. The 2019 exercise was used to better assess the variability of practices in terms of rating scales, in particular between institutions, using

²⁶ <https://www.bis.org/bcbs/publ/d424.htm>

²⁷ <https://eba.europa.eu/eba-advises-the-european-commission-on-the-implementation-of-the-final-basel-iii-framework>

different types of calibration for probability of default (purely continuous models, discrete direct estimates and grade-based estimation).

2.4.2 Monitoring of the LCR implementation

The EBA published its first report on the monitoring of LCR implementation in the EU on 12 July 2019²⁸. The report is a product of EBA's monitoring of the LCR, which contributes to a consistent application of EU law and promotes common supervisory approaches and practices in this area. The start of the application of the LCR is relatively recent (it has been applicable in the EU since 1 October 2015), and the LCR's full implementation at a minimum of 100% became effective in January 2018. This put an end to any national provisions in the area of liquidity requirements²⁹.

Commission Delegated Regulation (EU) 2015/61 (the LCR Delegated Regulation)³⁰ contains the specifications of the LCR. The LCR Delegated Regulation sets out a material number of national discretions to be exercised by CAs when implementing the LCR requirements and envisages some leeway for CIs in the assessment of some material LCR items. Against this backdrop and as per the EBA monitoring duties, with a view to contributing to a consistent application of EU law and promoting common supervisory approaches and practices in this area, the EBA has monitored the practical implementation of the LCR.

In the report, the EBA has highlighted areas in which further guidance is deemed useful for banks and supervisors in order to foster a common understanding and harmonisation of the application of the liquidity standard while tackling some issues relating to the level playing field. In particular, the report provides guidance on operational deposits and retail deposits excluded from outflows as well as notifications on additional liquidity outflows.

In addition, the EBA has identified areas that may need further attention from supervisors in their ongoing supervision of liquidity risks, in particular the time dimension of the LCR (a comparison between end-of-month LCR and intra-month LCR values) and cases in which banks are swapping some retained own securities. This report contains specific guidance for CIs and supervisors on different topics. The guidance identifies good and prudent practices in the application of several provisions of the LCR Delegated Regulation for which, currently, the degree of discretion is such that divergent and undesired results are reached, jeopardising the consistent application of those provisions and the level playing field. The EBA intends to follow a pragmatic approach to addressing these issues by publishing this guidance, with the expectation that CIs and supervisors will follow it. As a primary source for its monitoring activities, the EBA builds on the data reported by banks in accordance with the supervisory reporting requirements (COREP) on the LCR and additional monitoring metrics on liquidity. For the July 2019 report, which refers to data regarding the 30 June 2018 reporting reference date, this included 192 (large and small) institutions across 12 business model categories. The data are complemented by qualitative analyses of CAs. The EBA intends to regularly monitor the implementation of the LCR for EU banks and update the LCR monitoring

²⁸ <https://eba.europa.eu/eba-reports-on-the-monitoring-of-the-lcr-implementation-in-the-eu>

²⁹ Article 412(5) of the CRR.

³⁰ Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions (OJ L 11, 17.1.2015): <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0061&from=EN>

report on an ongoing basis, to set out its observations and provide further guidance if necessary. The EBA is currently working on the implementation related to outflows with interdependent inflows³¹, the LCR calculated by significant currency and high-quality liquid asset (HQLA) diversification.

The EBA will further assess how the guidance provided in the report will be used by banks and supervisors, and will consider taking further steps if needed (including some fully fledged products, such as GLs and recommendations) while continuing its monitoring of the aspects mentioned in the report.

2.4.3 Peer review on the RTS on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile

In 2019, a peer review regarding the application of the RTS on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile (RTS on identified staff) was carried out by the EBA and the CAs, to assess how the CAs comply with these technical standards. This peer review shows that, within the EEA, CAs properly applied the RTS during the reference period from 1 January 2015 to 31 December 2017.

The review panel identified a number of best practices and weaknesses from CAs. As to the best practices, the report highlighted in particular institutions' notification and prior approval process on the exemptions of identified staff, the assessment of the application of such exemptions and the supervisory tools for assessing institutions' compliance. As to the weaknesses, the report highlighted that, although CAs typically follow a risk-based approach, some of them have some difficulties distinguishing their standard risk-based methods of supervision from the application of the proportionality principle. This leads to diverging approaches and, in a few cases, the exclusion of certain institutions from the supervisory review on a systematic basis.

With a view to improving the consistent application of the RTS and harmonising CAs' practices, it was suggested that a targeted review of the application of the RTS after its amendment following the entry into force of Directive (EU) 2019/879 (CRD V)³² be carried out. The review will aim to ensure that the observed weaknesses will be addressed in a consistent manner by CAs.

³¹ Article 26 of the LCR Delegated Regulation.

³² <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2019:150:FULL&from=END> (See new Article 92, 150/270 — paragraph 26.)

3. Convergence in the continuum between ongoing supervision, recovery and resolution

The EBA has performed a comparative analysis of the recovery and resolution plans on a sample of EU banking groups, and the initial work has evidenced that further guidance work could be undertaken on additional aspects of interlinkages, in particular on the process of coordination between CAs and resolution authorities (RAs).

With regard to early intervention measures (EIMs), the EBA has conducted a survey, the results of which indicate that the set of EIMs introduced by the Bank Recovery and Resolution Directive (BRRD) has not increased, to the extent envisaged by the legislator, CAs' capability to prevent a crisis of institutions. The application of EIMs across the EU has been very limited so far.

3.1 Interlinkages between recovery and resolution planning

With continuous progress in the development of recovery and resolution planning under the BRRD, the EBA has considered it important to focus on checking the effective interlinkages between these two potentially contiguous phases, with the aim of contributing to maximising synergies and ensuring a smooth transition from one phase to another.

An effective interaction between recovery and resolution plans helps to avoid inconsistencies between their content and reduces the risk that CAs and RAs may send conflicting requests to institutions or take contradictory actions to overcome shortfalls in recovery or resolution plans. Ultimately, an effective interlinkage between recovery and resolution planning should also support CAs and RAs in fulfilling their tasks under the BRRD and promote more effective cooperation between them.

As a first step in analysing the interlinkages between recovery and resolution plans, the EBA has performed a comparative analysis of the recovery and resolution plans of a sample of European banking groups. The aim of the analysis was not to assess whether there is a full alignment between recovery and resolution plans, given their different purposes and different owners (institutions vs RAs). Instead, the aim was to verify the current state of interlinkages between recovery and resolution plans, as well as identify key trends and best practices.

To further support progress on interlinkages, the EBA has also examined a key aspect of interlinkages related to the assessment of the potential impact of recovery options on an institution's resolvability. Aggregating the current insights and best practices of EU authorities on this aspect, the EBA has been working to develop a practical tool ('assessment table') and a procedural approach, to provide guidance to CAs and RAs on how individual recovery options might impact resolvability.

This initial work has evidenced that further guidance work on interlinkages could be carried out on additional aspects of interlinkages, including some practical aspects related to the process of coordination between CAs and RAs.

3.2 Early intervention measures

In the first half of 2019, the EBA conducted, among CAs, a stocktake exercise on the application of EIMs according to the BRRD. The main objective of the survey was to examine the extent to which the EIMs had been applied in various EU jurisdictions during the 4 years following the BRRD's entry into force and understand the reasons underlying observed supervisory practices.

A stocktake was conducted according to a predefined questionnaire, which was composed of three parts: (i) implementation of EBA GLs on triggers for use of early intervention measures (EBA/GL/2015/03); (ii) empirical data on the application of EIMs (covering three stages — identification of breaches of EI triggers; meeting conditions for early intervention, application of EIM); and (iii) challenges and suggestions for the way forward.

The survey has revealed that the application of EIMs across the EU has been very limited so far, as they have been used in approximately 30% of jurisdictions and only a small number of EIMs have been applied. Moreover, almost half of the respondents to the survey decided to apply other supervisory powers (e.g. measures based on Article 104 of the CRD) instead of EIMs in cases in which early intervention conditions were met. This result might indicate that the set of EIMs introduced by the BRRD have not increased, to the extent envisaged by the legislator, the CAs' capability to prevent a crisis of institutions. The survey also identified the key challenges faced by supervisors in the application of the current regulatory framework on early intervention:

- interaction between EIMs and other supervisory powers (including overlap between EIMs and other supervisory powers and in terms of the conditions for applying them; the capability of existing EIMs to address crisis situations; sequence of applying EIMs);
- disclosure and reputation risks related to possible obligations to disclose the application of EIMs to market participants;
- specification of EI triggers (e.g. SREP scores and in the monitoring of key risk indicators).

Based on the survey, the EBA also analysed possible options for addressing the key implementation issues. The initial overview of the experience in the application of the current regulatory framework on EIMs indicates that amending the EBA GL on triggers for the use of early intervention measures, or replacing them with the RTS on the same topic (based on the possibility given to the EBA in Article 27(5) BRRD) does not seem to be sufficient to remedy identified challenges. The majority of the identified issues may possibly require changes to relevant Level 1 legislation.

4. Convergence in supervisory colleges

In closely monitored supervisory colleges, a very good level of involvement of college members was observed in 2019. These colleges made considerable efforts to conduct a thorough group risk assessment, and the areas that received the most supervisory attention, namely operational risk, including ICT risk, and internal governance, correspond to two of the 2019 key topics that the EBA has put forward in its 2019 convergence plan.

However, further improvements are required in the assessment of the IRRBB in some colleges and in channelling the findings of the group recovery plan (GRP) assessment and the money laundering/terrorist financing (ML/TF) risk assessment into the SREP. The EBA observed an emerging practice of not preparing a group liquidity risk assessment in some colleges, which is not in line with the legal requirements and which hampers a thorough assessment of the main components of the risk to liquidity and funding.

All closely monitored colleges reached an agreement on P2R, and the communication of the TSCR followed the formula described in the SREP GLs. While P2G was increasingly set, the EBA observed that not all CAs were prepared to set P2G in 2019. In terms of measures, colleges are encouraged to better reflect the outcome of the group risk assessments in the subsequent supervisory measures included in the joint decisions.

In 2019, the EBA performed one binding mediation related to recovery planning, in which a difference in views was successfully resolved by an amicable agreement of the parties involved during the conciliation stage.

In the colleges not selected for close monitoring by the EBA, discussions were of a good depth, and the key topics were largely covered in their work. Regarding the three joint decisions³³, an agreement was either reached or in progress.

4.1 Monitoring of supervisory colleges in 2019

Based on the information obtained from EEA consolidating supervisors in Q1 2019, the number of active supervisory colleges remained relatively stable. Overall, 62 colleges were reported as active for 2019 and were included in the 2019 list of supervisory colleges³⁴, compared with 63 in 2018. In addition, five active colleges were reported for third-country banking groups at the EEA sub-consolidated level (same number as in 2018), raising the total number of active supervisory colleges to 67.

³³ Capital, liquidity and GRPs.

³⁴ Annex to the EBA report on supervisory colleges in 2018: <https://eba.europa.eu/sites/default/documents/files/documents/10180/2710376/035ae7e7-82b4-46a7-bebb-4883bdba4daf/2018%20EBA%20Report%20on%20supervisory%20colleges.pdf>

Within its mandate of facilitating supervisory cooperation in supervisory colleges and enhancing their effective and efficient work, the EBA monitors the functioning of supervisory colleges.

Out of the 67 active supervisory colleges, the EBA continued to closely monitor 12³⁵ in 2019.

The EBA's participation in supervisory colleges is aimed at (i) promoting the colleges efficient and effective functioning; (ii) promoting and assessing supervisory convergence; and (iii) supporting the colleges in the implementation of relevant policy products and sharing observed good practices.

The monitoring and assessment of colleges in 2019 covered the following main elements:

- organisational aspects;
- colleges' interactions;
- colleges' legal deliverables:
 - i. group risk/liquidity risk assessments;
 - ii. a joint decision on capital and liquidity;
 - iii. a joint decision on the assessment of GRPs;
- key topics listed in the 2019 convergence plan for supervisory attention.

EBA staff in 2019 actively participated in interactions (meetings and conference calls) organised by colleges selected for close monitoring. This entailed delivering a presentation to a college on the key topics identified by the EBA for supervisory attention for 2019 and relevant policy developments. Furthermore, the EBA's interventions often addressed the key deliverables of colleges, i.e. the group risk/liquidity risk assessments, and the joint decisions on capital and liquidity and the assessment of GRPs.

Other activities included (i) keeping track of information exchanges in the colleges; (ii) providing structured feedback to the consolidating supervisors after college meetings; and (iii) identifying potential emerging issues among college members early on.

For non-closely monitored colleges, monitoring was undertaken mostly through self-assessment templates compiled by consolidating supervisors and, for the first time in 2019, the relevant CAs, enabling the EBA to have a balanced picture of (i) the functioning of colleges and (ii) whether the key topics for supervisory attention had been taken into account in the colleges' work.

