# REPORT ON CONVERGENCE OF SUPERVISORY PRACTICES IN 2020

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EBA
EUROPEAN
BANKING
AUTHORITY

# Contents

# List of figures

# Abbreviations

| | |
|---|---|
| **AIRB** | Advanced internal ratings based approach |
| **AML** | Anti-money laundering |
| **BCM** | Business continuity management |
| **BMA** | Business model analysis |
| **BoS** | Board of Supervisors |
| **BRRD** | Bank Recovery and Resolution Directive |
| **CA** | Competent authority |
| **CF** | Critical functions |
| **CFT** | Countering the financing of terrorism |
| **CRD** | Capital Requirements Directive |
| **CRR** | Capital Requirements Regulation |
| **CSRBB** | Credit spread risk in the banking book |
| **EBA** | European Banking Authority |
| **ECB** | European Central Bank |
| **EEA** | European Economic Area |
| **ESA** | European Supervisory Authority |
| **ESMA** | European Securities and Markets Authority |
| **EU** | European Union |
| **FIRB** | Foundation internal ratings based approach |
| **FOLTF** | Failing or likely to fail |
| **GL** | Guideline |
| **GRP** | Group recovery plan |
| **ICAAP** | Internal capital adequacy assessment process |
| **ICT** | Information and communication technology |
| **ILAAP** | Internal liquidity adequacy assessment process |
| **IRB** | Internal ratings based approach |
| **IRRBB** | Interest rate risk in the banking book |
| **IT** | Information technology |
| **JD** | Joint decision |
| **KRI** | Key risk indicator |

| | |
|---|---|
| **LGD** | Loss given default |
| **MDA** | Maximum distributable amount |
| **ML/TF** | Money laundering/terrorist financing |
| **MREL** | Minimum requirement for own funds and eligible liabilities |
| **NPE** | Non-performing exposure |
| **NPL** | Non-performing loan |
| **P2G** | Pillar 2 guidance |
| **P2R** | Pillar 2 requirements |
| **RA** | Resolution authority |
| **RAF** | Risk appetite framework |
| **RW** | Risk weight |
| **RWA** | Risk-weighted asset |
| **SA** | Standardised approach |
| **SEP** | Supervisory examination programme |
| **SLE** | Specialised lending |
| **SLSC** | Supervisory slotting approach |
| **SREP** | Supervisory review and evaluation process |
| **TLAC** | Total loss absorbing capacity |
| **TSCR** | Total SREP capital requirement |

# Executive summary

According to its founding regulation, the European Banking Authority (EBA) shall contribute to enhancing supervisory convergence across the internal market and it shall play an active role in building a common supervisory culture and consistent supervisory practices throughout the Union[1]. Specifically in the context of the supervisory review and evaluation process (SREP), this mandate has been further strengthened by the Capital Requirements Directive (CRD), in Article 107, which requires the EBA, i) to develop common procedures and methodologies for the supervisory review; as well as to ii) report annually on the degree of convergence of supervisory practices to the European Parliament and the Council.

The EBA, in order to drive the convergence efforts, sets an annual convergence plan by selecting key topics for prudential supervisory scrutiny based on its expertise in EU-wide risk analysis and policy development. The 2020 Convergence Plan aimed at informing competent authorities' (CAs') planning processes for selecting supervisory priorities for 2020 and influencing their supervisory practices, including in supervisory colleges established for the supervision of cross-border banking groups. The five key topics identified for 2020 that were confirmed by the EBA Board of Supervisors (BoS) as relevant in the context of the COVID-19 pandemic and crisis are: i) information and communication technology (ICT) risk and operational resilience; ii) loan origination standards; iii) profitability; iv) capital and liability management and v) money-laundering and terrorist financing risk (ML/TF) and other conduct risk for prudential supervisors.

This report summarises the EBA's observations on the degree of convergence of prudential supervisory practices in 2020 as well as the conclusions of the EBA college monitoring activity, all of which support the feedback loop to EBA policy development as well as to convergence planning activities. As a result, this report also incorporates the EBA 2021 Convergence plan that guides supervisory efforts in 2021.

*Summary of the assessment of convergence of supervisory practices in 2020*

In the context of the follow-up of the outstanding recommendations of the 2016-2017 bilateral visits, the EBA concluded that CAs have made further progress in the implementation of SREP GLs. The areas where considerable progress was achieved in 2020 are business model analysis (BMA), the monitoring of key risk indicators and link between the SREP, early intervention and the determination of failing or likely to fail (FOLTF). In these areas, all recommendations have now been implemented in supervisory practices. The recommendations that remain outstanding are linked to the capital adequacy assessment and the setting of Pillar 2 requirements (P2R).

Overall, this report finds that supervisors took into account the key topics of the EBA 2020 Convergence Plan in their supervisory work. Equally, the more detailed attention points linked to

[1] Article 1(fa) and Article 29 of Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC

the 2020 Convergence Plan shaped CA supervisory practices in 2020. Nevertheless, it can also be concluded that the implementation of the plan in supervisory practices was impacted by the COVID-19 related reprioritisation of supervisory activities, in the sense that the five key topics received a different degree of supervisory attention. Supervisory activities were targeted and focused on the items that were deemed to be the most critical in the context of the COVID-19 crisis.

As a result, increased supervisory attention was given to the assessment of profitability and the business model closely linked to asset quality, as well as to selected areas of ICT risk and operational resilience. The EBA's follow-up found some divergent supervisory reaction to how ICT risk is dealt with in the risk appetite framework (RAF) and the internal capital adequacy assessment process (ICAAP) of small and medium sized credit institutions. It can also be concluded that considerable supervisory efforts have been made to ensure credit institutions' compliance with the EBA outsourcing GLs.

The EBA also observed continued efforts by CAs to cooperate with their resolution authority (RA) counterparts on institutions' minimum requirement for own funds and eligible liabilities (MREL) targets and their ability to meet these requirements. In addition, prudential supervisory practices have also been converging in the context of ML/TF risk, as information received from anti-money laundering/countering the financing of terrorism (AML/CFT) supervisors increasingly feeds into the SREP. Nevertheless, some differences remain, which are expected to diminish following the issuance of the EBA's Opinion on how CAs should take ML/TF risks into account in the SREP and with the integration of this aspect into the SREP GLs, which is currently underway.

The loan origination key topic received less supervisory attention as COVID-19 shifted the focus within the 'life cycle' from loan origination to the management of distressed debtors and to the monitoring of risk exposures. This refocusing of supervisory attention is consistent with the EBA's pragmatic SREP GLs that put forward credit risk management as a key focus area for 2020. Nevertheless, loan origination practices should remain an area of attention for supervisors in 2021 and onwards.

In 2020, the EBA noted that some progress had been made in the convergence of practices in the setting of P2R, nevertheless, certain notable differences in supervisory approaches and methodologies remain, which may also contribute to the divergence of results. Regarding the setting of Pillar 2 guidance (P2G), not all CAs set P2G for institutions in their jurisdictions in 2020. While there are still some diverging practices, many CAs are planning to revisit their methodologies in 2021, and also align them with the requirements of CRD V.

The interactions of closely monitored supervisory colleges intensified in 2020 compared to 2019 and close cooperation was ensured during the pandemic. Overall, the EBA concluded that approaches for the risk assessment were well aligned, as most CAs followed the pragmatic SREP GLs, but this was also due to the additional efforts of the consolidating supervisors to coordinate the joint decision (JD) cycle. While clear improvements were achieved in 2020 with regard to the identification of material ICT risks, colleges are expected to give more consideration to MREL requirements and increasingly factor in ML/TF risks in the group risk assessment. Some of the topical tasks colleges were expected to address in 2020 still have to be acted on in 2021.

All closely monitored colleges that were required to reach a joint decision on capital and liquidity reached agreement in 2020. For the vast majority of banking groups, P2R and P2G were kept stable in 2020 and supervisory measures in 2020 were primarily qualitative in nature. The process of assessing group recovery plans (GRPs) and reaching joint decisions continued to progress smoothly and overall good quality was achieved thanks to the robust interaction between authorities.

*EBA policy work supporting supervisory convergence in 2020 and training*

The unprecedented circumstances of the COVID-19 pandemic and crisis reinforced the need for the EBA to safeguard and preserve the convergent supervisory approaches enabled by the SREP GLs. Therefore, the EBA published its pragmatic 2020 SREP Guidelines to demonstrate how flexibility and pragmatism could be exercised in relation to the SREP framework in the context of the crisis. Other policy products addressing supervisory convergence and ongoing supervision in 2020 were already reflected in the EBA 2020 Convergence Plan. The EBA is also committed to facilitating consistency in supervisory practices on how to factor ML/TF risks into the SREP from a prudential perspective and therefore the EBA published an Opinion in this regard in 2020.

In 2020, the EBA training team, amidst the COVID-19 pandemic and the subsequent closure of the EBA offices, successfully delivered a total of 11 trainings to 1627 participants. Contrary to physical training sessions, virtual trainings accommodated twice as many participants.

*Ongoing and future work*

A priority area of the EBA's current and future work in the context of common procedures and methodologies for SREP, is the alignment of the SREP GLs with the requirements of CRD V according to the EBA roadmap on the risk reduction measures package. The review also aims at enhancing the guidance based on observations from the ongoing monitoring and assessment of the convergence of supervisory practices. In addition, the review will aim to streamline and simplify the guidelines to facilitate their application.

The EBA will continue to follow up on the implementation of the 2021 Convergence Plan with the practice of selecting key areas that will require heightened supervisory attention.

# Background and introduction

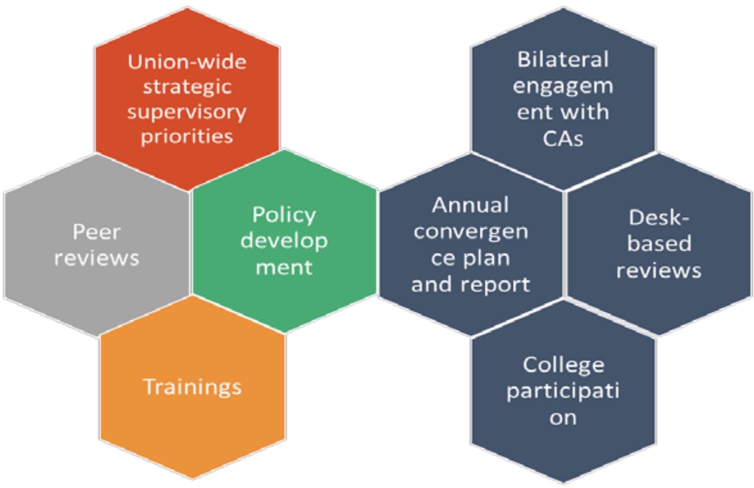
In line with its mandate to foster supervisory convergence and build a common supervisory culture, the EBA undertook various activities to pursue this convergence mandate over the course of 2020.

The EBA's convergence toolkit starts with the policy developments that contribute to high-quality common supervisory standards. With the aim of assisting the implementation of important policy products, training courses were offered to European Economic Area (EEA) supervisors in 2020, which were successfully shifted to virtual/online format in 2020 due to the restrictions caused by the pandemic.

Desk-based reviews, as well as bilateral convergence visits, aim to strengthen consistency in the application of the Level 2 regulation and EBA policy products, which the EBA continued to enhance in 2020. The EBA adapted its 2020 bilateral visits to the new remote working environment and ensured efficient and constructive dialogue with competent authorities in a virtual setting, addressing the practical implementation of various policies and the 2020 Convergence Plan.

For the first time in 2020, the EBA established two EU-wide strategic supervisory priorities, business model sustainability and adequate governance structures, for a three-year period, in order to establish forward-looking considerations. These long-term supervisory priorities provide the strategic direction for EEA supervisors, which is supported by the selection of key topics as part of the annual convergence cycle that contribute to achieving further convergence in supervisory practices and approaches.

Figure 1: The EBA's convergence toolkit



# 1. Convergence in the SREP and ongoing supervision

In order to be able to provide a comprehensive view of the degree of convergence of supervisory practices under the SREP and in ongoing supervision, the EBA assessed the evolution of practices in the following key areas: i) the status of outstanding recommendations from the 2016-2017 bilateral visits, ii) the implementation of the annual convergence plan that puts forward key areas for supervisory attention, iii) convergence in supervisory outcomes (measures), and iv) credit and market risk internal models.

## 1.1 Status of the implementation of SREP GLs

***In 2020, CAs progressed further with the implementation of the SREP Guidelines (GLs). The areas where considerable progress has been achieved are BMA, monitoring of key risk indicators and the link between SREP, early intervention and the determination of FOLTF. In these areas all recommendations have now been incorporated into supervisory practices.***

***Most of the observations and recommendations made by the EBA during the 2016 and 2017 bilateral convergence visits have now been addressed and only a small number of recommendations remain outstanding, linked to the capital adequacy assessment and the setting of P2R.***

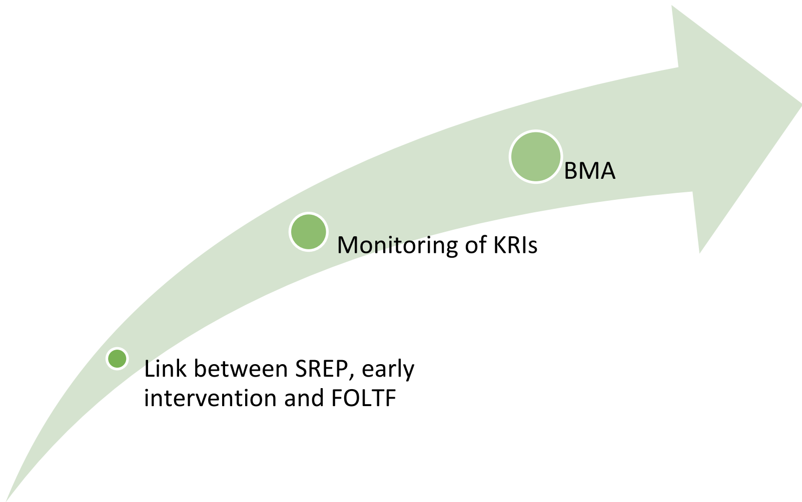
***Despite the steps taken by CAs to address recommendations relating to the determination of institution-specific additional own funds requirements, in some instances, the legally binding nature of P2R and the communication of the total SREP capital requirement (TSCR) to all institutions as a legally binding requirement have still to be addressed.***

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

These visits resulted in a number of recommendations and observations, thus, the EBA, on a yearly basis, follows CAs' efforts to further develop and refine their methodologies and practices in view of the common SREP framework.