In total, 35 consolidating supervisors from the 55 non-closely monitored colleges submitted their self-assessment templates; given this, the remaining colleges should reinforce their level of responsiveness in the future. When the response level is considered (64%), however, it should be taken into account that the self-assessment templates were collected in Q4 2019, by which point the number of colleges had started to shrink owing to structural changes in some banking groups (i.e. the sale of subsidiaries, the decrease in the significance of the UK operation, etc.). If these changes are considered, then the response rate better captures the reality (78%).

The EBA has also received 29 responses from host supervisors that are members in 19 banking groups. Their feedback was largely consistent with that of the consolidating supervisor's self-

³⁵ The selection of 12 closely monitored colleges for a 3-year period was decided in 2018.

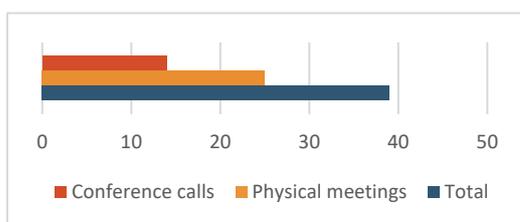
assessment, but in some instances, as explained in the various sections of this chapter, they offer further insights into areas for further improvement. While the consolidating supervisor's role includes the mandate to drive the college processes and the work with the key deliverables, relevant CAs have a key role of actively cooperating with the consolidating supervisor and the other host authorities in performing the duties of the college.

4.2 Quality of college interactions

Closely monitored colleges

In the 12 colleges selected for close monitoring by the EBA, 39 supervisory college meetings overall were organised throughout 2019. Out of those, 25 were physical meetings, whereas the remaining were conference calls.

Figure 13 — Type of college meeting



The EBA has assessed the quality of college meetings, based on the main driving forces of successful and effective college meetings, namely engagement of college members in discussions and the timely distribution of meeting documents/presentations.

In closely monitored colleges, a very good level of involvement and interactions among supervisory college members was observed. College members openly shared information during the vast majority of interactions, asked questions and mutually challenged each other's positions. The EBA is of the opinion that the group risk/liquidity risk assessment reports should benefit from the outcome of these discussions in all colleges and better reflect the shared concerns of supervisors.

In the majority of cases, consolidating supervisors promoted open discussions, encouraging other college members to ask questions. These efforts seemed to facilitate a good spirit of cooperation and engagement within the colleges. However, in some instances, challenging others' positions or posing questions during meetings remained one-sided and/or mostly driven by the consolidating supervisor. EBA staff noted that, if documents and reports had been shared well in advance of the college meeting, participants could have contributed more to the discussions. Therefore, the EBA promotes sharing the documents at least one week before the meeting. The EBA found that the majority of colleges are indeed committed to ensuring that the documents are shared at least one week before the meeting, as more than 60% of the closely monitored colleges included this guiding principle in their colleges' written coordination and cooperation arrangements (WCCA).

Regarding the risk assessment discussions, two approaches seem to prevail. One approach prefers to cover *all risks* included in the SREP GLs and in the group risk/liquidity risk assessment templates, as per the annex to Commission Implementing Regulation (EU) No 710/2014 on the joint decision process for institution-specific prudential requirements, i.e. the colleges discuss the assessment of all risks. The outcome of the risk discussions is usually an overall heat map that describes the risk profile of the group. The other approach is when some *selected key risks* are discussed in more depth in the college setting, which allows more engagement from college members and which could potentially pave the way for joint supervisory activities.

Meetings or calls also provided an occasion for members to agree on joint activities, e.g. inspections and meetings with management at group and/or entity level, allowing authorities to remain up to speed on supervisory activities and enabling host authorities to express their interest in taking part in the relevant supervisory activities. Apart from a few exceptions, the representatives of the banking groups also attended³⁶ meetings and provided relevant updates to colleges, which was well received by all members.

GOOD PRACTICES

- The college WCCA includes a guiding principle that all meeting documents are circulated in the college at least one week before the meeting, to enhance the involvement of all meeting participants by allowing ample time for preparation.

AREAS FOR COLLEGES' ATTENTION

- Colleges should enhance links between the risk assessment discussions and the supervisory actions and measures to be proposed.

Colleges not selected for close monitoring

In these colleges, interactions among college members were generally quite frequent. In the majority of cases, physical college meetings took place once per year, but additional interactions were carried out by phone and email.

Observations from consolidating and host supervisors about the college interactions were broadly similar. In general, discussions were reported to be of good quality and depth (74%).

³⁶ Part of the meetings.

Figure 14 — Quality and depth of discussions

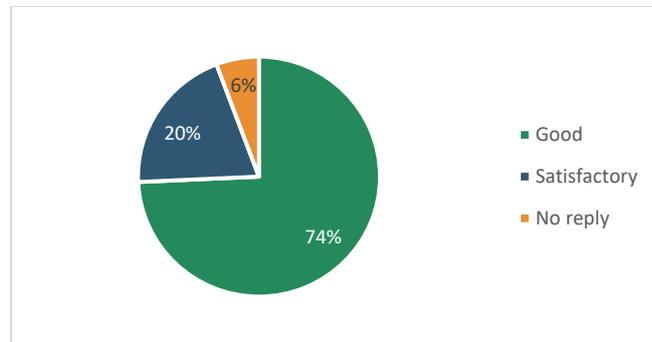
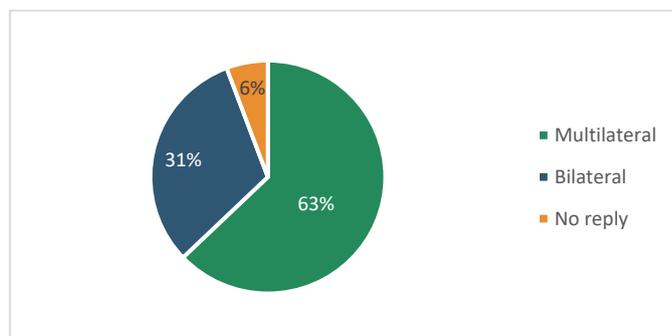


Figure 15 — College meeting discussions



Most supervisors (83%) reported that discussions usually included queries from national authorities on each other's contributions, e.g. regarding risk assessments and capital requirements, with the consolidating supervisor facilitating the discussion. Again, in 83% of these colleges, the bank representatives attended part of the college meeting and delivered presentations, mainly on the group strategy and plans. College members valued the proximity of the bank, and they were active in asking questions in most colleges (80%).

The outcomes of the college meetings, particularly if material issues were discussed or supervisory actions taken, were documented and communicated to the supervisory college in the majority of these colleges (71%). Minutes or write-ups were usually circulated some weeks after the meeting, although this did not occur in all colleges. When minutes were produced and circulated, the majority of the authorities (66%) noted the possibility of college members commenting on the draft minutes.

Concerning the challenges faced, consolidating supervisors noted (i) the efforts to improve the level and depth of the discussions during physical meetings, and (ii) the difficulties in aligning the SREP timelines between the consolidating and host supervisors.

GOOD PRACTICES

- Draft meeting agendas were discussed in calls, and there was the possibility for college members to raise topics/issues, i.e. agendas were not finalised only in written correspondence.
- The agenda of a college meeting included the description of the purpose of each agenda item (not only the purpose of the overall meeting), which helped focus participants' attention on the key objectives of each session.
- College discussions were organised on a risk-by-risk basis, starting with the group and then addressing all individual subsidiaries (instead of on an institution-by-institution format), to foster college discussions and facilitate the identification of common issues across the group.
- The involvement of the bank representative(s), whenever possible from an executive management level, enabled college members and observers to interact directly with the group.
- Host supervisors were asked by a consolidating supervisor to prepare dedicated presentations on specific topics, to promote active participation.

4.3 Quality of college deliverables

Group risk/liquidity risk assessments

Commission Implementing Regulation (EU) No 710/2014 on the joint decision process for institution-specific prudential requirements provides that one of the first steps in this process is the compilation of the group risk/liquidity risk assessment report, for which both the consolidating and the relevant CAs undertake their respective assessments³⁷.

The scope and structure of the supervisory assessment is driven by the SREP GLs as well as the templates provided by Commission Implementing Regulation (EU) No 710/2014³⁸. Colleges are the forums in which these draft group and individual risk/liquidity risk assessments are shared and discussed in order to arrive at a solid final group risk/liquidity risk assessment that incorporates all supervisory views on the risks that the group and its entities are exposed to.

The EBA, when reviewing risk assessment reports and participating in college discussions, also considered how the key topics identified for supervisory attention for 2019 have been embedded in the colleges' supervisory examination programmes (SEPs) and reflected in the colleges' work, for example in college discussions, joint activities, and on-site and off-site activities.

Closely monitored colleges

EU supervisory colleges made considerable efforts in 2019 to compile a thorough group risk assessment report. There was only one occasion when the group risk/liquidity risk assessment

³⁷ A draft group risk/liquidity risk assessment report and draft SREP reports.

³⁸ Annexes I-VIII.

report lacked the necessary granularity that would have corresponded to the size and complexity of the banking group that was noted in the EBA's feedback.

According to the heat map compiled by the EBA based on the group risk assessment reports of the 12 closely monitored colleges, the two areas that required the most supervisory attention in 2019 were:

- operational risk, including ICT risk and operational resilience;
- internal governance and institution-wide controls.

Findings on potential ML/TF have been channelled into both of the SREP elements: (i) operational risk, as far as the prudential impact is concerned; and (ii) internal governance, in connection with the lack of appropriate processes and controls.

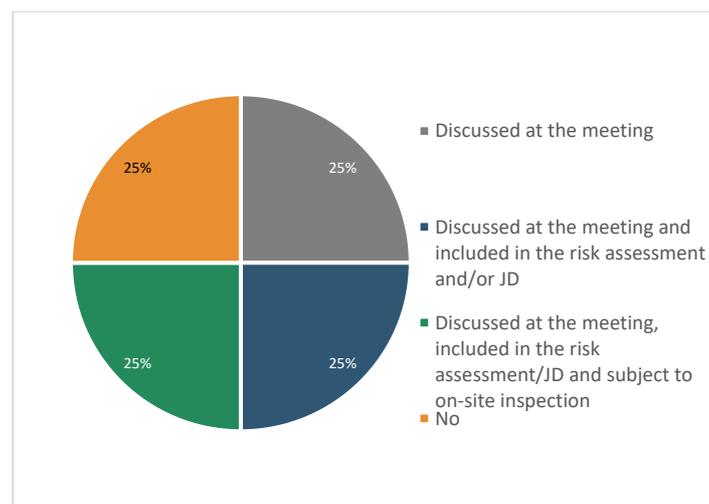
The outcome of the heat map, therefore, confirmed that two of the 2019 key topics for supervisory attention, namely ICT risk and operational resilience and internal governance, put forward by the EBA 2019 convergence plan, were high on the agenda of supervisory colleges in 2019.

Operational risk, including ICT risk and ML/TF risks

Regarding ICT risk and operational resilience, colleges looked into whether institutions have a clear ICT strategy that (i) is aligned with the business strategy and (ii) is operationalised by the implementation plan.

In 75% of the closely monitored colleges, the identification of material ICT risks was subject to discussion at college meetings; for half of the 12 colleges, this aspect was also explored in detail in the group risk assessment. In a quarter of the closely monitored colleges, additional on-site supervisory activities were conducted to substantiate the supervisory view that underpinned the assessment.

Figure 16 — Identification of material ICT risks in supervisory colleges



JD=joint decision

Out of the five ICT risk categories described in the EBA GLs on ICT Risk Assessment under the SREP (EBA/GL/2017/05), ICT change risk, including the ageing and fragmented IT systems and their complexity, ICT security risks and ICT data integrity risk have been noted as the most prevailing risks considering the level of inherent risk and controls.

The assessment of ICT outsourcing is coming under more supervisory scrutiny, which is also the EBA's intention. Therefore, this topic was selected for close monitoring, as part of the ICT risk and operational resilience for 2020³⁹, in the context of the implementation of the EBA GLs on outsourcing arrangements (EBA/GL/2019/02), with a particular view of outsourcing to cloud service providers.

Further aspects of operational risk that supervisors looked into, among other aspects, were the framework for operational loss data collection, whether the database is complete and reliable and surrounded by appropriate processes, and the evolution of operational losses. Supervisors in more colleges were concerned about the significant and/or increasing level of operational losses.

ML/TF risks

CAs also considered risk from ML/TF and other conduct risk in the SREP process but to different degrees. While the topic was and has been an integral element of the SREP assessment in more and more colleges, with the assessment of remediation actions and discussion on emerging conduct cases, not all colleges dedicated enough attention to the banking group's compliance with the relevant AML/countering the financing of terrorism (CFT) regulation. Supervisors may have conducted an assessment for their entities under their jurisdictions on these topics, the outcome of which did not give rise to concerns; however, this was not apparent from discussions in prudential supervisory colleges and/or from group risk assessments. Considering the increasing importance of AML/CFT, all colleges should ensure that ML/TF risks and conduct risks are reviewed by their respective supervisors⁴⁰ and, if material risks have been identified, that they feed into the SREP assessments. The EBA issued an opinion on communications to supervised entities regarding ML/TF risks in prudential supervision in July 2019 as well as joint GLs on AML/CFT cooperation, together with European Insurance and Occupational Pensions Authority (EIOPA) and ESMA, in December 2019.

When colleges assessed ML/TF and conduct risks, prudential implications were also explored in most cases, together with the possible reputational risk that it entails.

In order to raise further awareness in the supervisory community of the importance of (i) interactions between prudential and AML/CFT supervisors and (ii) incorporating the outcome of the ML/TF risk assessment into the overall prudential supervisory view about the supervised entities, the EBA picked AML/CFT as key topic for supervisory attention in its 2020 convergence plan.

³⁹ The EBA 2020 convergence plan is included in Chapter 7 of this report.

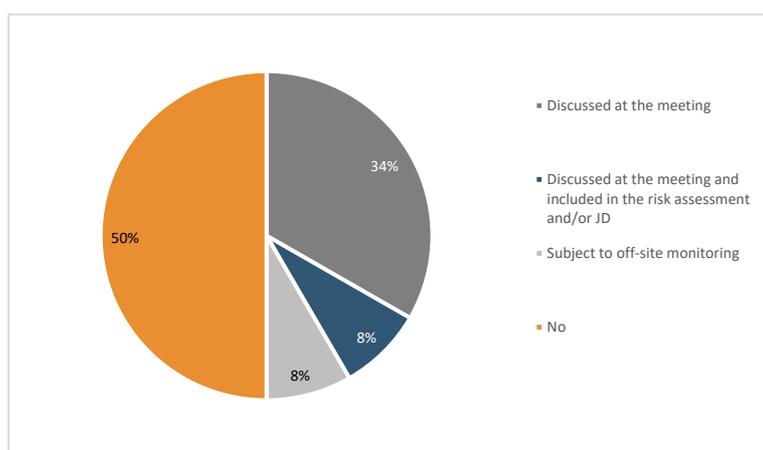
⁴⁰ AML and/or conduct supervisors.

Internal governance and institution-wide controls

CAs in supervisory colleges should assess whether the arrangements aimed at ensuring that the individual and collective suitability of the management body are implemented and carried out effectively upon appointment, in case of material changes and on an ongoing basis, in accordance with Articles 74 and 91(12) of the CRD and the EBA GLs.

The individual and collective suitability of the members of the management body and their reassessment was included in the colleges' action plans in half of the closely monitored colleges, either in the form of college discussions or as part of the group risk assessment report, or in one case the topics were subject to certain off-site focused reviews.

Figure 17 — Institution's re-assessment of the individual and collective suitability of the members of the management body



JD=joint decision

More colleges, however, that did not specifically address this topic in 2019, completed extensive work in governance related reviews over the course of 2018.

The assessment of institution-wide controls is a core element of all CAs annual SREP processes; therefore, the outcome of the supervisory assessments were well summarised in the 2019 group risk assessment reports. More authorities conducted deep dives or other dedicated assessments, focusing mainly on the compliance function. However, with regard to whether all elements of the assessment, as per the SREP GLs and EBA GLs on internal governance, were covered in the group risk assessments and/or college discussions, and to what level of detail, there were some differences observed across colleges.

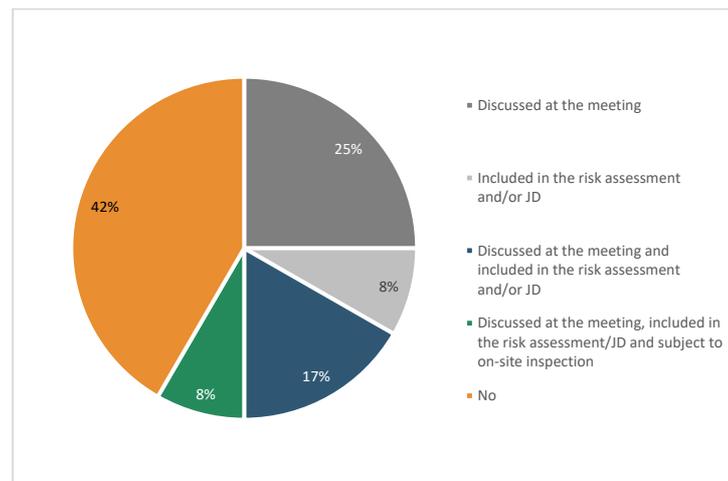
In 8 out of the 12 banking groups, supervisors identified weaknesses with the compliance function, and in six banking groups, they identified weaknesses with the risk management function, while the effective functioning of the internal audit was ensured in the three quarters of the institutions. In one third of the closely monitored colleges, supervisors concluded that both of the functions of

the second line of defence had weaknesses and should be enhanced for the respective banking groups.

Considering that supervisory colleges were established for the supervision of cross-border banking groups and in particular to ensure an effective oversight of the group across borders, many colleges explored the group-wide dimensions of the internal control framework. The EBA observed in-depth discussions in more colleges on the shortcomings of the group-wide controls and their repercussions in one or more subsidiaries.

Internal control functions should have sufficient resources. They should have an adequate number of qualified staff (both at parent level and at subsidiary level), according to the EBA internal governance GLs (EBA/GL/2017/11⁴¹) and the EBA SREP GLs. Overall, 58% of supervisory colleges assessed, accordingly, whether these functions were appropriately staffed, and indeed there were cases in which they concluded a lack of resources across the group. However, in 42% of colleges this was not apparent.

Figure 18 — Resources allocated to internal control functions



JD=joint decision

While the EBA's assessment did not explore whether all areas included in the SREP GLs were assessed by supervisory colleges, it was apparent from the group risk assessment reports that the risk infrastructure and risk data aggregation capabilities of banking groups⁴² have remained an area of attention in the vast majority of colleges.

To assess internal governance and institution-wide controls, CAs should also consider any findings and deficiencies identified in the assessment of recovery plans and recovery planning arrangements

⁴¹ <https://eba.europa.eu/sites/default/documents/files/documents/10180/1972987/eb859955-614a-4afb-bdcd-aaa664994889/Final%20Guidelines%20on%20Internal%20Governance%20%28EBA-GL-2017-11%29.pdf>

⁴² In connection with the Basel Committee on Banking Supervision 239 principles.

conducted in accordance with Articles 6 and 8 of Directive 2014/59/EU. The EBA found that only a quarter of the group risk assessments had made a link with the findings of the GRP assessment.

Further EBA observations related to the group risk/liquidity risk assessments

The adaptation to the EBA GLs on management of interest rate risk arising from non-trading book activities⁴³ varied across colleges. The assessment of IRRBB in general and the assessment of credit spread risk in the banking book (CSRBB) in particular will need to be enhanced in some colleges in next years' SREP cycle, to be in line with the GLs that came into force on 30 June 2019. Some CAs have already developed plans to analyse how institutions adapt to the new requirements that will include an analysis of the changes in the assumptions behind models, a control for negative interest rate shocks and the inclusion of earnings-based metrics in the capital computation.

According to the SREP GLs, CAs should integrate available information and outcomes from all other supervisory activities into the SREP assessments. An important example of such synergies is the interaction between the SREP and the assessment of recovery plans, whereby the conclusion of the latter can feed into the assessment of the relevant SREP elements⁴⁴.

According to the SREP GLs as well as Commission Implementing Regulation (EU) No 710/2014, college members prepare their respective contributions to the group liquidity risk assessments and submit them to the college for supervisory dialogue, before the finalisation of the assessment. In 3 supervisory colleges out of the 12, no stand-alone group liquidity risk assessment reports were prepared by the consolidating supervisor, instead the assessment of liquidity adequacy was only included in the relevant section of the group risk assessment report. This practice is not in line with the legal requirements, and it does not facilitate the thorough assessment of the main components of the risks to liquidity and funding: (i) inherent liquidity risk, (ii) inherent funding risk, and (iii) liquidity and funding risk management.

Good practices in conglomerate supervision

The EBA has observed some good practices in the supplementary supervision on financial conglomerates, driven by the desire of banking and insurance supervisors, as well as supervisors overseeing asset management to better understand the group dimensions in a cross-sectoral context. These practices explored themes such as potential conflict of interest, complexity, contagion, concentration and links in terms of contributions to group funding and income. Findings were added to colleges' agendas, in which the cross-border aspects were also explored. Apart from regular contact among themselves, sectoral supervisors often attended college meetings organised by the other sectoral supervisors. In some instances, the group was requested to present the group dimensions to the consolidating supervisor using a SWOT

43

https://eba.europa.eu/sites/default/documents/files/document_library//Guidelines%20on%20the%20management%20of%20interest%20rate%20risk%20arising%20from%20non-trading%20activities%20%28EBA-GL-2018-02%29.pdf

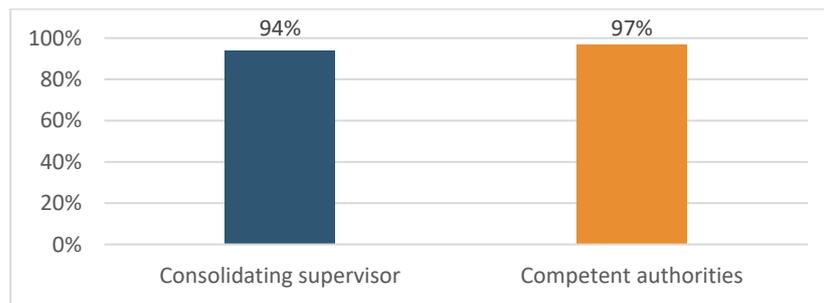
⁴⁴ As an example, the assessment and conclusions of the identification and mapping of core business lines and critical functions could inform the SREP business model analysis or the assessment of the recovery indicator framework, i.e. its consistency with the general risk management framework could feed into the assessment of the internal control framework.

analysis or to provide information on cross-selling links between the bank, the insurance company and potentially the asset manager. Such practices enhanced the level and quality of supervision for the financial conglomerate as a whole.

Colleges not selected for close monitoring

Based on the outcome of the self-assessment templates, the vast majority of these colleges prepared the group risk/liquidity risk assessments and also discussed them in the college setting. The views of the consolidating supervisors in this respect were concordant with those of the relevant CAs' colleges⁴⁵. None of the submissions reported issues with the group risk/liquidity risk assessment and process.

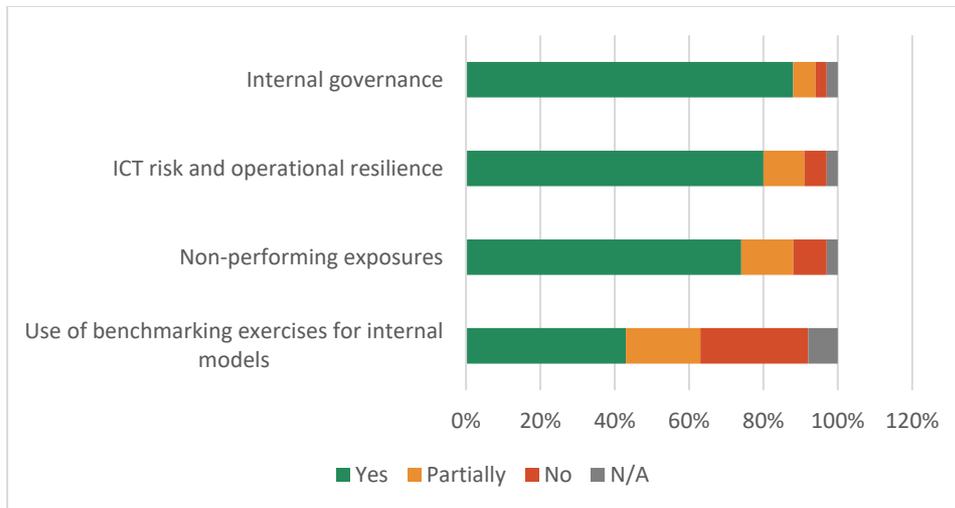
Figure 19 — Draft group risk/liquidity risk assessment reports prepared and shared and respective dialogues conducted



The EBA collected information on whether the key topics for supervisory attention for 2019 had been incorporated into the colleges' work. While the data collected do not allow a further analysis of whether all identified objective elements (attention points per key topic) were covered by these colleges, Figure 20 shows the overall outcome for the 35 reporting colleges:

⁴⁵ While the responses from the consolidating supervisors and the relevant competent authorities may not be entirely and directly comparable, presenting them together supports the overall understanding of colleges' functioning.