The areas where considerable further progress has been achieved are BMA, the link between SREP, early intervention and the determination of FOLTF and the monitoring of key risk indicators.

Figure 2: Areas where further convergence was observed in 2020 based on recommendations from the 2016-2017 bilateral convergence visits




## a. BMA

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. However, in some cases, BMA was not performed on a consolidated basis, i.e. it did not take due account of the assessment of material geographies in which institutions operate or the selection of the peer groups was not aligned with the focus of the BMA assessment.

In both of these aspects, CAs took considerable steps to enhance their methodologies and practices in the course of 2020. The offsite supervision framework was enhanced to ensure that the regular assessment of material geographies, which benefits from detailed prudential discussions with the group on BMA and strategy, feeds into the overall group risk assessment. For the enhanced peer comparison, new technical solutions have been developed that not only ensure the comparison of predefined peer groups[2], but also allow for the selection of peers of choice, depending on the purpose of the analysis[3].

## b. Monitoring of key risk indicators

The regular monitoring of key financial and non-financial indicators is an important element of the SREP process. In 2018-2019, a number of authorities implemented new monitoring indicators and

[2] E.g. based on the category of institutions, business model, etc.

[3] E.g. considering business segments and/or clients, etc.

limit systems in their key risk indicator (KRI) framework and ensured more comprehensive monitoring by integrating KRIs and early warning signals (EWS).

In 2020, the EBA observed further achievements in this regard with the application of new technical solutions for monitoring and analysing risk exposures and their development across institutions, including some solutions that feature prediction models as a forward-looking element of the monitoring framework.

### c. Link between SREP, early intervention and determination of FOLTF

The EBA observed further progress on supervisory practices in the continuum between ongoing supervision, recovery and resolution in the course of 2020. This included the establishment of internal procedures for the application of early intervention measures and interacting with the resolution authority (RA) for FOLTF assessments.

### d. Capital adequacy assessment

The role of TSCR and in particular the legally binding nature of P2R in the context of the maximum distributable amount (MDA) trigger and calculation under Articles 141 and 142 of the CRD is explained in the EBA's Opinion on MDA[4]. 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.

With the implementation of CRD V, authorities need to set P2R as a legally binding requirement 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 applicable. This means that P2R becomes legally binding in nature and must be considered in the MDA calculation and trigger.

While all affected CAs, as part of their work on implementing CRD V, took steps in 2020 to address the recommendations in this regard, some recommendations remain outstanding. It is envisaged that more CAs will formally establish binding P2R from in 2021 onwards after implementing the CRDV in 2020/2021. CAs also continue to work to ensure that they communicate the TSCR as described in the SREP Guidelines to all institutions subject to SREP.

The bilateral visits conducted in 2016 also gave rise to recommendations addressing the mechanics of determining additional own funds requirements and called on some CAs to review their practices

[4] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/983359/3f0814a6-342b-4679-8a65-fa1b51be1643/EBA-Op-2015-24%20Opinion%20on%20MDA.pdf

in this regard. The observations mainly related to the setting of the additional capital requirements in a holistic manner without decomposing the capital requirements on the basis of the underlying risk drivers. The EBA noted relevant improvements in 2020 towards a more risk-by-risk determination of the add-ons, with the ICAAP playing a heightened role in the determination of P2R and an enhanced focus on Pillar 2 risks.

## 1.2 Implementation of the 2020 Convergence Plan in the context of the COVID-19 crisis

***Overall, this report finds that supervisors took into account the 2020 key topics for supervisory attention in their work and the more detailed attention points linked to the 2020 Convergence Plan shaped their supervisory practices during the year.***

***Nevertheless, it can also be concluded that the implementation of the plan in supervisory practices was impacted by the COVID-19 related reprioritisation of supervisory activities in the sense that the five key topics received a different degree of supervisory attention which is perceived to be proportionate to the extent they have been affected by the COVID-19 pandemic and crisis. Supervisory activities were targeted and focused on the items that were deemed to be the most critical in the context of the COVID-19 crisis.***

***As a result, increased supervisory attention has been given to the assessment of profitability and the business model closely linked with asset quality, as well as to selected areas of ICT risk and operational resilience. The EBA also observed continued efforts by CAs to cooperate with their resolution authority (RA) counterparts on institutions' MREL targets and their ability to meet these requirements. In addition, prudential supervisory practices have been converging in the context of ML/TF risk, as information received from AML/CFT supervisors increasingly feeds into prudential supervisory processes, in particular into the SREP.***

***In contrast, the loan origination key topic received less supervisory attention as COVID-19 shifted the focus within the 'life cycle' from loan origination to the management of distressed debtors and the monitoring of risk exposures. Therefore, loan origination practices remain an area of attention for supervisors in 2021[5] and onwards.***

The EBA establishes an annual convergence plan which identifies key topics for heightened prudential supervisory attention and informs CAs' processes for selecting supervisory priorities for the upcoming year. The aim of the annual convergence plan is to drive supervisory convergence

[5] As part of the asset quality and credit risk management key topic in the 2021 Convergence Plan.

across the EU, focusing on a set of risks and priority areas where supervisory practices are expected to converge as a result of certain policy development.

The convergence plan is communicated to the supervisory community in Q4 for the next year and followed by a set of attention points (objective elements), that are i) defined to convey more detailed focus points to CAs for each key topic; and ii) allow for a structured follow-up on the degree of convergence in the supervision of the key topics across the EU.

As the 2020 Convergence Plan was finalised and shared with CAs well before COVID-19 hit, the key topics selected for supervisory attention in 2020 have been reviewed, with the integration of the plan into the 2019 Convergence Report, and it was concluded that they have become particularly relevant in the context of the COVID-19 crisis.

It was also confirmed that, for the 2020 Convergence Plan, when conducting the follow-up and assessment, the EBA will take into consideration the fact that supervisory efforts and resources had to be reallocated due to the pandemic and readjusted to accommodate crisis monitoring. Therefore, the assessment below draws overall conclusions bearing in mind these needs for reallocation and readjustment.

For the follow-up on the 2020 Convergence Plan, the EBA conducted i) a desk-based review to collect information from CAs in the relevant subgroup of the Standing Committee on Oversight and Practices (SCOP), and ii) bilateral convergence visits to better understand the applied practices. The bilateral visits supplemented the desk-based review to assess the implementation of the 2020 Convergence Plan and allowed for some in-depth insights into CA practices. These visits are considered beneficial for both the EBA and the CAs, because they allow the EBA to directly interact with CA staff and gain insight into supervisory practices, while CAs gain access to EBA experts and are able to raise issues and/or form a better understanding of relevant EBA policy products.

### a. ICT risk and operational resilience

In line with the 2020 Convergence Plan, the EBA Guidelines on ICT risk assessment under the SREP (EBA/GL/2017/05), as well as the updated EBA Guidelines on outsourcing (EBA/GL/2019/02), were the key focus points of the EBA's follow-up[6].

Considerable supervisory work had already been done in 2019, when supervisors reviewed credit institutions' practices for the identification, monitoring, assessment and mitigation of ICT risks, and ensured that ICT strategy existed at the vast majority of them. The 2019 Convergence Report concluded that the areas where some further supervisory attention would be needed were the

[6] The EBA ICT and security risk management GLs published in November 2019 and which entered into force on 30 June 2020 are considered in the 2021 Convergence Plan and will be followed up accordingly by the EBA.

formalisation of ICT risk appetite and how it cascades down the organisation, as well as ICT risk governance and controls.

*Supervisory practices in 2020*

***While ICT risk and operational resilience were at the forefront of supervisory attention in 2020, they were equally affected by the COVID-19 related reprioritisation of planned supervisory activities. The more focused nature of the ICT risk assessment was a distinct feature of the 2020 SREPs that affected both the scope of the review as well as the selection of the targeted institutions. In terms of scope, specific areas were prioritised in the 2020 ICT risk assessment reviews, such as business continuity management (BCM), security and cyber risk management (including incident reporting) and the outsourcing of critical services, along with a clearer risk-driven selection of the targeted institutions. Notwithstanding the adjustments made in the 2020 assessments, a number of CAs conducted a thorough assessment of ICT risks and operational resilience, at least for the targeted credit institutions. The EBA's follow-up found some divergent supervisory reaction to how ICT risk is dealt with in the RAF and the ICAAP of small and medium sized credit institutions. It can also be concluded that considerable supervisory efforts have been made to ensure credit institutions' compliance with the EBA outsourcing GLs.***

The competent authorities informed the EBA of an array of supervisory activities undertaken in 2020, starting from the use of the ICT risk assessment questionnaire(s) as part of the SREP process or the review of the relevant external/internal auditors' reports and engagement with the supervised institutions in prudential meetings. Almost half of the CAs performed some onsite activities in this regard.

The most widely used information source was the ICT risk assessment questionnaire that aimed to collect information from institutions on various aspects of ICT risk management, in line with the EBA Guidelines on ICT risk assessment under the SREP.

The pandemic had an effect on the supervisory activities of the CAs in 2020. Some CAs noted that due to COVID-19, ICT questionnaires were not launched, but rather relevant internal ICT policies/processes were assessed by the line supervisor or the ICT strategy and risk management frameworks were subject to supervisory dialogue with institutions if the risk profile so warranted. In other cases, the ICT risk assessment questionnaires were replaced by targeted information collections. Onsite supervision was also impacted by COVID-19, as most authorities postponed ICT inspections or performed them remotely.

Notwithstanding the aforementioned adjustments, a number of CAs conducted a thorough assessment of ICT risks and operational resilience for targeted institutions.

The existence of an ICT strategy is an important element of the EBA's ICT risk assessment GLs, and its alignment with business strategy has already been pursued by CAs in previous years. Thus, in 2020, the supervisory focus was mainly on the impact of COVID-19 on the institutions' ICT strategies and how the various ongoing projects were impacted.

As a follow-up to the conclusions of the 2019 Convergence Report, the EBA observed some improvements in terms of the supervisory coverage of ICT risk appetite and how it cascades down in the organisation, but found some divergent supervisory reaction to how ICT risk is dealt with in the RAF and the ICAAP of small and medium sized credit institutions.

More CAs scrutinised risk appetite and the ICAAP to ensure they sufficiently capture all material risks, including elements of ICT risk, and identified deficiencies in a number of credit institutions in terms of insufficient granularity of risk metrics for ICT risk.

On the other hand, other competent authorities did not necessarily challenge the fact that ICT risk is not assessed separately in the risk appetite or the ICAAP of some of their supervised institutions but subsumed under operational risk. While this difference may be explained to some extent by the proportionality principle, it indicates differences in the intrusiveness of supervisory approaches as well as in the application of supervisory frameworks. For the application of the EBA Guidelines on ICT risk assessment under the SREP, the competent authorities should consider the principle of proportionality also in the context of the operational environment of the institution, not only in regard to the nature, scale and complexity of its activities.

In relation to outsourcing, it can be concluded that considerable supervisory efforts have been made by the CAs to ensure the sector's compliance with EBA outsourcing GLs. One of the attention points linked to the 2020 Convergence Plan stressed that outsourcing institutions should maintain an updated register of information on all outsourcing arrangements, including those outsourced to cloud service providers, and therefore the EBA's follow-up also focused on this aspect.

The outcome of the desk-based review was that the vast majority of CAs have in place a national regulatory framework on outsourcing, which adhere to the EBA outsourcing Guidelines, and actively monitor the compliance of institutions with that framework. Only two CAs reported that they have not yet required institutions to have a register of outsourced activities in place, however, they have made considerable efforts to move forward with the implementation of this requirement and engage with the industry to address the upcoming changes. Half of the CAs noted that the register is verified during their onsite inspections.

The 2019 Convergence Report also highlighted further supervisory focus on adequate ICT risk governance. However, this area was not a priority in 2020 due to the COVID-19 related readjustment of supervisory activities. Therefore, the EBA has included this aspect in the 2021 Convergence Plan, in particular the clear roles and responsibilities for ICT and security risk management and the availability of adequate staff, including quantity and skills as well as an appropriate allocated budget for ICT operational needs and the implementation of the ICT strategy.

#### GOOD PRACTICES

- Two competent authorities provided specific training sessions on ICT risk assessment to line supervisors involved in thematic ICT-related supervisory activities. The training sessions covered ICT governance and strategy, as well as the categorisation of ICT risks and their definitions, as included in the EBA ICT risk assessment GLs.

- A number of CAs interacted directly with key ICT third party providers of credit institutions. One CA gathered more information on BCM matters and on the approaches followed during the pandemic in order to guarantee the smooth provision of ICT services. Another CA held a series of industry workshops with the most relevant ICT third party providers to flag supervisory expectations in line with the EBA Guidelines on outsourcing arrangements (EBA/GL/2019/02).

- One CA has developed ICT-related KRIs for regular monitoring purposes, covering the following areas: human resources, systems and processes, system failures, security incidents, e-banking and outsourcing of ICT services.

#### AREAS FOR CA ATTENTION

- It is recommended that all CAs challenge institutions' views on the assessment and materiality of ICT risk, when assessing their ICT risk profile, and thus the granularity with which it is embedded in the overall risk management framework, including the RAF and ICAAP.

### *Main outcomes of the supervisory review of ICT risks*

Overall, most supervisors have identified improvements in terms of the ICT risk awareness of credit institutions. More specifically, credit institutions are increasingly aware of the importance of strong IT governance and strategy.

In connection with the ICT strategy, supervisors expressed concerns regarding the implementation of the strategy, more specifically the lack of specific targets, deadlines and responsible manager(s), in particular a lack of necessary (skilled) IT personnel to assist with the implementation of the strategy. In the case of banking groups, supervisors noted a lack of local entity ownership of the ICT strategy. The issues identified were subject either to supervisory dialogue and/or supervisory recommendations. More CAs highlighted the need to adapt ICT strategies to the external environment and competitors taking into account the increase in digitalisation and FinTech firms.

In contrast, some banks had already updated their ICT strategies in 2020 or even earlier to reflect such developments, including the use of ICT services by third party providers, or the more extensive reliance on cloud based services. The shift in working arrangements from office to remote working brought about by the pandemic has also been increasingly reflected in ICT strategies.