Figure 20 — 2019 key topics discussed and embedded in college work



More consolidating supervisors mentioned the uncertainty around Brexit, in particular its impact on the group, and the post-Brexit relationship with UK authorities as challenges in 2019.

From a host supervisory perspective, colleges seem to work well, with good cooperation among college members. Host CAs appreciated the meetings with the bank representatives but also noted that, on the risk and compliance profile of the institution, more frequent interaction would be useful.

Some host authorities confirmed the EBA observation that better coverage of the prudential supervisory college of the ML/TF risks should be achieved. Host CAs also noted that AML colleges should now be set up and start cooperation among the authorities involved as well as with prudential supervisory colleges.

AREAS FOR COLLEGES' ATTENTION

- ML/TF risks and conduct risks, if material, are to be discussed with the AML/CFT supervisors and fed into the SREP assessment.
- All colleges are invited to discuss whether the internal control functions are sufficiently resourced at group and individual entity level.
- Colleges need to better reflect the outcomes of the GRP assessment in the SREP assessment.
- The assessment of IRRBB in general and the assessment of CSRBB in particular will need to be enhanced in some colleges to be in line with the respective GLs.
- All colleges are required to prepare group liquidity risk assessment reports, as per Commission Implementing Regulation (EU) No 710/2014, in order to facilitate a thorough assessment of the main components of the risks to liquidity and funding.

Joint decision on capital and liquidity

Closely monitored colleges

Article 113 of the CRD requires the consolidating supervisor and the CAs responsible for the supervision of subsidiaries of an EU parent institution⁴⁶ to reach a joint decision on:

- the required level of own funds for each entity within the group and on a consolidated level;
- any measures to address significant matters and material findings relating to liquidity supervision.

The process for reaching the joint decision and the mandatory content of the capital and liquidity joint decision is regulated by Commission Implementing Regulation (EU) No 710/2014.

The EBA, as a member of the supervisory college, did not identify any problems over the course of 2019 with the college processes for reaching a joint decision in any of the closely monitored colleges. All 12 closely monitored colleges finalised their group risk assessments and reached an agreement on the additional own funds requirements.

The content of the joint decision followed Articles 10-11 of Commission Implementing Regulation (EU) No 710/2014, which specifies the mandatory elements of the joint decision on capital and liquidity. Overall the joint decision was well reasoned with the conclusions of the outcome of the supervisory review of (i) the institutions' arrangements, strategies, processes and mechanisms, and (ii) the own funds and liquidity held by the institution.

Colleges made considerable efforts to ensure that the timelines available for reaching a joint decision, as per Article 113(2)(a)-(b) of the CRD, were met. Overall, the large majority of the colleges reached an agreement within the mandatory time period that starts with the submission of the final group risk/liquidity risk assessment report to the colleges. Despite the efforts of college members, 25% of the closely monitored colleges did not manage to reach a joint decision on liquidity within the available 1 month. While CRD V extended the timeframe for reaching a joint decision on liquidity from 1 month to 4 months, similar to the current process for reaching a joint decision on capital, CAs need to ensure that they are able to react swiftly and in appropriate amount of time.

⁴⁶ Or an EU parent financial holding company or an EU parent mixed financial holding company.

Figure 21 — Compliance with the 4-month requirement of the CRD for reaching a joint decision on capital

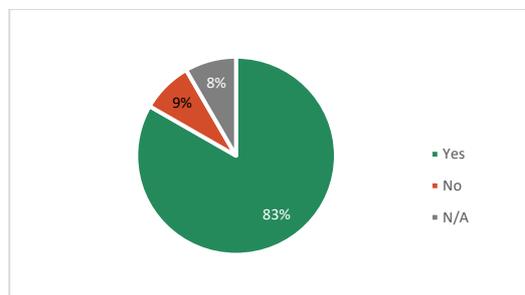
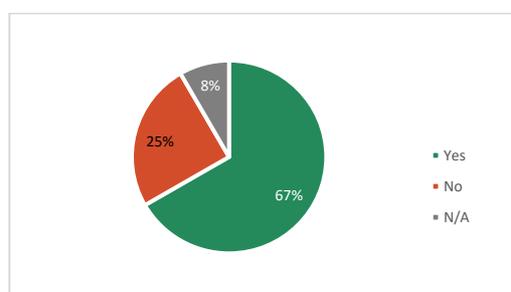


Figure 22 — Compliance with the 1-month requirement of the CRD for reaching a joint decision on liquidity



The convergence in the articulation of the additional own funds requirements (P2R) is crucial to achieving a consistent implementation of the SREP process and in the calculation of the stacking order. The communication of the TSCR in all colleges followed the formula described in the SREP GLs.

In addition, and as part of the assessment of capital adequacy, CAs should also determine whether the applicable own funds requirements can be met in stressed conditions. When the quantitative outcomes of relevant stress tests suggest that an institution may not be able to meet the applicable own funds requirements in stressed conditions or is excessively sensitive to the assumed scenarios, CAs should take appropriate supervisory measures to ensure that the institution is adequately capitalised. These include communicating, to institutions, the expectation of them having own funds over and above their overall capital requirements.

P2G has been set in half of the closely monitored colleges and duly reflected in the joint decision document as an information item in 2019. P2G is increasingly set not only at consolidated level but also at solo level. However, the EBA observed that not all CAs were prepared and had policies and mechanisms in place to allow for the setting of P2G in 2019.

CAs applied various supervisory measures, in addition to the quantitative capital and liquidity requirements, as per Article 104 of the CRD. While these measures are not subject to a formal joint

decision in the supervisory college, they should be discussed in the college framework and included in the joint decision as an information item⁴⁷.

Some common measures addressing internal governance and institutions-wide control deficiencies were (i) the requirement to establish and maintain a sound succession policy for management board members and (ii) the requirement to update the remuneration policies/processes, or (iii) the request to review and improve the ICAAP/ILAAP framework, including the related controls and the internal review and validation. In particular, supervisors expected the stress testing framework to incorporate entity-specific vulnerabilities for the local entities in core countries.

In connection with credit and market risk, a large number of supervisory measures addressed the necessary improvement of the internal model framework: (i) enhance the internal model development; and (ii) perform a validation of certain models.

Specifically for credit risk, the requirement to develop/update a strategic and operational plan to ensure the time-bound reduction of NPEs was among the measures that were applied at group and/or entity level. Institutions were often recommended to follow a specific provisioning policy.

Regarding operational risk, mainly ICT risk-related improvements were expected, such as the establishment of an IT strategy with a respective implementation plan.

Supervisory measures also addressed concerns around institutions' business models and/or capital planning, which are normally highly interconnected. With regard to the former, action plans with specific measures and a timeline for improving the sustainable operation were requested, in particular details on prospective measures to improve profit generation and the bank's position in the market. In connection with capital planning, mostly (i) regularly updated capital projections, (ii) the use of prudent assumptions and (iii) the cautious dividend policy were required.

Supervisors also addressed Brexit-related risks and requested appropriate preparation and the revision of internal policies and procedures to reflect organisational changes affecting customer business.

Liquidity and funding risk triggered various supervisory responses, such as (i) the more common requirement for specific LCR requirement in significant currencies at a consolidated and/or solo level and (ii) the expectation of developing and maintaining a holistic map of liquidity and funding risks with appropriate metrics and limits. Measures of a quantitative nature were also imposed in some cases, such as (i) the requirement to keep HQLAs corresponding to a certain proportion of the total lending and (ii) the additional liquidity resources to cover intra-day liquidity risk.

Considering that, according to the outcome of the group risk assessments, supervisors in 10 out of the 12 closely monitored colleges noted that there was a medium-to-high risk of a significant prudential impact because of (i) the level of inherent operational risk (including ICT risk) and/or (ii)

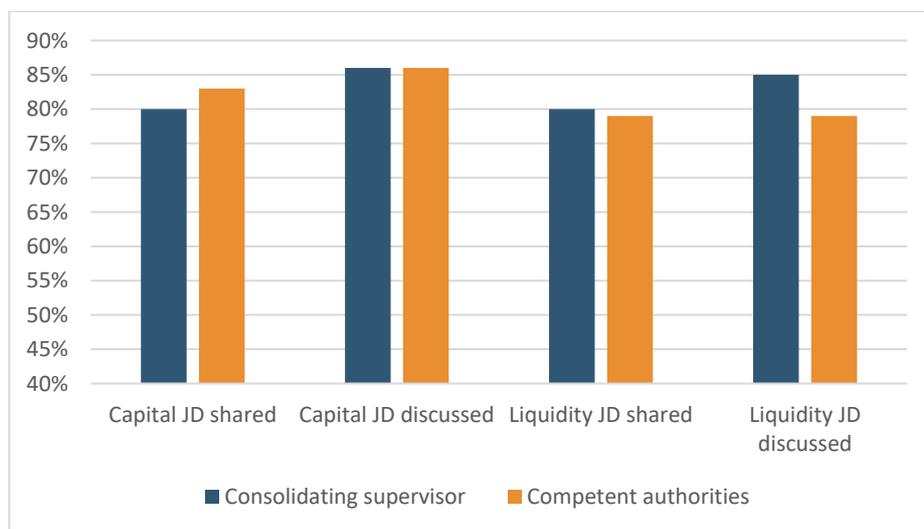
⁴⁷ Articles 10(1)(j) and 11(1)(h) of Commission Implementing Regulation (EU) No 710/2014.

the quality of ICT risk management and controls, the subsequent supervisory measures included in the joint decision documents do not seem to be proportional to these findings.

Colleges not selected for close monitoring

Overall, 80% of the reporting consolidating supervisors noted that, in their respective colleges, the capital and liquidity joint decision was shared, with a slightly higher percentage reporting that a sufficient dialogue took place between college members on the joint decision. Host CAs confirmed this in their responses⁴⁸.

Figure 23 — Joint decisions on capital and liquidity shared and respective dialogues conducted



JD=joint decision

More consolidating supervisors reported that collaboration with the relevant CAs improved in 2019, with some of them also referring to more frequent interactions as well as smoother processes. It was also noted in the self-assessments that the relatively small number of members (a few authorities only) in these colleges helps to make the communication easy and fluid.

Few host authorities noted the lack of a formal process for a joint decision on internal models, in particular the lack of timelines and the lack of a common view on when a joint decision is actually required.

⁴⁸ While the responses from the consolidating supervisors and the relevant competent authorities may not be entirely and directly comparable, presenting them together supports the overall understanding of colleges' functioning.

GOOD PRACTICES

- The institution was asked to conduct a self-assessment of the adequacy of its succession policy, taking into account the joint GLs on the assessment of suitability of members of the management bodies and key function holders.

AREAS FOR COLLEGES' ATTENTION

- All CAs need to have processes and/or mechanisms in place to allow for the setting of P2G, in line with the SREP GLs as well as the CRD V.
- CAs should discuss, in colleges, the approach to establishing P2G at solo level when no data from supervisory stress tests are available at solo level or, when relevant, agree on the application of P2G at consolidated level only.
- Clear articulation of supervisory measures with unambiguous action(s) is required from supervised institutions.

Joint decision on the assessment of GRP

Closely monitored colleges

The recovery plan assessment and related processes reached a good level of maturity in 2019. All of the closely monitored colleges used the EBA template provided in 2019 in the annex to the Single Supervisory Handbook module on the assessment of recovery plans for documenting the assessment of the GRP. Some of the initial assessments were not thorough enough in some colleges.

College meetings discussing the assessments of the GRP explored various aspects of the assessment, some of the most common aspects being the (i) integration of the former local plans into the GRP and potential further steps to improve the integration; and (ii) the calibration of recovery indicators, in particular the LCR and increasingly MREL.

CAs also exchanged views on the approach for the identification of the critical functions (CFs), which was developed further in 2019 to follow the ITS on resolution reporting⁴⁹. The importance of alignment between the CFs identified in the recovery and resolution plans were often discussed, including cross-referencing information between the two documents.

In order to increase the usability of the GRP, good practices such as the development of playbooks and dry-runs were also thoroughly discussed with some very practical questions, including how to avoid potential overlaps between the GRP and the playbook itself and which aspects of the recovery plan should be tested.

The compliance of the recovery indicator framework of the GRP with the EBA GLs on the minimum list of qualitative and quantitative recovery plan indicators were scrutinised by supervisors in

⁴⁹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32018R1624>

colleges. In many colleges, the trigger level of indicators and their ability to signal early warning were the centre of discussions.

In none of the closely monitored colleges were material deficiencies identified in the GRPs over the course of 2019.

According to Article 8 of the BRRD, CAs shall reach an agreement on (i) the assessment of the GRP, (ii) whether individual plans are to be requested and (iii) the application of supervisory measures addressing material deficiencies. All colleges reached this agreement within the time available (within 6 months from the submission of the plan by the institution — Article 6(2) of the BRRD).