Based on the outcomes of the 2020 supervisory assessment, ICT outsourcing risks, ICT security risk and ICT availability/continuity[7] risks are the key ICT risks in 2020. A number of CAs reported that ICT outsourcing was increasing, due, among other factors, to the lack of adequate oversight of outsourcing arrangements and inadequate controls in this respect. Therefore, requirements related to the use of third party providers and the management of ICT outsourcing risk, as well as the related exit strategies, will remain at the forefront of supervisory attention as per the EBA 2021 Convergence Plan.

Some deficiencies in cyber risk controls were noted, in addition to the increase in cybercrime in the EU due to the coronavirus outbreak. However, the majority of CAs seem to agree that while remote working may have entailed some vulnerabilities for institutions, at least at its transitionary phase, there does not seem to be a clear conclusion that overall ICT security risk significantly increased across the EU banking sector in 2020.

It could be concluded that credit institutions' business continuity and contingency management measures have worked well overall during the pandemic with no major issues concerning business continuity observed in 2020.

*Observations from the bilateral visits*

The assessment of ICT risk and operational resilience was an integral part of the SREP assessment at all visited CAs.

Three quarter of the CAs relied primarily on the use of a self-assessment template in 2020 that captured the ICT strategy, ICT risk appetite and contingency planning, and allowed for the identification of material ICT risks. For the remaining CAs, onsite inspections verified whether the ICT related requirements laid down either in national legislation or in CA recommendations/guidelines are met by institutions.

The bilateral visits confirmed the same key ICT risks as those observed in the desk-based review, also having regard to the operational circumstances caused by COVID-19, with the only difference being the order of the risks, as ICT availability and continuity was considered the most prevalent, followed by ICT security risk and ICT outsourcing risk.

The COVID-19 induced specificities of the ICT SREP are reflected in the intensive interaction with institutions on i) ICT availability/continuity risk in order to verify capacities to ensure continued

[7] The order of risks means the order of relevance as assessed by supervisors.

operation, including the transition to a remote working model (capacity management); ii) ICT security risk and incident reporting and monitoring, due to the increased number of cyber incidents[8], and iii) ICT outsourcing risk, including offshore outsourcing and contingency planning.

Two additional risks were also seen as a concern, irrespective of the COVID-19 crisis; namely ICT change risk, due to the various outdated IT legacy systems that will require large-scale projects and strategic planning to ensure a smooth transition and ICT data integrity in the context of the implementation of BCBS 239. The latter entailed a number of qualitative measures in supervisory colleges.

#### GOOD PRACTICES IDENTIFIED IN THE BILATERAL VISITS

- As COVID-19 shifted the focus towards remote working technology, one CA developed:
    - new guidelines for institutions concerning requirements for the remote working environment;
    - its own methodology for remote ICT inspections.

## b. Loan origination standards

The EBA published guidelines on loan origination and monitoring on 29 May 2020. The guidelines will apply from 30 June 2021, but institutions could benefit from a series of transitional arrangements, with possible data gaps to be addressed until 30 June 2024 together with the adjustment of monitoring frameworks and infrastructure.

The 2020 Convergence Plan invited CAs to work with institutions to improve their loan origination practices in preparation for the implementation of the guidelines by undertaking a gap analysis, allowing room for a pragmatic and proportionate approach to monitoring the implementation of the guidelines and exercising supervisory judgement, taking into account the operational challenges and priorities institutions may have due to the COVID-19 crisis.

### *Supervisory practices in 2020*

***The work on the implementation of these guidelines had been clearly impacted by the COVID-19 pandemic in terms of the effort that could be directly dedicated to this key topic both by the industry and by CAs. An overall conclusion based on supervisory input is that COVID-19 has shifted the focus within the 'life cycle' from loan origination to the management of distressed debtors and to the monitoring of risk exposures. This refocusing of supervisory attention is consistent with the EBA pragmatic SREP GLs that put forward credit risk management as a key focus area for 2020.***

[8] Although, overall, no major incidents have been observed.

Notwithstanding the crisis situation, almost 20% of CAs managed to either conduct a gap analysis based on the provisions of the guidelines or requested institutions, or a subset of institutions, to undertake their own gap analysis. An additional 10% of CAs started this work in 2020, which was either ongoing or put on hold, at the time of the EBA's stock-take, due to the COVID-19 related reprioritisation.

40% of CAs did not start a gap assessment, mainly because more urgent supervisory activities had to prevail, or, alternatively, some CAs are still in the process of implementing their own guidelines. Nevertheless, most of these CAs, as well as those that did not indicate whether a formal gap analysis had been performed, stated their good understanding of the overall preparedness of institutions under their supervision. These CAs, based on their day-to-day supervisory activity, confirmed that the basic principles of the framework for credit granting, in particular risk governance, risk appetite and creditworthiness assessments and related practices were already covered by local legislation or supervisory policies and in many jurisdictions these are also subject to onsite inspections. A more thorough supervisory gap analysis and/or monitoring of the relevant initiatives of institutions is also envisaged for 2021 by these CAs.

In 2020, as a result of the COVID-19 pandemic and subsequent economic situation, a key focus area for supervisory assessment was the ability of institutions to provide payment holidays to customers, followed by the expiry of these payment holidays together with banks' provisioning methodologies.

The above conclusions warranted loan origination practices remaining a key area of attention for supervisors in 2021 and onwards, and while the topic has not been singled out as a separate key topic for 2021, it will be an integral part of the overall 'asset quality and credit risk management' key topic in the 2021 Convergence Plan.

#### AREAS FOR CA ATTENTION

- All CAs should verify whether institutions have performed a gap analysis on their credit granting practices and prepared an adequate plan for the implementation of the guidelines; including whether the credit granting practices of the institution ensure the proper assessment and measurement of the creditworthiness and the credit risk of borrowers.

### *Main outcomes of the supervisory review of loan origination practices*

Findings from the gap analysis performed by a number of CAs and subsequent dialogue with the industry seem to suggest that institutions have a good overall awareness of the relevance and importance of the credit granting and monitoring practices as put forward by the EBA Guidelines and they expect to comply with the Guidelines by their application dates.

Some CAs stressed that a general conclusion of the gap analysis is that institutions will need to gather more information from their clients during the credit granting process, especially from SME clients, but in some jurisdictions also from retail clients and for short-term/low volume credits to verify and confirm income/revenues. Some entities have already put a comprehensive action plan in place, with the involvement of their IT outsourcer to implement adjustments in the related IT procedures.

On a more general level, the following areas have been highlighted for improvement by CAs either as part of their on- or offsite supervisory activities:

- Policies: lack of written policies for certain operations[9], policy breaches in credit granting;
- Pricing: issues with risk-adequate underwriting, pricing appears to only partially reflect the evolution of PD/LGD and other KRIs;
- Monitoring framework and risk parameters: data inconsistencies, conservativeness applied by financial institutions, adequacy of provisioning levels and issues with exposure classifications.

*Observations from the bilateral visits*

75% of the CAs visited performed a gap analysis on how the requirements included in the EBA GLs on loan origination and monitoring compare with those of their local legislation and/or supervisory recommendations/benchmarks and/or SREP methodology. The outcome of these reviews was that the provisions of the EBA GLs are relatively well covered in the existing legal framework and where necessary[10] the respective methodologies/recommendations have been amended, most of them entering into practice with the 2021 assessment cycle. These CAs, however, have not yet asked institutions to conduct a gap analysis, mainly due to the COVID-19 related circumstances, but this may be initiated in 2021. It was noted that some of the large institutions are in the process of conducting such an analysis anyway.

The remaining CAs did not directly carry out a gap analysis under the EBA GLs on loan origination and monitoring, but institutions were asked to perform a basic impact analysis[11] to understand the implications.

Overall, the EBA bilateral visits confirmed the outcome of the desk-based review that some planned activities either had to be postponed entirely[12] or had to be shifted offsite.

Concerning the more specific supervisory activities targeting loan origination, CAs disclosed information about the onsite inspection that was conducted at a subset of institutions in 2020 and looked into credit risk in general, including loan origination practices.

[9] E.g. operations with the management body

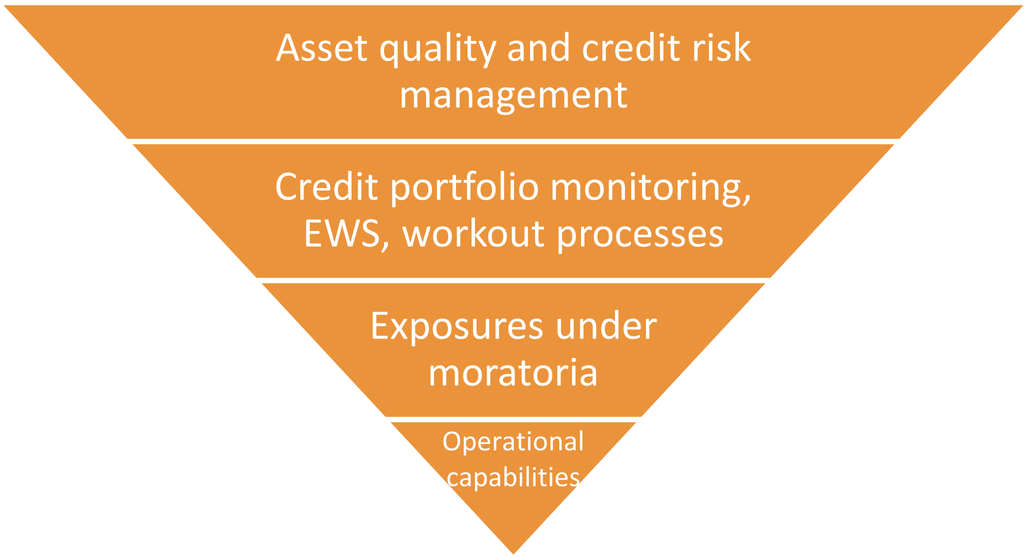
[10] E.g. governance related implications, the loan origination procedures

[11] Not a full gap analysis

[12] E.g. deep-dives

Supervisors explained during the bilateral visits that the supervisory focus in 2020 had largely shifted towards asset quality and credit risk management, in particular, credit portfolio monitoring and early warning systems as well as workout processes to understand whether banks overall were able to adapt their processes to cope with the effects of the crisis, including the identification and monitoring of exposures under moratoria and improving operational capabilities to effectively manage the increased number of non-performing exposures (NPEs). This refocusing of supervisory attention is consistent with the focus areas put forward by the EBA pragmatic SREP GLs.

Figure 3: The supervisory focus shifted in 2020 to:




## c. Profitability

The EBA put forward in its 2020 Convergence Plan some common aspects for the assessment of credit institutions' income generating capabilities and a set of common indicators[13] to monitor as part of the regular monitoring of key risk indicators. In particular, CAs were expected to identify, based on individual institutions' portfolios, whether the institutions understand the potential rise in the cost of risk and what it might imply for their profitability.

### *Supervisory practices in 2020*

***Profitability and the wider business model framework have been an integral part of the regular SREP assessment, but the COVID-19 outbreak and crisis increased their importance and the vast majority of CAs reported intensified supervisory actions in this area compared to 'business-as-***

[13] These indicators are, as a minimum: cost of risk, cost of income, net interest income to total net operating income, net fee and commission income to total net operating income, net interest margin.

***usual', most importantly intensive dialogue[14] with banks and several unplanned and additional activities, such as ad-hoc information collection or specific (horizontal) analysis. Overall, supervisory activities were clearly driven by the need to understand how the banking sector in general and individual institutions, in particular, has been impacted by the COVID-19 outbreak and crisis. The common indicators set by the EBA as part of the further attention points linked to the 2020 Convergence Plan were subject to ongoing monitoring activity by CAs.***

Given the uncertainty regarding the length and shape of the COVID-19 downturn, the focus was on the deterioration in profitability coupled with the ability of the institutions to adjust their business plans and strategies and, as such, the impact on stable earnings. From a profitability and business model perspective, this was closely linked to the analysis of their asset quality and more specifically of their credit portfolio.

Supervisory reviews typically targeted i) exposures to industries sensitive to the COVID-19 crisis, ii) institutions' participation in legislative or non-legislative moratoria and/or the application of other COVID-19 related forbearance measures, iii) the evolution of risk costs, and iv) scenario calculations to envisage the potential impact on banks' profitability.

It can be concluded that all CAs monitor the evolution of a set of key risk indicators on a monthly or quarterly basis, which, in the case of an overwhelmingly large portion of CAs, covered not only the common indicators put forward by the EBA, but also an extended list of indicators to capture developments in all components of profitability. COVID-19 increased the frequency of monitoring these indicators.

The assessment of institutions' vulnerability to economic deterioration is generally performed as part of their ICAAP reviews and, in 2020, some CAs conducted more focused ICAAP assessments covering the banks' internal stress testing methodologies and results of internal stress tests to understand financial resilience, as well as their approaches to capital planning. Detailed credit quality assessments (e.g. loan tapes) have also been pursued at banks that have offered payment holidays to customers. The aim of these exercises is to assess whether there is a risk of elevated credit risk related to such exposures, which would imply a potential (substantive) increase in provisioning, and which would therefore directly impact the profit and loss statement.

All CAs reported to have undertaken either top-down stress tests, sensitivity or vulnerability analyses to understand the impact of various scenarios on individual institutions. Multiple scenarios have been tested (baseline, V share, U shape, etc.) to better capture the sensitivity of the impact of the downturn to the underlying macroeconomic assumptions, including local specificities

[14] More frequent or more focused

regarding the evolution of the pandemic and to challenge institutions' loss forecasts and provisioning.

More specifically, in regard to the sensitivity analysis, simulations were made to project the evolution of write-offs of exposures in affected sectors and CAs also targeted some specific areas such as interest rate risk in the banking book (IRRBB) to model the sensitivity of interest income to interest rate shifts.

Not all CAs conducted onsite inspections, but all emphasised that profitability and capital adequacy forecasts were regularly on the agenda of supervisory discussions with firms in 2020, in particular with a view as to whether institutions indeed understand their own vulnerabilities and are able to take corrective actions if necessary. More institutions were requested to submit revised projections and capital plans as a result of these discussions.

*Main outcomes of the supervisory review of profitability*

At least one fifth of the competent authorities noted that banks under their supervision increased their level of provisioning considerably due to the COVID-19 crisis in order to prepare themselves for a potential increase in credit risk. An additional 14% of CAs either concluded that the vast majority of banks in their jurisdictions are aware of their vulnerabilities due to economic deterioration or are able to identify their key risks appropriately.

While there seem to be some differences between jurisdictions in how far the deterioration of credit quality had already affected the sector's profitability in 2020, as well as the extent to which the population of small and medium sized credit institutions is sensitive to a potential significant and prolonged economic downturn, there is a shared view that the rising cost of risk will further materialise in the upcoming years with the phasing out of various economic stimuli, such as unemployment measures or moratorium measures that could delay the materialisation of defaults.

Two CAs informed about breaches of recovery plan thresholds of certain profitability indicators for a number of institutions. Since Q4 2020, the EBA has been working on the treatment of recovery indicators in crisis and will also expect vigilance from all CAs in this regard as per the 2021 Convergence Plan, requiring CAs to monitor whether institutions experience trigger breaches and whether in such cases they activate proper escalation procedures and inform the supervisor promptly.

*Observations from the bilateral visits*

The bilateral visits confirmed that all visited CAs monitored profitability-related KRIs, including the common KRIs put forward by the EBA. Naturally, there were various additional indicators that CAs followed in 2020, including some forward-looking indicators. As part of the analysis of the short term viability of the firms, these indicators then were compared to the corresponding indictors of the peer group.

Supervisors conducted a number of prudential interviews with banks over the course of 2020 to identify whether they understand their own vulnerabilities to economic deterioration triggered by COVID-19. All CAs concluded that institutions overall were aware of their own vulnerabilities, which were often rooted in their business model and/or strategy and which were not necessary new vulnerabilities, but rather existing ones amplified by the crisis. More CAs noted that some smaller institutions, however, mainly with local ownership and with less opportunity for benchmarking, did not manage to identify their risks properly. Prudential interviews proved to be very useful in these cases to convey supervisory observations and helped to place the institutions in comparison with their peers.

Institutions undertook various measures as a reaction to the pandemic and to safeguard profitability that could be allocated to the following main groups of actions: 1) cost control measures[15], 2) measures addressing revenues[16] and 3) strategic measures[17]. These actions were scrutinised by all visited CAs and they were largely deemed effective at individual entity level. The crisis pushed some institutions to their limits in the sense that they were forced to address their ailing business models.

Some of the good practices/examples of the sensitivity/vulnerability analysis conducted by CAs:

#### GOOD PRACTICES IDENTIFIED IN THE BILATERAL VISITS

- Monthly sensitivity analyses that forecast whether the expected cost of risk could be absorbed by pre-provision profit and relies on banks' baseline and adverse scenarios;
- In another sensitivity analysis, the aggregated impact of the provision shortfall was simulated based on adjustments in the cost of risk in the most impacted sectors. Banks would be taken to the median provisioning levels, which may result in high impacts for some institutions;
- Forward-looking profitability related KRIs[18] have been developed by the CA relying on the previous years' trends to forecast the evolution of the values in the upcoming year and to supplement the viability analysis.

[15] E.g. reduction of office footprint; reduction in headcounts and reduced management positions; further outsourcing of non-core activities

[16] E.g. new services and sales channels - speeding up of digital transformation, decreeing retail deposit rates with no substantial outflows of funds

[17] E.g. strategic rethinking/repositioning, redesigning of the branch network, enhanced use of innovative technologies

[18] E.g. for risk cost, cost to income ratio, ROE

## d. Capital and liability management

In the EBA's 2020 Convergence Plan, competent authorities were invited to engage with institutions individually on their capital planning and investigate the outstanding amounts of legacy instruments in their regulatory capital to better understand institutions' intentions in regard to the treatment of these instruments at the end of the grandfathering period. This expectation was articulated in the context of the communication published by the EBA in early September 2019 on the prudential treatment applicable to own funds instruments at the end of the grandfathering period[19]. Further information was then announced by the EBA in October 2020 in the form of an Opinion to clarify the prudential treatment of these 'legacy instruments' in view of the end of the grandfathering period.

The other attention point in the context of capital and liability management was the institutions' awareness and preparedness in the build-up of MREL and total loss absorbing capacity (TLAC).

*Supervisory practices in 2020*

***CAs interacted with institutions on the future treatment of grandfathered instruments, where this was relevant and overall they found a good level of preparedness, with the vast majority of institutions already having taken steps to reduce, recall or redeem these instruments. The majority of CAs cooperated closely with their RA counterparts on institutions' resolution plans, including MREL targets and exchanged views on their ability to meet these requirements, but some CAs did not provide reassurance that cooperation with the RA in this respect is ongoing.***

CAs were differently impacted by the tasks linked to the phasing out of the grandfathered instruments, depending on the specificities of their local banking sector. Almost 60% of the CAs reported either that i) these instruments are not relevant for their local banking sector as capital tends to be made up solely of fully eligible CET1 instrument items, i.e. share capital, retained earnings and capital contributions from group entities, or ii) that only one or a very limited number of entities have such instruments on their balance sheets and their quantity is negligible.

On the other hand, the competent authorities with institutions under their direct supervisory remit that still have legacy instruments on their balance sheets[20], reported that some actions have already been initiated, in particular i) to understand their relevance, including the impact on capital ratios, ii) to identify legacy instruments held by these institutions that may pose infection risk to fully eligible capital and eligible liabilities instruments, and ii) to understand institutions' intentions with regard to these legacy instruments in particular in terms of the options presented in the EBA

[19] On 31 December 2021

[20] Applying statistical tools on regulatory reporting data or sending questionnaires to institutions

Opinion. As part of the supervisory dialogue, institutions' intentions regarding the future treatment of these instruments were discussed.

The landscape in resolution, in particular in terms of where resolution authorities (RAs) are with the development of their MREL policies and setting MREL accordingly, is somewhat diverse. At least around 20% of CAs reported that their resolution authority counterparts had yet to determine intermediate or final MREL targets. Therefore, the supervisory work in these cases mainly related to verifying market access for institutions in regard to MREL eligible instruments and following the resolution planning performed by the RA.

Close cooperation and consultations with the RA was indicated by the majority of CAs (60%), that covered i) information exchange on the quantification of P2R/P2G and on any decision that may impact the quantification of MREL[21], ii) consultation on the resolution plans, including MREL targets and on the ability of institutions to meet them[22], iii) consultation in the context of prior permissions for reductions of own funds and eligible liabilities.

While the remaining CAs also confirmed that the resolution plans are reviewed by them, based on the responses provided, it cannot be substantiated that there would be a close and ongoing cooperation with the RA on institutions' plans to meet MREL requirements or whether the CAs would engage with the institutions on the viability of their funding plans to meet MREL requirements. One of these CAs stressed that monitoring compliance with MREL requirements is the responsibility of the RA, without providing reassurance that cooperation with the RA in this respect is ongoing.

#### GOOD PRACTICES

- The ability and preparedness of institutions to meet MREL targets and the implementation of BRRD 2 is integrated into the supervisory dialogue with the institution, which is attended by the RA.

- The supervision also focuses on the outstanding amount of eligible liabilities governed by English law and the requirement of the BRRD that liabilities governed by the law of a third country must include clauses recognising the home jurisdiction bail-in power.

#### AREAS FOR CA ATTENTION

- In consultation with resolution authorities (RAs), **all** CAs should ensure that institutions have credible plans in place to meet MREL requirements according to the transition period

[21] E.g. any change in capital requirements throughout the year

[22] E.g. the feasibility of financing plans is assessed by the CA

set by the RA and that they engage with institutions on the viability of their funding plan to meet MREL requirements.

*Main outcomes of the supervisory review of capital and liability management*

For the vast majority of institutions impacted by the phasing out of grandfathering instruments, the competent authorities would not expect complications as many institutions have already taken steps to reduce, recall or redeem grandfathered instruments. For those institutions that still have outstanding amounts of legacy instruments on their balance sheets, shortly after the publication of the EBA Opinion in October 2020, CAs initiated more targeted discussions investigating the institutions' plans to address infection risk, aiming to better understand the effectiveness of the intended actions and to provide feedback to the EBA, which has committed to monitor the implementation of the Opinion. More concrete conclusions on these actions are expected in Q1-Q2 2021.

A third of the competent authorities stated that the institutions under their supervision either already meet MREL requirements or they do not expect problems with their compliance. While some banks will have to issue new instruments to meet MREL requirements, the shortfalls do not seem to pose a high level of concern for these supervisors.

The rest of the CAs, which have not provided overall conclusions on the sector's preparedness for MREL, reported that institutions which have MREL requirements that exceed capital requirements have incorporated these requirements and target levels into their funding and capital plans.

*Observations from the bilateral visits*

MREL shortfalls have been identified by RAs for a number of institutions and while the RA follows the development of the MREL shortfall more closely, the MREL build-up is also monitored by the CAs. Some challenges facing institutions were noted, in particular how the maturity of the local corporate bond market affects their ability to cover considerable MREL shortfalls over the upcoming years and the limited capacity of the local financial market to absorb issuances of MREL-eligible instruments in 2020 due to the economic impact of the COVID-19 pandemic.

In terms of more general capital management in the COVID-19 context, CAs focused mainly on i) the evolution of capital headroom with a forward looking view; ii) understanding managerial actions to handle the crisis (e.g. dividend distribution framework), and iii) the effects of capital requirement relief measures.

## e. ML/TF risk and other conduct risk for prudential supervisors

In the context of AML/CFT, CAs are expected to cooperate and exchange information with AML/CFT supervisors, consider the information received from them and factor it into their supervisory processes as appropriate, in particular in the context of the SREP.

*Supervisory practices in 2020*

***Considerable supervisory efforts were made to strengthen cooperation with AML/CFT supervisors in 2020 and supervisory practices have been converging as the relevant information received from AML/CFT supervisors increasingly feeds into prudential supervisory processes, in particular in the context of the SREP. Nevertheless, some differences remain, which are expected to diminish following the issuance of the EBA's Opinion on how CAs should take ML/TF risks into account in the SREP and with the integration of this aspect into the SREP GLs, which is currently underway.***

Most CAs informed the EBA that there was ongoing dialogue and exchange of information between prudential supervisors and AML/CFT supervisors. There are both formal and informal channels which exist and which facilitate the sharing of information as well as ad hoc requests.

Concerning the type of information that CAs receive from their AML/CFT counterparts, the summary of the ML/TF risk assessments, including the ML/TF risk score and information relating to the main weaknesses of an institution's AML/CFT systems and controls, as well as findings from AML/CFT onsite inspections, were the commonly noted inputs. Several CAs also receive and share onsite visit plans.

The prudential implications of ML/TF risks are mainly considered in the assessment of internal governance and institution-wide controls and in operational risk under the SREP, and to a lesser extent in BMA and liquidity risk. More CAs updated their methodologies by integrating considerations related to ML/TF risks, but there are also others where this development was pending in 2020.

A number of CAs stated that AML-related findings and shortcoming may impact the respective SREP scores (mainly those related to internal governance and operational risk) and the overall score. A particular example of this is when AML-related fines and warnings impact the operational risk SREP scores due to the reputational impact.

Depending on the specific situation and the materiality and severity of the findings, AML/CFT non-compliance could trigger prudential supervisory action or measures that contribute to the mitigation of prudential deficiencies. Examples of AML/CFT-induced P2 add-ons set in the SREP process have been reported as a temporary measure until the identified deficiencies are resolved.

**GOOD PRACTICES**

- Joint onsite inspections by AML/CFT and prudential supervisors;

*Main outcomes of the supervisory review of ML/TF risk and other conduct risk for prudential supervisors*

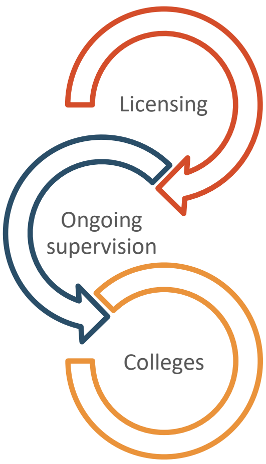
Overall conclusions cannot be drawn for this key topic because not all CAs provided answers on the outcome or conclusions of their ML/TF work. Nevertheless, it is clear that in spite of the challenges associated with restrictions on movement due to COVID-19 and the associated reductions in or adjustments to supervisory activity in many MS, AML/CFT competent authorities continued to identify non-compliance with AML/CFT regulation at supervised institutions in 2020.

At the same time, some CAs reported that they had found that the level of AML/CFT awareness among institutions' management had increased in some cases.

With regard to cooperation between the relevant supervisors, it is expected that the formalisation and improvement of the processes and procedures related to AML/CFT will continue following the transposition of the 5th AMLD into national law. In the meantime, in 2020, AML/CFT supervisors set up 18 AML/CFT colleges for the first time in spite of the challenges associated with COVID-19. This was a significant development and followed the introduction in 2019 of the EBA Guidelines on AML/CFT colleges. These colleges have brought together EU AML/CFT supervisors of the same financial group as members, and in most cases, prudential supervisors, who attend the colleges as observers. AML/CFT competent authorities have until January 2022 to set up AML/CFT colleges for all eligible cross-border institutions.

### *Observations from the bilateral visits*

Figure 4: Modalities of cooperation




The bilateral visits also confirmed the improvement in i) the cooperation between prudential and AML competent authorities, and ii) SREP methodologies in the context of incorporation of ML/TF risks. They allowed the EBA to gather more insights into the modalities of this cooperation, which in fact starts with the licensing process, including the qualifying holding procedures or fit and proper assessment, and continues as part of the ongoing supervision. Two CAs informed the EBA about a major upgrade of their SREP methodologies with the incorporation of ML/TF-related aspects into the risk assessment.

When competences for AML/CFT and prudential supervision are assigned to different authorities, this can increase the complexities of ensuring appropriate cooperation and information exchange amongst those authorities. In this context, two CAs made considerable efforts in 2020 to enable and establish information sharing with the authority responsible for AML/CFT supervision, in particular via the establishment or strengthening of the legal basis for cooperation and information exchange.

The other CAs, which operate under the integrated supervision model, noted synergies in the context of joint supervisory actions/screenings such as the cooperation in the sample testing of credit risk, when the client's ownership structure is reviewed.