In 2019, the EBA performed one binding mediation related to recovery planning, in which the difference in views was successfully resolved by the amicable agreement of the parties involved during the conciliation stage.

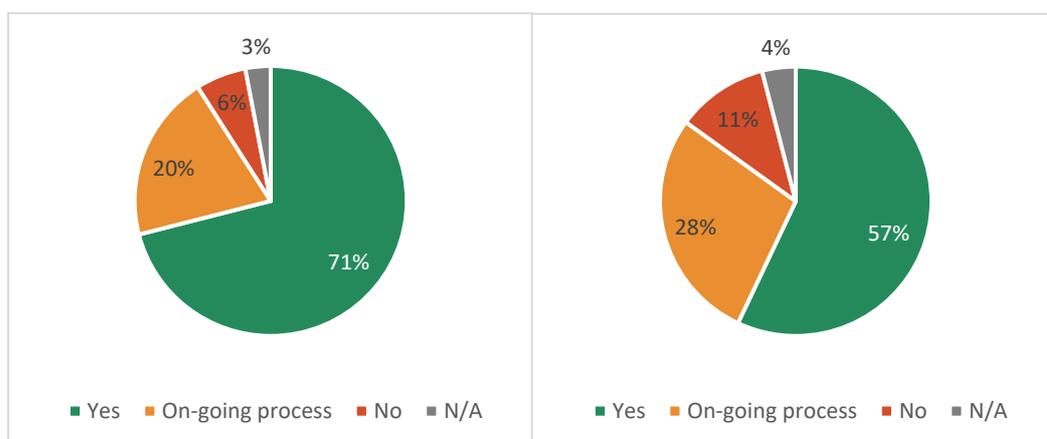
Colleges not selected for close monitoring

Substantial work was also conducted in this group of colleges to assess the GRPs. Some consolidating supervisors reported that a simplified recovery plan had been requested from an institution, considering its size and complexity.

In many colleges, the interactions on the GRP assessment took place in conference calls. Some supervisors noted that the colleges discussed how to incorporate college members' comments into the feedback letter.

The large majority of the colleges either reached an agreement on the GRP assessment or were in the progress of reaching an agreement at the time of the collection of the self-assessments; it was only in very few cases that colleges did not meet the applicable legal deadline. In some colleges, a joint decision was not applicable, as they function as a global college, without any EU colleges.

Figure 24 — Article 6 of the BRRD: 6 months and Article 8 of the BRRD: 4 months



According to the consolidating supervisor, in some colleges it was difficult to reach a joint decision on the GRP assessment, because timelines at consolidated and local levels were not aligned.

4.4 EBA tools for supporting supervisory colleges

EBA tool for the secure exchange of information

According to Article 21 of the EBA's founding regulation⁵⁰, the EBA 'may collect and share all relevant information in cooperation with the competent authorities in order to facilitate the work of the college and establish and manage a central system to make such information accessible to the competent authorities in the college'.

In this context, the EBA developed a collaboration site in Microsoft Office Sharepoint, with the following objectives.

- Share non-confidential information between college members, such as the EBA's binding technical standards (BTS), GLs and other deliverables. The workspace in the tool also contains an updated calendar showing future college meetings scheduled.
- Act as a hub through which college-related, confidential information can be securely shared, exchanged and stored, thanks to a two-factor authentication system.

Taking into account the feedback and proposals for improvement received from users regarding the functionalities of this tool, the EBA decided to upgrade and modernise it in 2019.

The updates are mostly related to the development of electronic messaging for granting access rights through the platform, bulk uploads and downloads, document library structure and EBA user approval.

The EBA invites the colleges that are still relying on less secure ways of exchanging confidential information to join the EBA collaboration tool.

EBA recommendation on the equivalence of confidentiality regimes

According to Article 116(6) of CRD IV, third-country supervisory authorities may participate in EEA supervisory colleges, only if their confidentiality regime is assessed as being equivalent to the requirements laid down in CRD IV.

To facilitate and support the work of colleges and in particular the participation of third-country supervisory authorities in EEA supervisory colleges as an ongoing activity, the EBA assesses the equivalence of the professional secrecy and confidentiality regimes of a number of non-EU supervisory authorities.

The assessment carried out by EBA staff, with the support of experts from CAs, seeks to establish whether the legal regime applicable to each third-country supervisory authority:

- contains the notion of confidential information;
- contains specifications on the existence of professional secrecy obligations;
- restricts the use of confidential information;

⁵⁰ Regulation (EU) No 1093/2010 of the European Parliament and of the Council establishing a European Supervisory Authority (European Banking Authority).

- establishes restrictions on the transfer of confidential information.

The outcome of the assessment work was published in the form of an EBA recommendation.

In 2019, the EBA continued its work on the third-country equivalence and — with the support of the Network of Equivalence — started assessments of a number of authorities on confidentiality and professional secrecy, including participation in the supervisory colleges. All these assessments are ongoing and expected to be finalised in the first part of 2020.

5. EBA policy work supporting supervisory convergence

The EBA worked on various policy products over the course of 2019, to contribute to fostering supervisory convergence in various areas of financial services, some of them with cross-institutional and cross-sectoral relevance.

Most importantly, the EBA set expectations for ICT and security risk management for CIs, investment firms and payment service providers in 2019. The publication of the EBA GLs on outsourcing arrangement in February 2019 laid down a common framework across the EU for the use of outsourcing and ensured a level playing field between different types of financial institutions.

The EBA is also committed to facilitating consistency of supervisory practices on the assessment of the IRB approach, and therefore it progressed towards completing its IRB roadmap in 2019.

The EBA, in conjunction with ESMA, continued to work on establishing a single framework of reporting requirements of intra-group transactions and risk concentration for financial conglomerates subject to supplementary supervision in the EU.

5.1 Supervisory review and evaluation process

5.1.1 Guidelines on ICT and security risk management

The pace of digitalisation in the financial sector and the increasing interconnectedness through telecommunications channels (internet, mobile and wireless lines, and wide area networks) and with other financial institutions and third parties have heightened ICT and security risks. The frequency of ICT-related incidents (including cyber incidents) is rising, together with their potential significant adverse impact on financial institutions' operational functioning. Moreover, as a result of the interconnectedness of financial institutions, ICT and security-related incidents risk causing potential systemic impacts.

In light of the European Commission's FinTech action plan⁵¹ published in March 2018, in which the ESAs were invited to consider issuing GLs aimed at supervisory convergence and enforcement of ICT risk management and mitigation requirements in the EU financial sector, and taking into account the growing complexity of ICT and security risks, the EBA responded to these by publishing, in November 2019, its final GLs on ICT and security risk management⁵².

⁵¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0109>

⁵² <https://eba.europa.eu/regulation-and-policy/internal-governance/guidelines-on-ict-and-security-risk-management>

The GLs will apply from 30 June 2020 and set expectations for ICT and security risk management for payment service providers (for their payment services), credit institutions (for all activities beyond their payment services) and investment firms (for all activities). The GLs integrate the GLs on security measures for operational and security risks of payment services under Article 95 of Payment Services Directive 2, which were published in December 2017 (EBA/GL/2017/17) and which will be repealed once the new GLs become applicable.

The GLs are based on the principle of proportionality, contribute to a level playing field for all financial institutions and set out how financial institutions should manage the ICT and security risks that they are exposed to. In addition, the GLs aim to provide the financial institutions to which the GLs apply with a better understanding of supervisory expectations for the management of ICT and security risks.

ICT operational units are recognised as the first line of defence in the GLs, along with the requirement of a sound internal governance and internal control framework that sets clear responsibilities for financial institutions' staff, including the management bodies. An independent and objective control function, appropriately segregated from ICT operations processes and not responsible for any internal audit, and an independent internal audit function are prescribed for the management and mitigation of ICT and security risks.

The maintenance of up-to-date inventories of business functions and their classification in terms of criticality, based on the confidentiality, integrity and availability of data, are required by the GLs with specific provisions on information security.

The management of ICT operations is key for the effectiveness of the ICT and security risk management; therefore, a number of high-level principles are outlined in the GLs. Requirements on ICT project and change management and specific expectations on ICT business continuity management are also set out in the GLs.

5.1.2 Supervisory risk taxonomy

When the final EBA SREP GLs were approved by the EBA Board of Supervisors (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 of the BoS, in particular a stocktake exercise of supervisory practices on risk taxonomies and their practical applications, and the development of the draft supervisory risk taxonomy, which was shared with the supervisory community for a testing period, with two rounds of feedback collected (end of 2017 and in 2018). The testing and the feedback collected confirmed that supervisors and risk experts used the supervisory risk taxonomy in a wide array of supervisory activities.

In 2019, the EBA worked on the finalisation of the taxonomy, which reflected on the supervisory feedback received. The EBA aims to complete the supervisory risk taxonomy in 2020, in line with

the Pillar 2 roadmap⁵³, by incorporating the corresponding coverage in terms of own funds requirements and measures under Pillar 1 and Pillar 2.

5.2 Ongoing supervision

5.2.1 Amended RTS and ITS on passport notifications

In 2019, the EBA started a review of a set of technical standards relating to passport notifications for the purposes of the exercise of the freedom of establishment and the freedom to provide services in accordance with Articles 35, 36 and 39 of Directive 2013/36/EU. As a result, a consultation paper was published on 13 November 2019⁵⁴. Such provisions mandate the EBA to specify the information to be notified and establish standard forms, templates and procedures for notifications. The EBA delivered such mandates by developing the RTS and ITS on passport notifications⁵⁵, which were subsequently endorsed by the European Commission enacting Commission Delegated Regulation (EU) No 1151/2014 and Commission Implementing Regulation (EU) No 926/2014.

As recognised by the EBA report on the peer review on the RTS published in July 2018⁵⁶, the two regulations have significantly improved the convergence of supervisory practices and smoothed out the procedures for passport notifications, providing an important contribution to the effectiveness of the internal market. The report also identifies several areas of desired modifications to the technical standards that would improve the quality and consistency of passport notifications and the ability of CAs to assess them. Upon the CAs' request, the EBA has therefore decided, in accordance with Article 29(d) of Regulation (EU) No 1093/2010 establishing the EBA, as subsequently amended, to revise both Commission Delegated Regulation (EU) No 1151/2014 and Commission Implementing Regulation (EU) No 926/2014, with a view to updating the information requirements to be notified by the CI to the home CA. The ultimate goal of the technical standards review is to clarify CIs' information requirements in order to facilitate the accuracy, comprehensiveness and consistency of the supervisory assessment of both branch and services passport notifications.

Further to the assessment of the feedback to the public consultation, the EBA plans to conclude the review of the amended RTS and ITS by H1 2020.

⁵³ Further information on the Pillar 2 roadmap is included in Section 5.4.2 of Chapter 5.

⁵⁴ Available at <https://eba.europa.eu/amended-rts-and-its-passport-notification>

⁵⁵ The final draft RTS are available here: <https://eba.europa.eu/documents/10180/522312/EBA-RTS-2013-08+%28RTS+on+Passport+Notifications%29.pdf/c03df2c9-cd8c-42e6-b3fa-1df65b156850>; the final draft ITS are available here:

<https://eba.europa.eu/documents/10180/522312/EBA+ITS+2013+05+%28ITS+on+Passport+Notifications%29.pdf/b584af51-1c4c-4301-93ee-9ed0e5f9b6ec>

⁵⁶ EBA peer review on the RTS on passport notifications, 10 July 2018:

<https://eba.europa.eu/documents/10180/2087449/Report+on+the+peer+review+of+the+RTS+on+passport+notifications.pdf>

5.2.2 Draft ITS on the reporting of intra-group transactions and risk concentration for financial conglomerates

One of the main responses to the latest financial crisis was the establishment of a single set of harmonised prudential rules in the EU to facilitate the functioning of the internal market and prevent regulatory arbitrage opportunities. A single set of harmonised prudential rules also reduces regulatory complexity and diminishes banks' reporting burden, especially for banks operating on a cross-border basis.

The ITS on the reporting of intra-group transactions and risk concentration for financial conglomerates offer a single framework of requirements for the reporting due by financial conglomerates subject to supplementary supervision in the EU. They help coordinators and CAs to identify relevant issues and exchange information more efficiently, reduce costs and foster a level playing field across EU financial conglomerates.

They provide the foundation for the full harmonisation of reporting, with a single set of templates, a single embedded dictionary using common definitions and a single set of instructions for filling in the templates.

The ITS on reporting of intra-group transactions and risk concentrations⁵⁷ will form part of the single set of harmonised prudential rules and will become directly applicable in all Member States, once adopted by the European Commission and published in the Official Journal of the EU⁵⁸.