**GOOD PRACTICES**

- The EBA expects prudential supervisors to develop a sufficient understanding of ML/TF risks that enables them to identify ML/TF risks in the context of their work, so the EBA finds it a good practice that in some MS, AML/CFT experts provided training to prudential supervisors and colleagues responsible for licensing over the course of 2020.
- A joint working group consisting of ML/TF experts and prudential supervisors at one CA performed the update of the SREP methodology by identifying mutual points of interest between AML/CFT and SREP, including respective data needs and information sources.

## 1.3 Convergence in the application of P2R-P2G

***In 2020, the EBA observed that some progress had been made in the convergence of practices as CAs apply risk-by-risk considerations in their assessments and apply the floor of Pillar 1 minimum own funds requirements per risk type. Nevertheless, certain notable differences in supervisory approaches and methodologies remain, which may also contribute to divergence in results. These differences are rooted predominantly in i) the ICAAP assessment, more specifically in the extent to which ICAAP figures are used in the P2R setting; ii) the types and granularity of risks covered by the P2R; and iii) the approaches to the level of transparency with institutions regarding the methodologies used for the quantification of P2R.***

***Regarding the setting of P2G, not all CAs have set P2G for institutions in their jurisdiction and therefore in some cases P2G will be adopted starting from 2021. While there are still some diverging practices, many CAs are planning to revisit their methodologies in 2021, also to align them with the requirements of CRD V.***

As described in detail in the 2019 Convergence Report, the EBA carried out an analysis of the P2R and P2G levels imposed by CAs based on SREP outcomes in 2017 and 2019. In 2019, increased convergence was already observed, with a narrowing range of supervisory practices on setting P2R and the implementation of the common framework for setting P2G introduced by the SREP GLs.

Going forward, the EBA intends to continue observing the trends in P2R and P2G setting in a similar manner. Therefore, the EBA has launched a survey to collect data for 2020 but the data are not yet available and hence the outcomes will be presented in the next convergence report. However, due to the COVID-19 pandemic and application of the pragmatic SREP, it is expected that the results will not differ significantly from the figures reported for 2019. As part of the pragmatic 2020 SREP, many CAs decided to leave P2R and P2G levels unchanged and only adjusted them in exceptional cases. In addition, taking into account the difficult economic conditions resulting from the pandemic, many CAs allowed their institutions to temporarily operate below P2G.

In addition, the EBA engaged in bilateral discussions with selected CAs, where, among others, the methodologies for P2R and P2G setting were reviewed. It can be observed that while there was some progress in the convergence of practices, certain notable differences in supervisory approaches and methodologies remain, which may also contribute to divergence in results.

While as part of the SREP all authorities assess the ICAAPs of institutions, the extent to which the ICAAP figures are used in P2R setting differs significantly across CAs. Some CAs rely entirely on their own methodologies for the quantification of P2R for a given type of risk, ensuring the comparability of risk assessment and consistency of P2R levels across institutions within their jurisdiction. Other CAs use a combination of own and institutions' methodologies. For instance, the institutions' calculations are compared with certain benchmark tools. The ICAAP figures may be used where reliable, otherwise an additional add-on is applied. Another possible hybrid approach is to use supervisory benchmarks for the most common types of risk, while relying more on ICAAP figures in the case of less common and institution-specific risks. Finally, for some or all types of risk, the ICAAP figures may serve as the main basis for P2R, where the adjustment is applied only if the calculations are not reliable. This approach is typically accompanied by more specific instructions for institutions on how to perform the ICAAP. In this case, the ICAAP figures also serve as a floor for P2R on a risk-by-risk basis.

Some CAs complement the risk-by-risk assessment with a holistic view of the appropriate level of own funds requirements. Such a holistic view is applied either at the beginning of the quantification process, setting the ranges for the possible final outcomes, or at the end of the process, allowing for some overall expert based adjustments.

There are also some differences with regard to the types and granularity of risks covered by the P2R. However, at least some of these differences reflect the specificities of local markets and are therefore justified by the risk profiles of the institutions in a given jurisdiction.

In relation to the methodologies used for the quantification of P2R, CAs have different views and approaches regarding transparency levels with institutions. Some CAs publish their methodologies and encourage institutions to use them in their ICAAP calculations. Other CAs treat the methodologies as confidential and expect institutions to develop their own approaches for the identification and assessment of risk. However, almost all CAs note that although institutions have in general improved their ICAAPs over the last year, there is still room for further improvements and this is subject to ongoing dialogue between the authorities and institutions.

Further convergence of practices is expected in the coming years with the implementation of CRD V and review of the SREP GLs. Where practices are not yet in line with CRD V, the CAs are planning to amend their approaches starting from 2021.

It should be noted that the practices of CAs are already to a large extent compliant with the requirements of CRD V. In general, CAs apply risk-by-risk considerations in their assessments and apply the floor of Pillar 1 minimum own funds requirements per risk type. The EBA has also observed further improvements in the use of benchmark tools and methodologies. CAs enhance and develop their benchmark approaches for a wider spectrum of risks, contributing to a better understanding of the risk profiles and improving the comparability of requirements between institutions.

With regard to the composition of capital, in the context of the COVID-19 pandemic, some CAs have accelerated the application of CRD V provisions and have already incorporated them in their 2020 SREP. Further convergence will be achieved in the following years when the composition of capital as required by CRD V will be adopted by all CAs.

In the area of P2G setting, while there are still some diverging practices, many CAs are planning to revisit their methodologies in 2021, also to align them with the requirements of CRD V. Until now, not all CAs have set P2G for institutions in their jurisdiction, and therefore in some cases P2G will be adopted starting from 2021.

For the purpose of setting P2G, CAs use either the EU-wide stress tests or their own supervisory stress tests. Where own supervisory stress tests are used, the methodologies are often similar to that used in the EU-wide stress tests, but include some targeted adjustments or simplifications. This contributes to a certain degree of convergence in the results.

The aspects that often differ between the CAs are (i) the fixed threshold defined for the purpose of the P2G setting; (ii) the degree to which the CAs use expert judgement and adjustments in their quantifications; and (iii) the application of floors and caps at P2G level.

The revisions of P2G methodologies are expected to lead to a greater convergence of practices between CAs and a higher degree of consistency in P2G levels across the EU. In particular, with a view to achieving institution-specific outcomes the currently applicable floors and caps are expected to be eliminated. In addition, the EBA is planning to revisit its methodology for EU-wide stress testing with a view to achieving more realistic results and eliminating the need for some of the currently applied adjustments.

It should be noted that while the CAs are revisiting their P2R and P2G methodologies in regard to the new requirements introduced by CRD V, the EBA is also reviewing its SREP GLs. The objective of the review is not only to align the SREP GLs with CRD V, but also to enhance the guidance drawing from the current experience and best practices. This is expected to bring further convergence in supervisory practices over the coming years. More details on the review of the SREP GLs are included in Section 5.1.1.

## 1.4 Benchmarking exercises for 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 (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 requirements[23]. The EBA calculates benchmark values on selected portfolios, which allows a comparison of individual institutions' risk parameters. It helps CAs to identify internal models that show significant deviation of risk parameters and risk-weighted assets (RWAs) and potential significant underestimations compared to those of their peers. The benchmarking portfolios, templates, definitions, IT solutions and reporting instructions are communicated by the EBA through implementing technical standards (ITS) that are updated every year[24] (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.

### a. Market risk benchmarking – report on the 2020 exercise

With respect to market risk, the 2020 exercise represents the second exercise with the new set of hypothetical instruments and portfolios. The new set of instruments, which is more extensive in terms of the number of instruments to model than the previous exercises (2016-2018), is made up of almost entirely of vanilla instruments. The 2020 analysis, consistent with 2019, shows a 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 probably due to the simplification of the market risk benchmark portfolio, the clarifications provided with respect to the previous exercise (2019) and an improvement in the 'outliers' definition for risk measures. Nonetheless, some dispersion still exists due to a plurality of factors: such as misunderstandings in the definitions of some instruments and also to differences associated with differences in model choices and calibration.

The majority of the dispersion has been examined and justified by the banks and the CAs. A small part of 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.

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[23] More than 130 institutions at the highest level of consolidation.

[24] In May 2020, the EBA published an updated ITS for the 2021 data collection https://eba.europa.eu/eba-updated-its-package-2021-benchmarking-exercise-includes-ifrs9-template.

The quantitative analysis, which has been extended with respect to the previous exercises, was also supplemented 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 ongoing analysis.

### e. Credit risk benchmarking – report on the 2020 exercise

The 2020 credit risk benchmarking exercise provided for the usual data collection and analyses. While data as of 31 December 2019 are not impacted by COVID-19, the actual data collection, delivery and analysis was clearly hampered by the pandemic. In particular the interviews with banks and the survey on selected topics, which were performed in previous years, were dropped.

In addition, the credit risk data collection for this year's exercise contained, for the first time, more granular specialised lending (SLE) portfolios (aligned to the slotting approach risk categories of SLE) as well as high-default retail portfolio consumer credits and qualified revolving exposures. Another new element of the 2020 data collection was the split of the large corporate portfolio into those exposures that will still be included under the Advanced Internal Ratings Based Approach (AIRB), following the finalisation of Basel III, and those that will no longer be included in scope of the AIRB.

The results are largely comparable with the last exercises, which can be seen as an indication of the general stability of bank portfolios and internal model outcomes. However, along with the general supervisory benchmarking analysis, a focus analysis on the variability of capital requirements for SLE exposures under the Internal Ratings Based (IRB) approach was conducted in the 2020 exercise. This analysis may provide support not only for the assessment of the quality of the IRB approaches implemented for SLE exposures, but may provide information for the outstanding discussion on a potential review of the slotting approach at the Basel table.

The bottom-up analyses conducted show that the average risk weight (RW) consumption of SLE exposures is lower for AIRB models than for the Foundation Internal Ratings based approach (FIRB) or those under the supervisory slotting approach (SLSC). For example, the median RW for exposures under an AIRB approach equals 43% whilst this metric is 56% in case of FIRB and around 82% for SLSC, thus reflecting a relevant degree of variability in RWAs. It should also be noted that the comparison of the median RW, calculated using the standardised approach (SA) (around 89%/RW (SA) in Table 15) echoes the more significant impact which is expected for SLE portfolios under the IRB approach following the implementation of the finalised Basel III reform (due to the new SA output floors). It is interesting to see that the median RW under SLSC is close to the median RW under SA for the portfolios considered. However, the variability is higher under the SLSC, as is to be expected.

# 2. Convergence in supervisory colleges

***Overall, closely monitored supervisory colleges held 25% more college interactions in 2020 than in 2019, which is largely due to the intensified cooperation due to the pandemic.***

***The unprecedented nature of the pandemic and crisis led most CAs to reconsider their 'standard' risk assessment process and thus the JD timetables. Overall, the EBA concluded that approaches for the risk assessment were well aligned among college members and consolidating supervisors made additional efforts to coordinate the JD cycles.***

***College interactions and the group risk/liquidity risk assessment report, reflecting on the nature of the supervisory activities in 2020, became focused and concentrated on the risks and vulnerabilities that were the most critical and relevant in the context of COVID-19. Positive developments include the assessments of the material ICT risks in colleges, as well as the cooperation between prudential and AML/CFT supervisors. Ongoing improvements are expected in the colleges' coverage of MREL requirements and further developments in the incorporation of ML/TF risks into the SREP.***

***All closely monitored colleges that were required to reach a joint decision on capital and liquidity reached agreement in 2020. For the vast majority of banking groups, the P2R and the P2G were kept stable in 2020 and supervisory measures in 2020 were primarily qualitative in nature.***

***During 2020, the process of assessing GRPs and reaching joint decisions continued to run smoothly and overall good quality was achieved thanks to the robust interaction between home and host authorities. The quality of the content of supervisory assessments of GRPs continued to benefit both from the further experience gained in developing and evaluating recovery plans over the last few years.***

## 2.1 Monitoring of supervisory colleges in 2020

Based on the information obtained from EEA consolidating supervisors, the number of active supervisory colleges decreased compared to 2019. Overall, 56 colleges were reported as active for 2020 and were included in the 2020 list of supervisory colleges[25], compared to 62 in 2019. In addition, three active colleges were reported for third-country banking groups at the EEA sub-consolidated level, raising the total number of active supervisory colleges to 59.

[25] Annex to the EBA report on supervisory colleges in 2019: https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2020/884370/Report%20on%20Convergence%20of%20supervisory%20practices%20for%202019.pdf

The number of supervisory colleges decreased both for EEA banking groups as well as for third country banking groups. The main reason for these changes was the reorganisation of the banking groups and the extended wind-down of operations, including the sale of subsidiaries, the handing back of banking licences or the conversion of subsidiaries into branches due to the decrease in their activities.

As part of its mandate to facilitate supervisory cooperation in supervisory colleges and enhance their effective and efficient work, the EBA monitors the functioning of supervisory colleges. Out of the 59 active supervisory colleges, the EBA continued to closely monitor 12[26] in 2020.

Accordingly, the EBA's college monitoring activity in 2020 aimed at i) ensuring that supervisory colleges are functioning well and they serve as the forum for coordinating supervisory matters, in particular in the context of the COVID-19 crisis and identifying potential emerging issues among college members early on; ii) facilitating the EBA's supervisory convergence work and the implementation of the 2020 convergence plan, and iii) serving as a feedback loop for policy development.

Since the strategic refocusing of the college monitoring activity in 2018, the EBA's participation in colleges developed towards a more thematic approach in alignment with the focus of the annual convergence plan, which was further enhanced in 2020 with the follow-up of certain topical items relevant for that year.

The EBA college-monitoring activity for 2020 covered organisational aspects and college interactions, with a focus on colleges' legal deliverables, namely the group risk/liquidity risk assessments, the joint decision on capital and liquidity and joint decision on the assessment of GRPs. All of these elements have been viewed in the context of the key topics as put forward by the 2020 Convergence Plan and with a particular view on the COVID-19 implications. In 2020, EBA staff actively participated in interactions (meetings and conference calls) organised by colleges selected for close monitoring.

For non-closely monitored colleges, the interactions centred around communications regarding the 2020 Convergence Plan and its attention points for key topics as well as on exchanges in the context of COVID-19.

[26] The 12 supervisory colleges were selected for close monitoring in 2018 for a 3-year period.