The harmonisation of the intra-group transaction and risk concentration templates aims to fully align reporting under the Financial Conglomerates Directive in order to enhance supervisory overview regarding group-specific risks, in particular contagion risk⁵⁹. In addition, the templates will increase comparability among financial conglomerates of different Member States, improving supervisory consistency.

5.3 Internal governance

5.3.1 Guidelines on outsourcing

In the last decades, banks have been offering more and more sophisticated services to the economy, and thus facilitating many technological advances. In particular, competition from FinTech firms forces banks to continuously invest in more customer friendly technology, especially if distribution channels do not provide the flexibility that consumers demand. Within this context, banks have become increasingly interested in outsourcing business activities or functions, to create a more efficient business model with an improved cost-to-income ratio.

In this era of digitalisation and the growing importance of new financial technologies, banks use these technologies not only to create additional value by offering new services, information and

⁵⁷ Under paragraphs 2b and 2c of Article 21a of the Financial Conglomerates Directive, Directive 2002/87/EC.

⁵⁸ To date, it is not clear yet what the exact application date will be.

⁵⁹ Mixed financial holding companies are prone to contagion effects and defaults arising from undertakings of the group and spread risks within the financial conglomerate.

distribution channels, but also to become more cost effective. With this in mind, it is important that the public are able to continue to trust the proper conduct of business by banks and that outsourcing is performed in a safe and controlled way. While the EBA recognises the benefits of outsourcing in terms of flexibility, scalability and enabling innovation by reducing ‘time to market’, the outsourcing of important or critical functions creates specific risks for banks and must remain subject to appropriate oversight.

The publication of the EBA GLs on outsourcing arrangement in February 2019 should address these concerns, together with the sound governance arrangements to be implemented by banks. As part of the Single Rulebook, the GLs ensure a level playing field between different types of financial institutions (investment firms/banks/payment institutions and electronic money institutions) and cross-sectoral consistency (insurance for example).

The GLs cover the whole outsourcing process, from the initial risk analysis and entering into an outsourcing contract to the exit strategies from existing arrangements. Banks must not only assess the risks of outsourcing a function but also perform due diligence processes that include analysing the ability of the service provider to perform the outsourced function.

Firstly, institutions must identify and manage all their risks, including risks caused by contracts with third parties that are not outsourced (third-party risk management). Banks, therefore, have to determine whether a contract with a third party falls within the scope of the definition of outsourcing. The GLs specify the criteria to determine whether the outsourcing of critical or important functions is involved. The outsourcing of critical or important functions has a greater impact on the risk profile of banks or can, if the service is carried out inappropriately, lead to severe business disruptions, significant financial losses and breaches of regulatory requirements. Therefore, the requirements are stricter than the requirements for other, less risky outsourcing arrangements.

The GLs also specify that outsourcing to service providers does not rule out the responsibility of banks for their compliance with all regulatory requirements and also vis-à-vis their customers. Specific details on the relationship between institutions and suppliers are provided, including their rights and obligations (description of critical functions, financial conditions, location of data). An outsourcing contract should specify whether the outsourcing of critical or important functions or material parts of critical or important functions is allowed.

A key aspect of the requirement for banks is to maintain adequate business continuity plans and regular monitoring of their operations with regard to critical or outsourced critical functions. Institutions should have documented exit strategies. They must ensure, in particular, that they are able to exit outsourcing arrangements without any interruption to their activities, without limiting their compliance with regulatory requirements and without prejudice to the continuity and quality of service provision to customers.

The GLs set out the expectations for the monitoring of outsourcing contracts. In particular, access rights and audits for institutions, payment institutions and CAs should be ensured. For the outsourcing of important or critical functions, these rights need to be ensured for the banks in any case. For other contracts, they should be ensured according to a risk-based approach. However, in the case of the banking supervisory authorities, this right has to be ensured in any case.

The obligation for institutions to set up a register of outsourcing contracts, containing a list of all outsourcing contracts, distinguishing by critical/not critical outsourcing contracts for which there is more information to be filled in, is important. This register, or the information contained therein, must be made available to the authorities in the event of a request in part or all of the register.

The GLs have been in force since 30 September 2019. A transitional period for implementing the register has been prolonged until 31 December 2021, to ensure that institutions have sufficient time to review their outsourcing arrangements and set up a respective database or exit from arrangements that are not compliant with the GLs.

5.4 Roadmaps

5.4.1 IRB roadmap

The EBA is finalising its regulatory review of the IRB approach, which is part of the IRB roadmap set out in the report published in February 2016. The work on the regulatory review of the IRB approach, as set out initially in the IRB roadmap, was finalised by publishing the final draft RTS on the nature, severity and duration of economic downturn in November 2018, and the EBA GLs on the downturn loss given default (LGD) estimation in March 2019.

In addition, to complement the regulatory review, the EBA has initiated work on the GLs on Credit Risk Mitigation for institutions applying the IRB approach with own estimates of LGDs, which resulted in a consultation paper published in February 2019. Throughout 2019, the EBA continued its work on finalising these GLs, which are planned to be published early 2020.

The IRB roadmap is composed of three main strains of work: apart from the regulatory review of the IRB approach, the EBA is also committed to facilitating the consistency of supervisory practices on the assessment of the IRB approach as well as ensuring appropriate transparency. In July 2019, the EBA published a progress report on the IRB roadmap, which marks the finalisation of the regulatory review of the IRB approach. The report sets out expected implementation timelines for the regulatory review and explains further steps focusing on the remaining two strains of work.

The IRB roadmap promotes best practices in modelling risk parameters and consistent assessments by CAs by, among other actions:

- harmonising the concepts and requirements of the IRB approach using a number of technical standards and GLs;

- providing a harmonised methodology for assessing the IRB approach by CAs that clarifies the scope, methods and criteria of the assessment;
- providing efficient tools for CAs and allowing the monitoring of the outcomes of internal models, which is mostly based on the annual supervisory benchmarking exercise.

The main objective of the IRB roadmap is to restore the trust of market participants in the outcomes of internal models and ensure a level playing field and own funds requirements that adequately reflect the level of risk taken on by institutions. It is expected that the implementation of the IRB roadmap will lead to more consistent supervisory practices on the assessment of the IRB approach and substantial improvement in the comparability of risk estimates and RWAs across institutions.

5.4.2 Future work — roadmap for the delivery of the EBA mandates on Pillar 2

In 2019, the EBA published a roadmap for the delivery of the EBA mandates on Pillar 2 stemming from the revised CRD (CRD V) and the revised CRR (CRR II) adopted by the Council of the EU and the European Parliament on 20 May 2019⁶⁰.

The Pillar 2 roadmap outlines the planned review of the EBA SREP GLs. The review is aimed at aligning the SREP GLs with CRD V and CRR II. The roadmap will also allow consistency with other EBA regulatory products that have been issued since its publication⁶¹ to be ensured and will make the framework fit for purpose in view of ongoing and new challenges. The EBA findings from the ongoing monitoring and assessment of the convergence of supervisory practices will also feed into this work.

The revision of the EBA SREP GLs will focus on a number of areas including:

- enhancing proportionality throughout the GLs, reflecting how similar risk profiles will be assessed for the purposes of the SREP in order to ensure a consistent and proportionate approach, and aligning the SREP categorisation of institutions when relevant with the new CRR II definition of ‘small and non-complex institutions’;
- incorporating AML/CFT-related aspects from a prudential perspective into the supervisory assessment for the purpose of the SREP;
- aligning the provisions on Pillar 2 capital add-ons and P2G with CRD V, including the conditions for setting Pillar 2 capital requirements for institution-specific material risks or elements of risks not (sufficiently) covered under Pillar 1⁶²;
- bringing the relevant sections on the assessment of risks to liquidity, funding and excessive leverage in line with the latest developments in the EU regulation.

⁶⁰ The roadmaps are available on the EBA website: <https://eba.europa.eu/eba-publishes-its-roadmap-risk-reduction-measures-package>

⁶¹ In particular, the EBA GLs on the management of non-performing and forborne exposures, the EBA GLs on loan origination and monitoring, and the revised EBA GLs on outsourcing arrangements.

⁶² For this work, the EBA will be able to leverage on the comprehensive supervisory risk taxonomy that is currently under development. The supervisory risk taxonomy will ensure a common understanding of the risks, their categorisation and the corresponding prudential tools, according to their coverage of Pillar 1 or Pillar 2.

In addition, the GLs will need to be aligned with CRD V on the Pillar 2 capital coverage of risks or elements of risks identified as material pursuant to the SREP assessment that are not covered or not sufficiently covered by the own funds requirements under Pillar 1. For this, the work will leverage on the supervisory risk taxonomy to ensure a common understanding of risks and their respective categorisation, in order to strengthen convergence in the identification and assessment of risks and a consistent determination of Pillar 2 capital requirements.

The Pillar 2 roadmap already points forward to the next revision of the SREP GLs after 2021. That revision will enable the EBA to include both guidance on the treatment of ESG risks under the SREP and align the IRRBB section of the GLs with the new IRRBB-related guidance under CRD V. Both of these areas will be included in the next revision of the SREP GLs in view of the timing of the underlying work. For the ESG risks, the EBA is mandated to issue a report, to the Commission, on the assessment of the potential inclusion of these risks in the SREP by 28 June 2021. For IRRBB, the EBA has several mandates to develop technical standards and GLs under CRD V, including for the supervisory outlier test under the economic value of equity and net interest income (NII) perspective. The revised SREP GLs are expected to be published by end 2021. A prior publication is planned in 2020 on the incorporation of ML/TF risks into the SREP process, given the urgency of the need to provide common guidance on this.

6. Training as a convergence tool

Training is one of the main tools for the EBA to build a common supervisory culture and foster convergence in supervisory practices. The EBA prepares its training programme in cooperation with authorities. In 2019, the EBA continued its training programme for CAs and RAs, with the aim of assisting in the implementation of important policy products.

Overview of training provided in 2019

Residential training

In 2019, the EBA delivered 11 training events to CAs and RAs: 10 sectoral training sessions and 1 joint cross-sector training session with EIOPA on 'ICT and cyber risk', held on 21-22 October 2019. In total, 488 participants took part in the training offered in 2019 (compared with the 1 687 attendees registered for the 27 training events offered in 2018).

Furthermore, in 2019, the EBA delivered three regional training events, together with staff of the Bank of Portugal and the Bank of Spain and European Central Bank (ECB) experts in Frankfurt. The training sessions at the on-site locations allowed a greater outreach to policy experts around Europe, which fostered greater convergence.

On 5-7 March 2019, the EBA's joint annual training with the Basel Financial Stability Institute attracted 61 participants. The training mainly focused on the most recent updates to the Basel framework and implementation challenges within the EU, i.e. an overview of the various components of the Basel III framework, updates on the LCR, Pillar 3 disclosures and securitisation, including a detailed presentation on the market risk framework.

In September and November 2019, the EBA teamed up with industry experts from Alvarez & Marsal and True Sales International for joint training sessions on 'Valuation' and 'Securitisation', an initiative that fostered insightful interaction and exchange between policy experts and industry representatives. This afforded participants the much-needed real life experience of the different approaches used by industry and a better understanding of the market from different perspectives.

Overall, 43 CA staff members took part in the ESAs' cross-sector training on 'ICT and Cyber Risk' held on 21-22 October 2019. The training provided participants with the opportunity to familiarise themselves with the draft GLs currently under development and recent developments on the digital agenda of the EU and the ESAs, and share experiences of supervisory practices regarding ICT supervision in the financial sector. Immediate feedback received from the participants was very positive.

Online training

In 2019, the EBA continued to offer training sessions on its training platform, which was visited by over 860 registered members from CAs, the EBA and other public bodies. As a result of the EBA's relocation to Paris, existing courses such as the MREL course were updated, while new modules, 'Supervisory Reporting', 'Crypto-Assets for Supervisors', 'Breach of Union Law', 'Outsourcing to

Cloud’ and ‘IRB’, were prepared for delivery in 2020. The delivery of new courses in 2020 within the EBA Learning Hub will boost further growth of convergence.

In January and February 2019, interest in the online modules ‘Bank Recovery Planning’ and ‘SREP’ remained constant. As a result of the interactive nature of the ‘Bank Recovery Planning’ course, a maximum of 35 participants were accepted, with 26 registrants waitlisted for the next rerun. In total, 32 participants out of 35 successfully completed the course. Feedback was very positive, with 100% of participants stating that they would further recommend the course to a colleague. Participants lauded the organisation and the high standards of the EBA’s subject matter experts.