## 2.2 Quality of college interactions

*Closely monitored colleges*

***Overall, supervisory colleges intensified their interactions in 2020 to ensure close cooperation during the pandemic. The EBA concludes that the colleges extensively discussed the implications of COVID-19 pandemic and crisis for the respective banking groups and focused on the key topics. Ways for improvement mainly reside in earlier sharing of the documents, at least one week ahead of the meeting, and in reserving sufficient time for questions and discussions in college meetings. Some of the topical tasks colleges were expected to address in 2020 remain to be acted upon in 2021.***

The EBA closely followed the interactions of the closely monitored colleges in 2020 in regard COVID-19. Seven out of the 12 colleges had at least one dedicated call to discuss observations on how the banking group and its entities had been impacted and to inform each other on government measures or supervisory initiatives that affected the group and its entities in host jurisdictions. These discussions covered the types and levels of relief measures applied and further information on payment moratoria and the estimated relief brought to clients. The application of the EBA Statement on dividend distribution, share buybacks and variable remuneration[27] and the allocation of capital within banking groups was also a key point of discussion.

The EBA has seen some exemplary college cooperation, with regular, weekly or biweekly calls at the height of the pandemic, where college members discussed updates on postponed and planned supervisory activities and these interactions also allowed for the coordination of supervisory activities or potential ad hoc information requests, which were collected by the consolidating supervisor and shared within the college so host authorities were equally informed and did not need to request such reports separately, also limiting unnecessary additional strain on the bank's resources.

A few colleges used the opportunity to interact with the firm and host CAs were either invited to participate in such calls to receive updates directly from the group on crisis preparedness and local contingency planning or received updates from the consolidating supervisors on the outcome of such calls.

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27 https://www.eba.europa.eu/sites/default/documents/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20provides%20additional%20clarity%20on%20measures%20to%20mitigate%20the%20impact%20of%20COVID-19%20on%20the%20EU%20banking%20sector/Statement%20on%20dividends%20distribution%2C%20share%20buybacks%20and%20variable%20remuneration.pdf

The EBA staff observation was that the quality of the interactions dedicated to COVID-19 varied, with more discussions being clearly interactive, while others were less engaging. In four colleges the information exchange on COVID-19 mainly took the form of written communication. In these colleges, the consolidating supervisor provided updates for college members on the ongoing supervisory activities that were based on prior engagement between the consolidating supervisor and the host authorities. There was only one closely monitored college where COVID-19 related information sharing and cooperation could have been enhanced.

The 12 closely monitored college held 25% more college interactions in 2020 than in 2019, which is largely due to the sharp rise in interactions at the beginning of the pandemic and over the course of the summer.

Due to COVID-19, most college meetings were held remotely in 2020. This situation had the advantage of colleges being more focused on some specific topics, but it also entailed drawbacks, including a lack of time for questions in some colleges, as the timing of certain meetings had to be significantly condensed[28].

In almost all closely monitored colleges, 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 colleges. However, in some instances, challenging another's position or posing questions during meetings remained one-sided and/or mostly driven by the consolidating supervisor or potentially by the EBA staff.

The EBA staff observed some deterioration in the timely sharing of college meeting documents before meetings in 2020. The EBA is cognisant of the fact that the COVID-19 pandemic and crisis warranted not only considerable reprioritisation of supervisory activities but also certain adjustments to the 2020 SREP cycles and processes, therefore, it would be premature to conclude that this signals a negative trend. Nevertheless, based on the EBA's experience that if documents and reports are shared well in advance of the college meeting, participants in general contribute more to the discussions, then the EBA must continue to stress the importance of the timely sharing of documents.

Regarding the risk assessment discussions, a consolidated view only was presented in more college meetings in 2020, which in some college meetings was supplemented by a per-entity presentation of the risks. There are also increasing examples of conducting risk discussions on a risk-by-risk basis instead of a country-by-country basis, which required a continued and more active involvement of the subsidiaries' relevant competent authorities.

[28] Meetings which used to be one-day meetings had to be compressed into a couple of hours and two day meetings had to be condensed into a one-day call.

In half of the cases there was a time slot devoted to the bank's attendance and presentation. In all these cases, this was very much appreciated. Meetings or calls also sometimes provided the occasion for members to agree on joint activities, e.g. inspections, 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 ones.

### *Topical tasks for colleges in 2020*

Apart from the close cooperation in the context of COVID-19, colleges were expected to exchange views on dividend arbitrage trading schemes (Cumex) in line with the EBA's Action plan on dividend arbitrage trading schemes[29] and in connection with the assessment of the internal governance framework. Nevertheless, no discussions on this matter were initiated in any of the 12 closely monitored colleges. It should be added that the topic was included on the agenda in more colleges, when some of the banking groups were actually facing Cumex-related legal proceedings years ago.

Another aspect that colleges were expected to pay attention to is the UK's departure from the EU, and, in this context, to start discussing the terms of the UK's participation in the college and reviewing the written coordination and cooperation agreements (WCCA) in this regard. Half of the closely monitored colleges are affected by the changes that the UK`s withdrawal from the EU implies for their composition. No significant developments were observed by the EBA in this respect in 2020 as no discussions on the terms of the UK's participation have been initiated in these colleges.

Both of the items remain topical tasks for colleges to address in 2021.

### *Colleges not selected for close monitoring*

Colleges not selected for close monitoring also held various interactions over the course of 2020, or had increased written exchanges compared to previous years.

While many of these colleges also organised various interactions due to the escalating COVID-19 situation, not all colleges shared information in a multilateral setting, in particular on the implications of the pandemic and crisis on the banking group and its subsidiaries/branches. Therefore, the EBA reminded all the consolidating supervisors of these colleges to actively use the college as a forum of information sharing and for coordinating supervisory actions in this regard.

The EBA addressed all colleges not selected for close monitoring again in May and shared some good practices observed in the wake of the escalation of the COVID-19 situation.

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

## 2.3 Quality of college deliverables

The consolidating supervisor and the competent authorities responsible for the supervision of subsidiaries have an ultimate goal for supervisory colleges under CRD Article 113, which is to ensure that they reach a joint decision on the capital and liquidity position of the banking group, including the required level of capital and liquidity the banking group and its entities have to meet, as well as on any additional guidance they need to hold, on top of the own funds requirement.

The precondition of reaching a joint decision is that college members, with the lead of the consolidating supervisor, must develop a group risk/liquidity risk assessment report to which they contribute with their respective assessments that will enable them to understand the overall risk profile of the banking group.

Supervisory colleges are also mandated by BRRD Article 8 to review and assess the GRP and decide whether an individual recovery plan shall be drawn up for institutions that are part of the group and the application of the measures referred to in Article 6(5) and (6) of the BRRD.

This chapter of the report summarises the EBA's observations from its college monitoring activity for these three core college deliverables for 2020.

### 2.3.1 Group risk/liquidity risk assessments

***The process for developing the group risk/liquidity risk assessments report was affected by the COVID-19 pandemic, in particular the unprecedented nature of the crisis led most competent authorities to reconsider their 'standard' risk assessment process and thus the JD timetables.***

The EBA followed the joint decision cycle with a particular view to the key topics set by the 2020 Convergence Plan and followed up on how the pragmatic approach have been implemented in the 12 closely monitored colleges.

The EBA disseminated its 2020 Convergence Plan to all supervisory colleges in October 2019 to inform them about the common key areas for attention early on and to support CA activities with its implementation in the respective supervisory examination programmes (SEPs). The key topics were reviewed and subsequently reinstated by the EBA BoS in April 2020 in the context of COVID-19. The key topics were also presented by EBA staff during the first college interactions in 2020.

While most colleges followed the pragmatic SREP, very few competent authorities continued to apply the SREP GLs, and thus contributed to the group risk assessment process accordingly.

***Overall, the EBA concluded that approaches for the risk assessment were well aligned among college members in closely monitored colleges and additional efforts have been made by the***

***consolidating supervisors to coordinate the JD cycles, including early engagement and transparency in regard to the envisaged methodology and process.***

According to the EBA's observations in 2020, this resulted in either:

- the optimisation of the intermediate steps of the JD cycle, in particular certain adjustments in the timing of the sharing of i) the host assessments with the consolidating supervisor, and, consequently; ii) the submissions of the group risk/liquidity risk assessment report to the college, or potentially

- in a staged risk assessment process where the assessment and discussions first covered the risks less impacted by the pandemic and later in the year they were completed with the supervisory view on risks and vulnerabilities more greatly affected by the crisis and the institution's ability to react to the crisis.

Nevertheless, none of these adjustments have compromised the deadlines of the annual JD cycle, meaning that all competent authorities participating in supervisory colleges have clearly devoted considerable efforts to ensuring the successful implementation of the pragmatic SREP approach.

The ICAAP/ILAAP continued to be a key information source for CAs in performing the 2020 SREP. In more cases, the assessment was streamlined and focused on banks' ability to understand their vulnerabilities in the context of the crisis and (re)assess their capital plans. Some CAs postponed the due date of submissions, others did not but, overall, all CAs received the ICAAPs in due time for their SREP process.

The pragmatic 2020 approach allowed for a focused SREP and this more focused risk-based approach has been reflected in the vast majority of the group risk assessment reports.

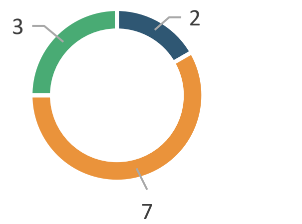
The risks and vulnerabilities that gained the most supervisory attention in 2020 are 1) credit risk; 2) ICT risks; 3) profitability and business model sustainability; and 4) institutions' capabilities to handle the crisis. The EBA put forward these key risks and vulnerabilities in its pragmatic 2020 SREP GLs together with a 5$^{th}$ risk, liquidity and funding risk, which together with market risk, attracted heightened supervisory attention in the first months of the pandemic, and then on a more institution-specific basis.

As a general principle, risk scores and viability scores were kept unchanged, unless justified by exceptional circumstances affecting an institution or by a significant change in the risk profile or controls.

## ICT risk and operational resilience

As this topic was also among the key priorities in 2019, the 2019 Convergence Report stated that CAs in supervisory colleges were increasingly implementing practices put forward by the EBA GLs on ICT risk assessment under SREP. Nevertheless, it also concluded that a quarter of colleges have not discussed this important topic or have not included it in their risk assessment.

Figure 5: Identification of material ICT risks in supervisory colleges




Based on its monitoring activity in 2020, the EBA concluded that in 2020 further improvements were achieved with regard to the identification of material ICT risk, as all CAs addressed this topic either via discussions in supervisory colleges, or via a narrative assessment included in the group risk assessment report, or potentially via both. Nevertheless, it is also clear that college interactions and risk assessment reports became more focused and did not necessarily explore all the material ICT risk types, but concentrated on the risks and vulnerabilities that were the most critical and relevant in the context of the COVID-19 pandemic. In contrast to the previous year, CAs did not engage in onsite activities due to the constraints caused by the pandemic.

All supervisory colleges addressed the question of ICT strategy and how that strategy has been impacted by COVID-19. Furthermore, supervisors were eager to understand whether budgets for the implementation of the ICT strategy have been affected by the crisis and to what extent.

As part of the ICT risk and operational resilience key topic of the EBA 2020 Convergence Plan, the assessment of ICT outsourcing and contingency planning were also selected for close monitoring in 2020, which, in the context of the contingencies brought about by the pandemic, came to the forefront of CA activities. The EBA observed more targeted supervisory actions in this regard, with CAs in two supervisory colleges conducting onsite inspections or specific offsite activities. Large, complex and to some extent ageing IT systems also pose a risk for a number of institutions. Thus, ICT change risk was also addressed in more depth.

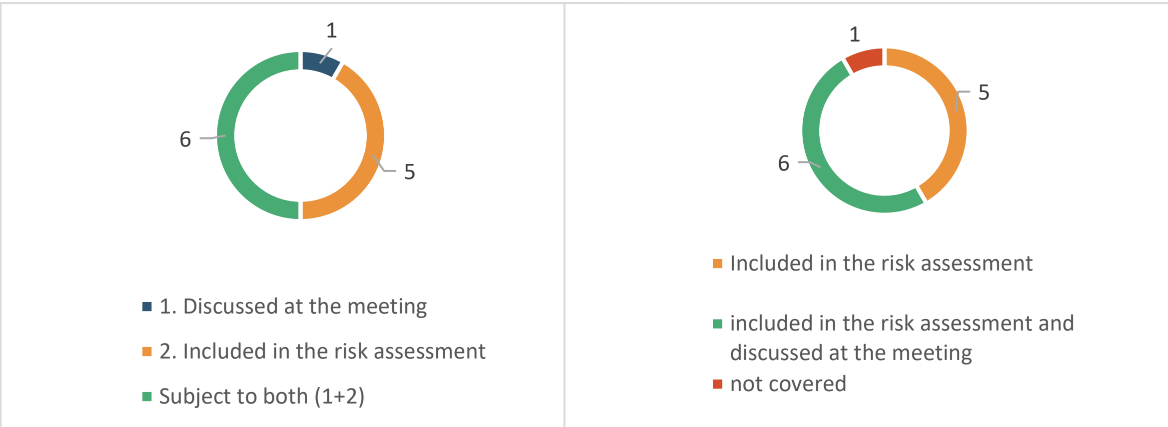
## Profitability and BM with a link to credit risk

This topic has been receiving ongoing supervisory scrutiny in recent years due to the low interest rates environment, and in 2020 it was further analysed not only because of the short term implications of the pandemic on profitability but also in the context of the potential fragility of business models and weaknesses of and shift in longer term strategies.

The EBA's college monitoring activity further supported the conclusion that supervisory authorities closely monitored the evolution of profitability in 2020 relying on a set of KRIs, which were supplemented by various sensitivity analyses and scenario calculations to forecast institutions' vulnerabilities. Profitability was thoroughly analysed in the risk assessment reports, including the outcome of supervisory forecasts, by all colleges except one and half of the colleges also discussed the analysis during college meetings/calls.

Figure 6 (Left): Vulnerability of banks to potential economic deterioration

Figure 7 (Right): Monitoring profitability with a set of KRIs

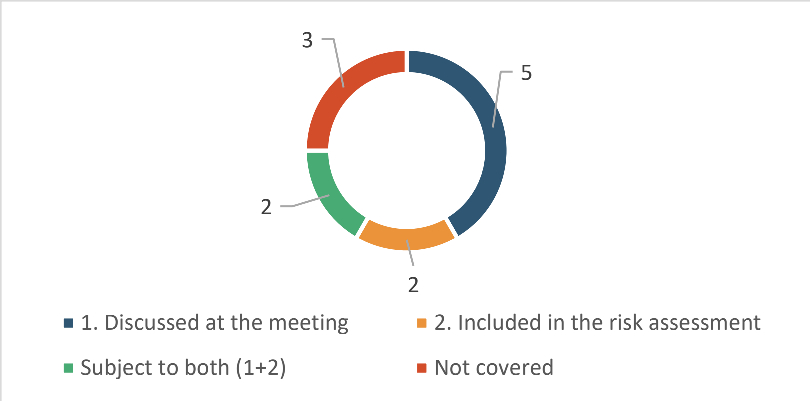



Supervisory activities addressing profitability and the business model were closely linked to credit risk and in particular to the cost of risk, because the evolution of the cost of risk could directly impact earnings, therefore, supervisors in colleges discussed estimations for future developments in the cost of risk, as well as the potential underestimation of loan loss provisioning. Some colleges observed issues with the implementation of applicable IFRS 9 accounting rules implying issues with the timely identification of significantly increased credit risk and credit impairment on exposure level.

## Capital and liability management

Most colleges touched on the MREL requirements set for the banking group. These discussions mainly covered MREL eligible instruments, potential shortfalls and institutions' plans to ensure the ongoing build-up of MREL eligible liabilities, e.g. planned issuances. Nevertheless, a quarter of the closely monitored colleges have not addressed this topic.

Figure 8: Coverage of MREL in supervisory colleges

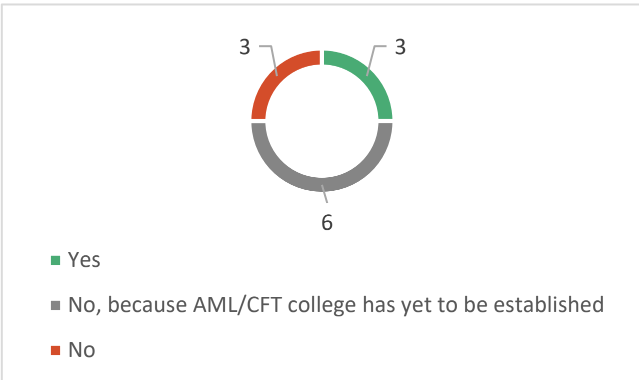



## ML/TF risk for prudential supervisors

According to the topical tasks for supervisory colleges for 2020, prudential supervisors and supervisory colleges were advised by the EBA to cooperate and exchange information with the AML/CFT college, when and where it has been established in order to develop a better understanding of the ML/TF risk to which the institution is exposed and the effectiveness of the AML/CFT systems and controls implemented by the institution, which may have an impact on the supervised entity's overall risk profile and internal controls framework.

In this regard, the EBA observed that cooperation between prudential and AML/CFT supervisors improved over the course of 2020 as a result of the initial establishment of AML/CFT colleges and the practical application of the agreement signed between the majority of EU AML/CFT supervisors and the ECB in January 2019.

Figure 9: Cooperation between prudential and AML colleges




A quarter of the closely monitored supervisory colleges had interaction[30] with the AML/CFT colleges either at least once in 2020 or on a more frequent basis. Nevertheless, for half of the closely monitored colleges the corresponding AML/CFT colleges have yet to be established, so it was impossible to determine the extent of cooperation and exchange of information between the

[30] when prudential supervisory colleges received input from AML/CFT colleges in a multilateral setting

various supervisors responsible for the supervision of these institutions. A quarter of the closely monitored colleges of prudential supervisors did not directly exchange information between the two types of colleges, however, the prudential supervisors attended the newly established AML/CFT colleges in the case of two institutions and, in the case of one, the prudential supervisor will be invited to attend the AML/CFT college going forward. Nevertheless, the EBA expects that cooperation and the exchange of information will intensify in 2021, as more AML/CFT colleges are being established and with the EBA's publication of Cooperation guidelines under Article 117 of the CRD for consultation in the first part of 2021.

The 2019 Convergence Report stressed that not all colleges dedicated enough attention to the banking group's compliance with the relevant AML/CFT regulation and exposure to ML/TF risks and called all CAs' attention to the exchange information with AML/CFT supervisors and factoring ML/TF risks, if material, into SREP assessments.

While the overall awareness of ML/TF risks among prudential supervisors is increasing, the number of colleges that addressed ML/TF risks in their overall group risk assessment report itself was still relatively low in 2020 (5). However, it was evident that four colleges discussed the issues at their meetings (without including them in the risk assessment report). One college conducted specific offsite monitoring of the topic, while two colleges did not cover ML/TF risk at all.

It should be noted that, in 2020, prudential supervisors had a number of unplanned activities of various dimensions that had to be prioritised, nevertheless, the EBA expects the integration of the ML/TF risk into the SREP will continue to be enhanced, particularly as a result of the publication of the EBA Opinion on how ML/TF risks should be taken into account in the SREP, as well as the more detailed guidance arising from the current revision of the guidelines, which will be published for consultation in the second part of 2021.

### 2.3.2 Joint decisions on capital and liquidity

***The EBA observed that all closely monitored colleges that were required to reach joint decisions on capital and liquidity[31] reached agreement in 2020. The mandatory content of the capital and liquidity JDs, as regulated by Commission Implementing Regulation (EU) No 710/2014, was respected by colleges, notwithstanding the possible simplifications introduced for 2020 by the pragmatic SREP GLs.***

In addition to the EBA's observations explained in section 2.3.1, another distinct feature of the 2020 SREP cycle was that colleges paid close attention to initiating the discussion on the JD immediately after the discussions concerning the group risk assessment, or organised the two processes in

[31] 11 closely monitored colleges

parallel to ensure that the yearly cycle, as required by the CRD, is respected. This was a pragmatic solution as the 2020 cycle was somewhat shorter due to the outbreak of the pandemic and the respective uncertainties in its aftermath.

Colleges made considerable efforts to ensure that the four-month legal deadline available for reaching the capital joint decision from the submission of the final risk assessment report by the consolidating supervisor to the relevant competent authorities, as per Article 113(2)(a) of the CRD, were respected.

However, this was not the case for liquidity joint decisions, where only three colleges managed to reach a joint decision within the one-month period as per Article 113(2)(b) of the CRD. It should be added that CRDV has already extended the available time from one month to four months for liquidity joint decisions, so the same timeframe will apply to the capital and liquidity joint decisions.

For the vast majority of banking groups, the P2R and the P2G were kept stable in 2020, there were very few new requirements set a group level, and only limited number also at subsidiary level. New requirements addressed typical Pillar 2 risks like IRRBB or credit concentration risk, but requirements were also set for credit risk (IRB internal model), ICT risk and due to pension risk or increased conduct risk.

In line with the EBA GLs on the pragmatic 2020 SREP, emphasis shifted towards qualitative measures in 2020. 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 item[32].

In line with the key themes for 2020, most qualitative measures centred around 1) ICT risk and operational continuity; 2) profitability and business models closely linked to capital planning; 3) credit risk management; 4) internal governance arrangements closely linked to crisis management activities.

Regarding ICT risk, improvements were expected in the management of third-party providers, including reviews of third parties to check their compliance, controls and performance, taking into account the EBA Guidelines on outsourcing arrangements or the reassessment of exit strategies. In cases where institutions did not initiate the review of their BCPs, they were asked to do so by supervisors and to incorporate the lessons learned from the crisis. Another aspect of ICT-related measures aimed to ensure that key IT projects and implementation plans were not affected by the crisis, including the execution of remediation plans from onsite inspection. There was also a general supervisory expectation that the control framework must be adapted to the new working

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

arrangements, including, where necessary, the allocation of sufficient resources and IT investments.

In the context of profitability and the business model, most attention was dedicated to short and long term planning, so common measures requested i) the review and update of the annual budgets and forecasts, as well as strategic and capital plans taking into account the most up-to-date scenarios, so that mitigation actions are adequately aligned, as well as, ii) a more proactive approach from institutions in the identification of deviations from the budget or capital plan. Some supervisors also called institutions' attention to the fact that cost reductions should not compromise robust risk management.

Concerning credit risk, the recommendations/requested actions addressed the credit risk management and control framework, in light of COVID-19 situation, whereby institutions were asked to tighten their group-wide oversight and steering of the credit risk assessment and monitoring processes, including relief measures. Not only on a more general level (as described in the internal governance related measures) but also specifically in the context of credit risk arrangement, institutions were asked to pay attention to the consistent implementation of policies across subsidiaries. Furthermore, the levels of provisioning were scrutinised by supervisors and more banking groups were requested to apply more realistic scenarios to calculate the forward looking component of their provisioning. This is also linked to credit risk modelling, the other area that, in general, attracted considerable attention and where improvements concerned the internal controls at all levels of model development and planning.

The effectiveness of internal governance and institution-wide controls were at the forefront of supervisory attention in 2020, in particular in the context of the crisis. Two aspects were particularly relevant for more groups, namely the clear responsibilities of the main decision-making bodies in a special situation, and the integration of the crisis management framework in the overall internal governance framework, including steering at subsidiary level in crisis situations. Secondly, the more general requirement that all relevant group policies and regulations must cascade down to all subsidiaries and (foreign) branches taking due account of local laws and regulations to ensure sufficient group oversight. The strengthening of the local governance structure and risk and control functions were requested, with sufficient staffing and competencies.

Supervisors have been aware of issues with data aggregation capabilities for quite some time, but these were clearly highlighted in 2020, so institutions were asked to improve their preparedness and IT infrastructures. For some institutions ML/TF risk was also on the prudential supervisory radar and entailed actions, in particular, that sufficient focus is dedicated to the topic by the management bodies and that sufficient resources and attention are assigned accordingly.

In the context of the liquidity, issues with contingency funding plans ( countermeasures that are not up-to-date or timing allocated for execution), liquidity stress testing (limited scenarios), and with capabilities (processes, and IT systems) for timely and adequate liquidity reporting were the main topics addressed by supervisors in 2020.

### 2.3.3 Joint decisions on group recovery plans

According to Article 8 of the BRRD, CAs shall reach a joint decision 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.

In 2020, the process of assessing GRPs and reaching joint decisions within supervisory colleges continued smoothly and, overall, good quality was achieved thanks to the robust interaction between home and host authorities. All closely monitored colleges reached the joint decision within six months from the submission of the plan by the institution, thus meeting the regulatory deadline specified in Article 6(2) of the BRRD. Most monitored colleges concluded the joint decision on the assessment of GRP during the first quarter of 2020 with regard to plans submitted by banks in the last quarter of 2019. Therefore, the majority of the 2020 joint decisions on the assessment of GRPs had not been impacted by the COVID-19 outbreak.

In 2020, material deficiencies were identified in the joint decision on GRP assessment of only one banking group that was closely monitored by the EBA. However, later in the year this banking group met the request sent out by its CAs, resubmitting its GRP within three months and successfully addressing all material deficiencies. None of the remaining closely monitored colleges identified any material deficiencies in joint decisions reached in 2020. Therefore, there was no need to consider the application of supervisory measures addressing material deficiencies in line with Article 6(6) of the BRRD.

In most colleges closely monitored by the EBA, the consolidating supervisor and host competent authorities held comprehensive discussions about their supervisory assessments of GRP in physical meetings or calls. However, some colleges did not follow this good practice and limited their discussion to draft joint decisions and feedback letters to the institutions, which negatively affected the overall quality of the discussions.
The quality of the content of supervisory assessments of GRPs continued to benefit both from increasing experience gained in developing and evaluating recovery plans over the last few years. The assessments often noted progress in the description of recovery options including institutions' assessments of their feasibility and credibility. Moreover, competent authorities indicated further improvements in the identification of critical functions (CFs) also due to the progress made in developing methodologies to identify CFs introduced by the resolution authorities. Further progress on the identification of CFs and more effective interlinkage between the recovery and

resolution plans in this area is expected in the next iterations of the recovery plans, also benefiting from the guidance provided in the EBA report on interlinkage between recovery and resolution planning published in May 2020.

Similar to previous years, the 2020 assessment of recovery plans often highlighted weaknesses in recovery plan scenarios, especially in terms of their description and severity. To some extent, identified deficiencies were linked to the increased supervisory expectations in that area relating to their importance in calculating institutions' overall recovery capacity. Moreover, CAs very often observed deficiencies in the recovery indicators framework, particularly in terms of insufficiently prudent calibration of recovery thresholds and unclear escalation procedures to be followed upon their breach. Based on this experience and taking into account the crucial role of recovery plan indicators in spotting incoming crises, the EBA is currently working on developing further guidance on the calibration of recovery indicators and their breaches.

During 2020, in the context of the COVID-19 pandemic, the EBA issued a statement underlining the importance for credit institutions of maintaining a strong focus on effective crisis management and preparedness. In particular, while providing operational relief in some parts of the plans submitted in 2020, the EBA asked institutions to update the recovery plan to take into account the specific COVID-19 stress situation, in particular, to maintain a strong focus on the monitoring of recovery indicators and understanding which recovery options are necessary and available under the current stressed conditions. The EBA expects the assessment of recovery plans in the 2021 cycle to focus on those aspects.