Table 1 — Overview of the training events that the EBA provided to EU CAs in 2019

No	Title	Date	Host	Attendees
1	Securitisation (for staff of the ECB only)	15 January 2019	ECB, Frankfurt	18
2	Supervisory Convergence in POG (for SCPS members only)	16 January 2019	EBA, London	7
3	Bank Recovery Planning	21 January-4 February	Online	35
4	New regulatory framework and significant transfer of risk in securitisations (for staff of the Bank of Spain)	25 January 2019	Bank of Spain, Madrid	30
5	Supervisory Review an Evaluation Process (SREP)	11-19 February	Online	112
6	Basel III updates and CRR implementation challenges	5-7 March 2019	EBA, London	61
7	Securitisation (only for staff of the Bank of Portugal)	5 April 2019	Bank of Portugal, Lisbon	22
8	Valuation, including for resolution purposes	24-25 September	EBA, Paris	86
9	Cross-sectoral seminar on ICT and cyber risk	21-22 October 2019	EIOPA, Frankfurt	32
10	Introduction to STS Securitisation and New Securitisation Framework	13 November 2019	EBA, Paris	85
11	Crypto-Assets for Supervisors	December 2019	Online	N/A
Total				488

7. EBA 2020 convergence plan

Introduction

According to its founding regulation, the EBA should actively foster supervisory convergence across the Union, with the aim of establishing a common supervisory culture⁶³.

The EBA has a number of tools at its disposal to fulfil this mandate, and the establishment of the yearly convergence plan is one practical element of this toolkit that complements the other significant elements, such as policy development and training.

The EBA defines supervisory convergence as ‘a process of achieving comparable supervisory practices in Member States that are based on compliance with the Single Rulebook and leading to consistent supervisory outcomes’.

The convergence plan, with the identification of key topics for heightened prudential supervisory attention across the EU, aims to

- a. inform CAs’ processes for selecting supervisory priorities for the upcoming year;
- b. influence the supervisory practices of CAs on the selected topics.

The convergence plan, which the EBA establishes every year, is published together with and as an integral part of the convergence report for the previous year.

CAs are expected to consider these key topics when developing their 2020 SEPs for the institutions that they supervise. SEPs allow CAs to choose the most appropriate supervisory activities⁶⁴ to supervise these key topics for heightened supervisory attention. Policy and risk experts as well as specialist functions within CAs are key contributors to high-quality prudential supervisory oversight through their cross-institutional scope. They also shape supervisory priorities and support line supervisors in the implementation of SEPs; therefore, they are also invited to observe the key topics identified in this report.

The outbreak of coronavirus disease (COVID-19) and its global spread in 2020 has brought about significant challenges to society and substantial uncertainties for companies and the banking sector. The potential implications of COVID-19 on credit institutions can materialise in different ways, affecting institutions’ operations and operational resilience as well as financial positions, including their earnings. Therefore, the key topics selected for supervisory attention in the 2020 convergence plan have become particularly relevant in the context of this crisis.

The EBA is also mandated to assess and increase the degree of convergence of supervisory practices under the SREP, in line with Article 107 of the CRD as well as Article 20a of the EBA’s founding regulation. Therefore, the observations collected through the monitoring and assessment of these key topics will feed into the overall conclusions on the degree of convergence of supervisory

⁶³ Preamble paragraph 40.

⁶⁴ For example, thematic reviews, deep dives, other off-site activities, interviews with management and on-site inspections.

practices under the SREP by complementing observations from other assessments or exercises⁶⁵ undertaken by the EBA for this purpose.

The EBA will review the approach applied by CAs for the supervision of the identified key topics and will use the most appropriate convergence tools at its disposal to conduct the assessment, in particular the monitoring of colleges, questionnaires and the bilateral convergence visits, if and as appropriate. When conducting the follow-up and the assessment, the EBA is going to take into consideration the fact that significant supervisory efforts and resources are and will be dedicated to monitoring the contingency measures and crisis preparedness of institutions in 2020, as well as further implications of COVID-19 on credit institutions' operations and financial soundness.

In order to facilitate the objective assessment and comparability, as well as support CAs in focusing their attention in relation to each topic, the EBA has developed some objective elements or attention points per key topic. The identification of these objective elements has been discussed with CAs in the SCOP Sub-group on Ongoing Supervision (SGOS), similar to the last year's practice.

Key topics identified for the 2020 convergence plan for prudential supervisory purposes

The yearly convergence plan puts forward key topics for prudential supervisory scrutiny and/or implementation for the upcoming year that:

- rely on the outcome of the EBA's risks and vulnerabilities assessment work;
- refer to recent and challenging policy areas to be implemented;
- benefit from the input provided by CAs' practical experience and observations, as shared within the SGOS.

While some items continue to be selected for close attention in 2020, such as ICT risk and operational resilience, others have been replaced. This, however, should not prevent CAs, when adopting individual SEPs, to tailor supervisory actions to the risk profile of an institution and potentially continue to focus on some of the 2019 key topics, if those are more relevant⁶⁶ to a particular institution.

1. ICT risk and operational resilience

ICT plays an increasingly important role in the overall functioning of the financial system and individual institutions. The opportunities and risks associated with ICT create significant prudential impacts and may threaten the viability of an institution and stability of the system.

As a result of the increasing importance of ICT in the banking industry, some recent trends include:

- the emergence of new technologies and products;
- the emergence of (new) cyber risks, together with the increased potential for cybercrime and the appearance of cyber terrorism;

⁶⁵ For example, benchmarking exercises and college monitoring.

⁶⁶ For example, the NPE reduction strategy.

- increasing reliance on outsourced ICT services and third-party products, often in the form of diverse packaged solutions resulting in manifold dependencies and potential constraints and new concentration risks.

The growing importance and increasing complexity of ICT risk within the banking industry and in individual institutions, as well as the increasing potential adverse prudential impact from this risk on an institution and the sector as a whole, prompted the EBA to develop own-initiative GLs to assist CAs in their assessment of ICT risk as part of the SREP and promote common procedures and methodologies in this area. These GLs on ICT risk assessment under the SREP⁶⁷ were published in May 2017 and entered into force on 1 January 2018.

COVID-19 has amplified potential risks associated with banks' information and communication systems and has brought institutions' ability to continue to ensure smooth operations and cyber resilience to the forefront. Therefore, understanding vulnerabilities in this respect as well as implementing appropriate measures should be the focus of institutions as well as supervisors in 2020.

In recent years, financial institutions have been increasingly interested in outsourcing business activities to improve their flexibility and efficiency, as well as reduce costs. Outsourcing arrangements in general and ICT outsourcing in particular should be scrutinised by CAs, to ensure that inherent risks in material outsourced services (e.g. ICT services) are properly identified, measured and ultimately mitigated by the institutions.

The EBA updated the GLs on outsourcing⁶⁸ by setting out specific provisions for governance frameworks with regard to their outsourcing arrangements and the related supervisory expectations and processes. The recommendation on outsourcing to cloud service providers, published in December 2017, was integrated into the GLs. The GLs entered into force on 30 September 2019.

In 2020, the EBA will continue to monitor developments in technology generally and IT risk and operational resilience in particular. The EBA will integrate the outcomes of this assessment into its yearly convergence assessment.

2. Loan origination standards

The quality of credit portfolios improved in 2019 because of the offloading and resolution of NPEs by many institutions and the pick-up in lending in general. Past experience has shown that lending standards are loosened during an economic upswing and subsequently tightened substantially. This is of particular importance in the context of the COVID-19 pandemic, as institutions need to tread a fine line between maintaining lending to the economy in which great flexibility is required for existing borrowers while adequately managing new credit risk in new lending.

Supervisors should therefore work with institutions to improve loan origination practices in line with the EBA's forthcoming GLs on loan origination and monitoring in a pragmatic and

⁶⁷

<https://eba.europa.eu/documents/10180/1841624/Final+Guidelines+on+ICT+Risk+Assessment+under+SREP+%28EBA-GL-2017-05%29.pdf>.

⁶⁸ <https://eba.europa.eu/documents/10180/2551996/EBA+revised+Guidelines+on+outsourcing+arrangements>.

proportionate manner in order to avoid procyclical effects. Such lending standards and practices in the current COVID-19 circumstances may be influenced by all relevant flexibility in the existing legislation, subject to the clarification of such flexibility provided by the EU and national authorities, and by recognising the measures put forward by governments to mitigate the impact of the COVID-19 pandemic, including various public guarantees and their conditions.

3. Profitability

Although profitability in the EU banking sector has experienced an increasing trend since 2014, and the average return on equity was 6.8% in Q1 2019 (at the same level as that in Q1 2018), this level of profitability may not prove to be sufficient to guarantee long-term sustainability or adjustments of banks' prevailing business models.

The prolonged low interest rate environment has been a key factor contributing to subdued profitability in the EU banking sector through the declining NII. Along with the declining NII, efficiency in the banking sector has further deteriorated. The cost-to-income ratio rose from 65% in Q1 2018 to 66.3% in Q1 2019.

Generating income to support investments in general, and in technology in particular, and with a view to enhancing banks' risk data aggregation and reporting capabilities, is vital to ensure the long-term sustainable operation of banks.

This topic has received ongoing supervisory scrutiny in recent years, and supervisors have been looking into banks' business models and strategies to see whether they are viable/sustainable. The EBA, by including this topic in its 2020 convergence plan, among the key topics for supervisory attention, puts forward some common aspects for supervisory consideration for the assessment of CIs' income generating capabilities, conducted as part of the business model analysis under the SREP:

- a. Measures taken by institutions to improve profitability and address potential further pressure on interest margins and from more negative yielding assets. It is vital to understand whether (some of) the measures might, in the short term, increase profitability but at the same time increase risks mid-to-long term.
- b. The vulnerability of banks to economic deterioration in general and to the adverse systemic economic impact of COVID-19, particularly considering their portfolio mix. Banks' actions to tackle these risks.
- c. Banks' benchmark for their profitability and measurement of this benchmark.
- d. In connection with legacy NPEs ⁶⁹, the estimated impact of the calendar provisioning (if applicable) on future profitability. Potential further impact of the banks' NPL reduction strategy (if applicable) on profitability.

⁶⁹ The [EBA statement on actions to mitigate the impact of COVID-19 on the EU banking sector](#) should be considered, in particular the flexibility in the implementation of the EBA GLs on management of non-performing and forborne exposures and the EBA's call for a close dialogue between supervisors and banks, on non-performing exposure strategies, on a case-by-case basis.

- e. Bank's preparedness to keep up with the challenges/further competitive pressure from new technologies (e.g. FinTech) as well as the actions taken to address outdated/legacy IT systems. Digitalisation⁷⁰ and competition from new players can represent additional challenges for institutions, and it is important to see how they adapt to this new environment while preserving a sound and prudent risk management. Supervisors should also be vigilant that digital transformation projects may create unintended risks⁷¹ that institutions are not prepared to identify and/or manage.
- f. Overall, dividend policies must take into account the current challenging economic and financial conditions, and banks are urged to refrain from dividend distribution or share buybacks, which result in a capital distribution outside the banking system, in order to maintain a sound capital base and provide the support that the economy needs.

In 2020, the EBA will review the approach followed by the CAs to monitor and assess institutions' earnings-generating capacity and the actions/arrangements that institutions have taken to increase their adaptation to a more challenging environment.

4. Capital and liability management

The EBA published, in early September, a communication announcing that it will clarify the prudential treatment applicable to own funds instruments at the end of the grandfathering period drawing to an end on 31 December 2021. In this context, the EBA will provide clarity on the appropriate treatment of the so-called 'legacy instruments' at the end of 2021, when the benefits of the grandfathering period will expire. The aim of the clarification is to preserve a consistent and high-quality capital base for EU institutions under the CRR.

While reflecting on this issue, the EBA will also clarify interaction with the new grandfathering provisions, introduced by the recent banking package, and the corresponding amendments to the CRR and the BRRD, when relevant for own funds instruments and eligible liabilities.

The EBA aims to publish a communication on the end treatment of the 'legacy' grandfathered instruments by mid-2020 so that institutions can adequately prepare for the end of the grandfathering period. In the meantime, CAs are invited to:

- engage with the institutions individually, in the context of the supervisory dialogue on their capital planning;
- investigate the outstanding amounts of the grandfathered capital instruments within the regulatory capital;
- better understand institutions' intentions with the intended future treatment of these instruments.

⁷⁰ Of the services offered by banks to customers as well as their internal processes.

⁷¹ For example, a reduction in workforce running parallel with digitalisation may result in deteriorating risk management or conduct practices, or elevated ICT security risk due to the digitalisation of the credit granting process.

Beyond own funds, CRR II has introduced the concept of total loss absorbing capacity (TLAC) that requires global systematically important institutions to hold eligible liabilities on top of their own funds. Banks need to build up loss absorbing capacity, and RAs, in coordination with CAs, are expected to ensure compliance with the requirements, in accordance with Article 45h (8) of BRRD II.

CAs must coordinate with RAs to require and verify that all banks meet the minimum amount of own funds and eligible liabilities, as per Article 45(15) of the BRRD, which is reinforced by BRRD II. A breach of MREL must be treated as seriously as breach of capital requirements, and CAs must engage with institutions on the viability of their funding plan to meet MREL.

The EBA will assess how CAs, in cooperation with RAs, will engage with CIs to ensure that TLAC and MREL is gradually accumulated and possible shortfalls are eliminated.

5. ML/TF risk and other conduct risk for prudential supervisors

a. ML/TF risk

Recent developments in the EU banking sector suggest that the quality of some institutions' ML/TF risk assessments and controls has to be enhanced substantially. At the same time, there is a need for closer cooperation between relevant supervisors, both domestically and in relation to the supervision of cross-border banking groups. In a Member State, the competences for AML/CFT and prudential supervision may be assigned to different authorities, which can increase the complexities of ensuring appropriate cooperation and information exchange among those authorities.

The EBA, together with the other two ESAs, has been working to clarify the practical modalities of cooperation and information exchange between prudential and AML/CFT CAs for the purposes of AML/CFT supervision of credit and financial institutions, both domestically and on a cross-border basis. In January 2019, ESAs supported the conclusion of the multilateral agreement between the AML/CFT CAs and the ECB. Thereafter, the joint GLs⁷² on the cooperation and information exchange for the purposes of Directive (EU) 2015/849 (the AML Directive) between CAs supervising credit and financial institutions was finalised and published on 16 December 2019. These GLs will change the way AML/CFT and prudential supervisors cooperate, and, consequently, how prudential supervisors approach AML/CFT issues in the context of their work.

The EBA has also issued an opinion on communications to supervised entities regarding ML/TF risks in prudential supervision⁷³ in July 2019 to call relevant authorities to strengthen the crucial link between AML/CFT supervision and prudential supervision, both at home and abroad. The EBA recommended that prudential supervisors also communicate to institutions that concerns stemming from AML/CFT supervision of individual institutions and that may have an impact on an

⁷²https://eba.europa.eu/sites/default/documents/files/document_library//Joint%20Guidelines%20on%20cooperation%20and%20information%20exchange%20on%20AML%20-%20CFT.pdf

⁷³<https://eba.europa.eu/documents/10180/2622242/Opinion+on+Communication+of+ML+TF+risks+to+supervised+entities.pdf>

institution's safety and soundness will be considered in the prudential supervisory process, in particular in ongoing supervision and in the context of SREP.

The fight against ML/TF also received further emphasis and clarification in the new legal framework (CRD V), and a number of actions and objectives were set out in the AML action plan of the European Council issued in December 2018. Safeguarding the integrity of financial markets and the fight against financial crime remains important, even in times of crisis, such as the COVID-19 outbreak.

Based on the abovementioned policy products, the EBA in 2020 will look into, among other topics, the following areas:

- CAS' practices with regard to cooperation and information exchange with AML/CFT supervisors;
- Whether the ML/TF risk assessment receives appropriate attention from a prudential perspective, in particular if material risk has been identified and whether it feeds into the overall SREP assessment. This would imply supervisory discussions around the possible crystallisation of the risk and the impact of that risk on the institution's safety and soundness should it crystallise.
- Potential measures applied by prudential supervisors to mitigate that risk.

b. Other conduct risk

In addition to ML/TF, the conduct risk of financial institutions also includes retail conduct, i.e. risks arising from their conduct towards consumers. Retail conduct matters for regulators not only from a consumer protection perspective, but also from a prudential perspective and in relation to their objective of promoting market confidence, financial stability and the integrity of the financial system in their national jurisdictions and at the European level. The misconduct of financial institutions, as manifested for example in the mis-selling of often badly designed financial products, can cause significant consumer detriment, result in significant litigation and redress costs, undermine market confidence and threaten the integrity of the financial system.

In order to address some of these conduct risks, the EBA developed GLs on product oversight and governance arrangements for retail banking products⁷⁴ that fall into its consumer protection remit⁷⁵. The GLs provide a framework for robust and responsible product design and distribution by manufacturers and distributors and have applied since 3 January 2017. Prudential supervisors rightly have a sense of concern about a bank's treatment of customers, because risks deriving from unfair and unsound business conduct and treatment of customers has incurred significant costs to banks, i.e. fines and penalties imposed through regulatory proceedings; settlements with regulators; sums paid to third parties as required by regulators, such as redress and compensation; or sums paid in relation to litigation proceedings; all of these are examples of direct costs that had to be borne by institutions.

⁷⁴ <https://eba.europa.eu/documents/10180/1141044/EBA-GL-2015-18+Guidelines+on+product+oversight+and+governance.pdf>

⁷⁵ Residential mortgages, personal loans, deposits, payment accounts, payment services and electronic money.

The SREP GLs also call CAs' attention to conduct risk, as a sub-risk category of operational risk, because of its pervasive nature as well as its potential prudential impact.

As a result of the increasing importance of conduct risk in relation to retail customers, the EBA will monitor how CAs assess the relevance and significance of institutions' exposures to conduct risk. In this regard, it is crucial for prudential supervisors to understand how the provisions of the EBA GLs on products oversight and governance arrangements for retail banking products have been respected by institutions. Prudential supervisors should therefore liaise closely with their consumer protection counterparts so as to understand what supervisory measures are being taken at national and EU levels to ensure a consistent implementation of these GLs.

In light of the exceptional circumstances caused by the spread of COVID-19, when engaging with customers regarding temporary measures, financial institutions need to ensure that they act in the interest of consumers and grant these measures in compliance with EU law.

8. Key tasks for supervisory colleges in 2020

Mandatory tasks

Supervisory colleges are forums for planning and coordinating supervisory activities, and conducting supervisory risk/liquidity risk assessments according to the single EU SREP framework for the cross-border banking group and their entities.

Given that the regulatory framework set the expectations on the organisation of supervisory colleges in the EU, as well as the key tasks that these colleges are envisaged to perform during their annual supervisory cycle, the main mandatory tasks are briefly reiterated here for the colleges' attention:

- a) establishing or updating the mapping of cross-border group entities with all relevant information envisaged in the template of Annex I to Commission Implementing Regulation (EU) 2016/99 (ITS on colleges of supervisors) and sharing the mapping with the AML/CFT college upon request;
- b) establishing and maintaining the WCCA in the form of Annex II to the ITS on colleges of supervisors;
- c) organising regular physical meetings (i.e. at least one per year) and maintaining ongoing interaction in other forms (e.g. conference calls, emails and consultations in written format);
- d) adopting the annual college SEP, noting joint and individual supervisory activities, resources committed from respective college members, and the timing and duration of these activities;
- e) organising and establishing timelines for joint decisions envisaged by the CRD (e.g. Article 113) and the BRRD (Article 8);
- f) concluding group risk assessments and group liquidity risk assessments and formalising the outcomes in the respective reports (as annexes to Commission Implementing Regulation (EU) No 710/2014);
- g) reaching joint decisions on capital and liquidity;
- h) reaching joint decisions on the assessment of GRPs, measures to address impediments to these plans, if any, and the need for individual plans covering entities of the group;
- i) organising and concluding joint decisions, as required by the regulatory framework (e.g. approval of internal models, determining liquidity subgroups, and other CRD/BRRD-related joint decisions) and as triggered by institutions' applications.

Supervisory colleges are invited to continue with the good cooperation that the EBA observed in its college monitoring activity over the course of 2019.

Supervisory colleges are expected to carefully plan the various steps of the joint decision cycle in order to ensure an appropriate dialogue within each college on the items required by law, most importantly the group risk/liquidity risk assessment and the joint decisions on capital and liquidity and the assessment of the GRP.

In addition, and in order to ensure that the college is able to complete the supervisory cycle in a timely manner, it is crucial that the update of the mapping template and the completion of the annual college SEP is ensured early on in the year, preferably in Q1.

Key tasks deriving from the EBA 2020 convergence plan

The key topics for supervisory attention were shared with the supervisory community early on⁷⁶ in order to ensure that CAs (also in supervisory colleges) can consider these key topics when developing their 2020 college SEPs, as this will allow CAs to choose the most appropriate supervisory activities to supervise these key topics.

In order to support CAs in focusing their attention in relation to each key topic as well as the activities to be undertaken in the college framework, the EBA complemented the 2020 convergence plan with some objective elements/attention points and highlighted the relevant aspects to be discussed and/or explored in the supervisory college context.

The consolidating supervisors are expected to take a leading role in planning and conducting such activities, in particular by:

- initiating discussions in colleges on how and to what extent the key topics/objective elements will be reflected in colleges' work in 2020;
- giving an overview presentation, during college meetings, on how and to what extent these key topics/objective elements have actually been or will be embedded in colleges' work in 2020 and reflected in colleges' deliverables.

The EBA will review the approach applied by CAs for the supervision of the identified key topics and will use the most appropriate convergence tools at its disposal to conduct the assessment, in particular the monitoring of colleges, questionnaires and the bilateral convergence visits, if and as appropriate.

Topical tasks requiring the attention of supervisory colleges in 2020

⁷⁶ November 2019.

Supervisory colleges are also expected to pay attention to specific matters of importance in 2020, in particular:

- They have an ever-crucial role in sharing information in a multilateral setting on the implications of the COVID-19 on the banking group and its subsidiaries/branches, including public and private payment moratoria, potential buffer reliefs, dividend policies and remunerations, as well as coordinating supervisory activities and actions in this regard.
- In line with the Action plan on dividend arbitrage trading schemes⁷⁷ and in connection with the assessment of the internal governance framework, CAs in supervisory colleges need to do the following:
 - Discuss whether there are policies, procedures and processes in place to ensure that the banking group always respects all applicable legal requirements, including tax regulation.
 - Discuss and explore, considering the specificities of their domestic tax regimes, whether potential dividend arbitrage trading schemes are possible in the Member States involved and whether they are treated as tax crimes.
 - Discuss whether the links between (potential) tax crimes and the weaknesses of the internal control framework and wider governance framework area are considered and/or whether tax crimes committed have an impact on ML/TF risk.
 - Discuss potential (joint) supervisory activities in case of concerns (e.g. targeted reviews, inspections).
- In order to develop a better understanding of other supervisory activities, such as AML/CFT supervision, which may have an impact on the supervised entity's overall risk profile, prudential supervisors and supervisory colleges are expected to cooperate and exchange information with the AML/CFT college, when and where it has been established.
- With the UK's departure from the EU, supervisory colleges need to initiate a review of their WCCA and start a discussion on the terms of the United Kingdom's participation going forward.

⁷⁷ See also the EBA Report on competent authorities approaches to tackling market integrity risk associated with dividend arbitrage trading schemes

9. Annex: 2020 list of supervisory colleges

EEA home country	Name of cross-border banking group
AT	Erste Group*
AT	Addiko Bank
AT	Bausparkasse Wüstenrot
AT	HYPO-Bank Burgenland Aktiengesellschaft
AT	Porsche Bank Group
AT	Raiffeisen Bank International AG
BE	KBC*
CZ	J&T Group
DE	Deutsche Bank*
DE	Clearstream Financial Holding Group
DE	Commerzbank AG
DE	DZ Bank AG Deutsche Zentral-Genossenschaftsbank
DE	Finanzholding der Sparkasse in Bremen Group
DE	ProCredit Group
DE	Wüstenrot & Württembergische AG
DK	Danske Bank*
DK	Saxo Bank A/S
EL	Alpha Bank, S.A.
EL	Eurobank Ergasias, S.A.
ES	BBVA*

EEA home country	Name of cross-border banking group
ES	Grupo Santander*
ES	Banco de Sabadell, S.A.
FI	Nordea*
FR	BNP Paribas*
FR	Société Générale*
FR	Crédit Agricole S.A.
FR	ODDO ET CIE
FR	RCI Banque SA
HU	OTP Bank Nyrt*
IE	Allied Irish Banks plc
IE	Bank of Ireland Group plc
IT	UniCredit Group*
IT	Banca Mediolanum SPA
IT	Intesa Sanpaolo SPA
LI	VPB Group
LU	Havilland S.A.
LU	Precision Capital S.A.
LU	Quilvest Wealth Management S.A.
NL	ABN AMRO Group N.V.
NL	ING Groep N.V.
NL	Coöperatieve Rabobank
NO	DNB ASA Group
PL	Getin Holding
PT	Banco Comercial Português, SA
PT	Finantipar Group

EEA home country	Name of cross-border banking group
SE	Skandinaviska Enskilda Banken (SEB)*
SE	Handelsbanken
SE	Swedbank
SI	Nova Ljubljanska Banka (NLB)
UK	Barclays Banks plc
UK	FCE Bank
UK	HSBC Group
UK	Lloyds Banking Group
UK	Schroders plc
UK	Standard Chartered Group
UK	The Royal Bank of Scotland Group
56	Total number of colleges for EEA banking groups

*Closely monitored colleges (12 in total).

Name of third-country banking group
Sberbank Europe
Citibank
EFG Bank
Three colleges for third-country banking groups



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