# 3. EBA tools for supporting supervisory colleges

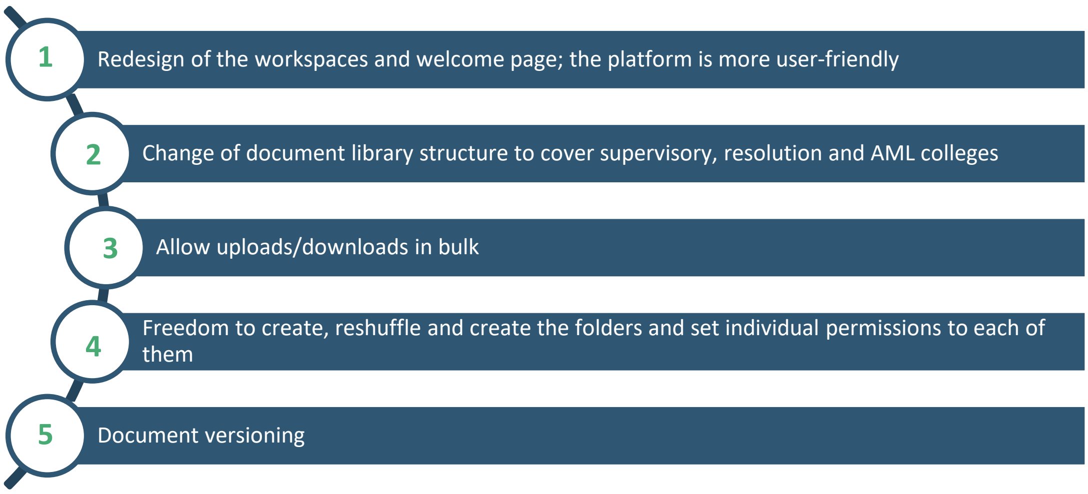
## 3.1 Update of the EBA college platform

In line with the EBA's role in the efficient functioning of colleges, the EBA maintains an EBA college platform that is used to facilitate a secure and user-friendly channel for the continuous exchange of information and collaboration between the authorities within the framework of supervisory, resolution and AML/CFT colleges.

In May 2020, the EBA launched the updated EBA college platform based on the experience of its internal and external users.

The updated platform is now more user-friendly, providing new functionalities and more rights for users. The platform has strong IT security standards (authentication, issuance and suspension of access rights) and appropriately sets rights for reading, modifying and deleting.

Figure 10: Update of the EBA college platform




The EBA continues to work on enhancing the platform, pulling together resources and efforts to make the European supervisory, resolution and AML/CFT platform accessible to all relevant colleges and meeting various objectives and responsibilities of authorities.

While the use of the EBA college platform is not mandatory for authorities, the EBA invites the colleges that are still relying on secured email for exchanging confidential information to use the EBA college platform.

## 3.2 Revised guidelines on equivalence of non-EU authorities for participation in supervisory colleges

The EBA updated its Guidelines on the equivalence of confidentiality and professional secrecy regimes in 2020. The EBA Guidelines are designed to help EU authorities in their assessment of third country equivalence and to facilitate cooperation with third country supervisory authorities and their participation in supervisory colleges overseeing international banks.

# 4. EBA policy work supporting supervisory convergence and ongoing supervision

***The EBA published its Guidelines on loan origination and monitoring in 2020, as well as its Opinion to clarify the prudential treatment of 'legacy instruments' in view of the end of the grandfathering period on 31 December 2021. The EBA also adopted a 10-point action plan on dividend arbitrage trading schemes. These policy products addressing supervisory convergence and ongoing supervision were all reflected in the EBA's 2020 Convergence Plan.***

***An important policy item that directly influenced the SREP process was the EBA pragmatic 2020 SREP Guidelines that set a special procedure for 2020 in order to safeguard and preserve convergent supervisory approaches and outcomes in the context of the crisis.***

***The EBA is also committed to facilitating consistency in supervisory practices in regard to how to factor ML/TF risks into the SREP from a prudential perspective, and therefore the EBA published an Opinion in this regard in 2020 also in line with its Pillar 2 roadmap.***

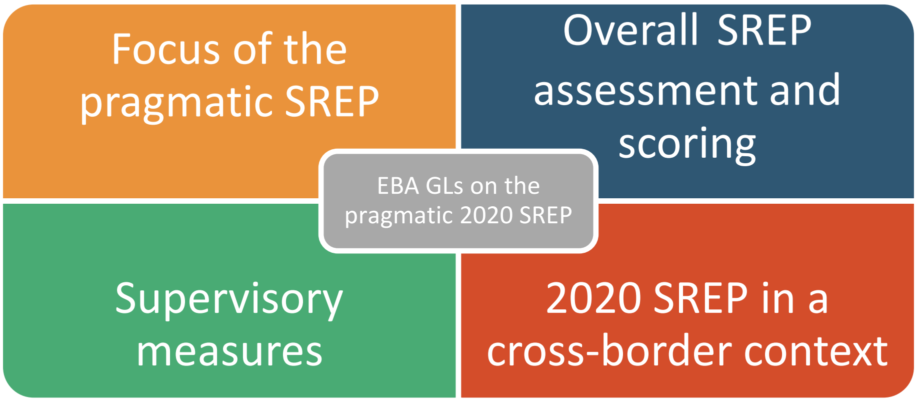
## 4.1 Supervisory review and evaluation process

### 4.1.1 Guidelines on the pragmatic 2020 SREP in light of COVID-19 crisis

The COVID-19 pandemic has significantly affected the banking sector and from an operational perspective, competent authorities themselves. After issuing a statement on 22 April 2020 on how the principles of effectiveness, flexibility and pragmatism will guide supervisory approaches in relation to the 2020 SREP, the EBA outlined the modality of the implementation of SREP GLs for the particular circumstances of 2020. The EBA GLs on the pragmatic 2020 SREP in light of the COVID-19 (EBA/GL/2020/10) put forward the key features of this pragmatic SREP in order to safeguard and preserve, in the context of this crisis, convergent supervisory approaches and outcomes enabled by the SREP GLs.

These guidelines, complementing the SREP GLs, were addressed to competent authorities and established a special procedure for the SREP for the year 2020.

Figure 11: Key areas of the EBA GLs on the pragmatic 2020 SREP




The risk-driven approach put forward by these guidelines builds on the existing requirements of the CRD and the SREP GLs and adapts them to the exceptional circumstances of the COVID-19 pandemic, as well as ensuring the exercise of supervisory judgement to the greatest possible extent.

Figure 12: Focus of the pragmatic 2020 SREP


The GLs also stressed that drawing supervisory conclusions on the viability of an institution and its ability to meet the capital and liquidity requirements was paramount in a crisis. Therefore, these guidelines introduce a consistent approach for the overall SREP assessment of the viability of an institution that in 2020 reflects the conclusions of the supervisory review conducted according to these guidelines with the exercise of supervisory judgement.

In terms of the supervisory measures applied in the 2020 cycle, the guidelines expressed a preference for qualitative measures in the first instance and acknowledged that P2R/P2G may remain stable, if appropriate, and should be met by the institution at all times. The guidelines acknowledge the usability of the P2G in the current circumstances and provide for an enhanced supervisory follow-up to ensure eventual restoration.

These guidelines provide a consistent approach in the supervision of cross-border banking groups, with a set of key risks and vulnerabilities that support competent authorities in reaching a shared view on the most material risks in the context of this crisis, taking into account institutions' specific considerations.

### 4.1.2 ML/TF risk in the context of the SREP

In 2020, the EBA published an Opinion to set out in high level terms how it expects competent authorities to take into account ML/TF risks in SREP. In addition to the Opinion, the EBA will include more detailed guidance on how it expects competent authorities to take into account ML/TF risks in SREP in the current revision of the guidelines aimed to be completed by end December 2021.

As set out in the Pillar 2 roadmap, the revision of the SREP Guidelines is mainly focused on alignment to the revised level 1 framework and will focus on a number of areas including ML/TF risks in SREP. Further to Article 97(6) of Directive 2013/36/EU, as amended by Directive (EU) 2019/878 (CRDV) and the AML Action Plan, the EBA needs to enhance supervisory convergence by providing common guidance on how to factor ML/TF risks into SREP from a prudential perspective. This common guidance is important in view of the clear links between AML and prudential supervision, and in view of the fact that failure to address ML/TF risks can have detrimental effects on the financial soundness of individual institutions, the integrity of the internal market and financial stability as a whole.

The EBA is using an integrated approach to embed the guidance on how to take into account ML/TF risks in the relevant risks and areas of existing SREP components. The aim is to make competent authorities aware of the SREP areas in which potential ML/TF risks could be identified when conducting their SREP assessment. Such indications of potential ML/TF risks include deposit taking in high-risk jurisdictions, or a funding mix that cannot be explained by the business model or strategy of the institution. During their assessment, competent authorities can also identify deficiencies that may give rise to ML/TF risks such as weaknesses in the institution's IT system or an internal governance and control framework that can be exploited by criminals for ML/TF purposes. When competent authorities identify such risks or deficiencies, they should liaise with the AML/CFT supervisor of the institution. The mutual exchange of information and supervisory assessments should enhance the overall supervisory view on the institution, its viability and risks.

For cross-border groups, the aim is for prudential supervisors to pay attention to the cross-border prudential implications of issues related to AML/CFT, and the potential ML/TF risks linked to cross-border banking group structures and activities, and to cooperate with AML/CFT supervisors in this respect.

Cooperation between competent authorities and AML/CFT supervisors is required under CRDV Article 117(5). The modalities for this cooperation for different areas of supervision, including risk assessments and SREP, will be set out in the AML Cooperation Guidelines the EBA is developing under Article 117(6) of the CRDV. The AML Cooperation Guidelines are expected to be finalised in H2 2021.

## 4.2 Ongoing supervision

### 4.2.1 Guidelines on loan origination and monitoring

The EBA published its Guidelines on loan origination and monitoring in 2020, which expect institutions to develop robust and prudent standards to ensure newly originated loans are assessed properly.

The Guidelines specify internal governance arrangements for the granting and monitoring of credit facilities throughout their lifecycle and clarify the credit decision-making process including the use of automated models, building on the requirements of the EBA Guidelines on internal governance.

Banks and other creditors should adjust their practices on the basis of the gap analysis to make sure that they are in line with the requirements for the creditworthiness assessment of borrowers, including the collection of information for this assessment, the valuation of collateral, loan monition and the associated governance arrangements covering loan origination, decision-making and monitoring through the lifecycle of a loan.

The EBA has developed these Guidelines building on the existing national experiences, addressing shortcomings in institutions’ credit granting policies and practices highlighted by past experiences. At the same time, these Guidelines reflect recent supervisory priorities and policy developments related to credit granting, including environmental, social and governance factors, anti-money laundering and countering terrorist financing, and technology-based innovation.

The Guidelines also aim to ensure that the institutions’ practices are aligned with consumer protection rules and respect fair treatment of consumers.

### 4.2.2 EBA Opinion on the prudential treatment of legacy instruments

In October 2020, the EBA issued an Opinion to clarify the prudential treatment of legacy instruments in view of the end of the grandfathering period on 31 December 2021. In its Opinion, the EBA proposes policy options to address the infection risk when created by such instruments. The EBA’s recommendations aim at ensuring a high quality of capital for EU institutions and a consistent application of rules and practices across the Union.

When reviewing EU institutions’ legacy instruments and examining the clauses that led to their grandfathering, the EBA identified two main issues, which could create infection risk, i.e. the risk that other layers of own funds or eligible liabilities instruments are disqualified. The first issue relates to the flexibility of distribution payments principle, while the second involves clauses that might contradict the eligibility criterion of subordination. Legacy instruments will need to be subject to different tests to be cascaded down into a lower category of capital or as eligible liabilities instruments without creating an infection risk.

To address the infection risk and preserve the quality of regulatory capital, the EBA, in its Opinion, envisaged two main options. Institutions can either call, redeem, repurchase or buy-back the relevant instrument or, alternatively, amend its terms and conditions. In a limited number of cases, where institutions are able to demonstrate to their competent authorities that neither of these two options can be pursued, and taking into account all the relevant circumstances, the EBA also considers a third, last resort, option. This option would allow institutions to keep the legacy instrument in their balance sheet while it would be excluded from regulatory own funds and TLAC/MREL eligible instruments.

Shortly after the publication of the Opinion, competent authorities initiated discussions with institutions to identify the legacy instruments that might pose an infection risk and the planned actions to address this risk. In 2021, the EBA will monitor the situation of legacy instruments, placing particular focus on the use of the proposed options across jurisdictions with a view to ensuring a consistent application. In addition, the EBA will consider the transposition of specific provisions of Directive 2014/59/EU into national legislation and how this may alleviate concerns about the existence of infection risk linked to subordination aspects.

### 4.2.3 EBA Action Plan on dividend arbitrage trading schemes

Following an inquiry into dividend arbitrage trading schemes, such as cum-ex or cum-cum, requested by the European Parliament on 28 November 2018, the EBA adopted a 10-point action plan on dividend arbitrage trading schemes.

During its inquiry, the EBA carried out a survey submitted to competent AML/CFT authorities to gain an understanding of whether dividend arbitrage trading schemes such as cum-ex and cum-cum schemes were treated as tax crimes and, consequently, whether the handling of proceeds from such schemes would amount to money laundering in line with Directive (EU) 2015/849. In addition, the EBA followed up with prudential supervisors to gain an understanding of how financial institutions' involvement in such schemes complied with the prudential framework and in particular with the provisions on institutions' governance arrangements under Directive 2013/36/EU.

On 12 May 2020, a report was published that summarises the EBA's findings in relation to the above surveys and sets out what competent AML/CFT and prudential authorities should do to mitigate the risks associated with dividend arbitrage trading schemes, considering that tax authorities are generally better positioned to detect and combat tax crime.

The EBA's inquiry showed that national authorities do not share the same understanding of dividend arbitrage trading schemes, due to differences in Member States' domestic tax law. The inquiry concluded that facilitating or handling proceeds from tax crimes undermines the integrity of the EU's financial system. A 10-point action plan for 2020/21 has been put in place to enhance the framework of prudential and anti-money laundering requirements covering such schemes and aims to provide a better understanding of such schemes and foster supervisory convergence.

As part of the action plan, the EBA is strengthening its Guidelines on internal governance, its Guidelines on the assessment of the suitability of members of the management body and key function holders, and its Guidelines on SREP. It also monitors how prudential colleges follow up on cum-ex related guidance. The same will be done for the prudential package for investment firms.

With regard to AML requirements, the EBA is amending its Guidelines on money laundering and terrorist financing risk factors, its Guidelines on risk-based AML/CFT supervision, and its biennial Opinion on ML/TF risks. The EBA will also allocate explicit time to such schemes during its staff-led AML/CFT implementation reviews of national authorities and monitor AML/CFT colleges for financial institutions that are exposed to significant ML/TF risks associated with tax crimes.

Following the completion of the aforementioned reviews of its guidelines, the EBA will carry out a second formal inquiry to follow up on the actions taken by financial institutions and national authorities to supervise compliance with the amended requirements.

# 5. Ongoing and future work

## 5.1 Supervisory review and evaluation process

### 5.1.1 Work on the revision of the EBA SREP GLs

In November 2019, the EBA published its roadmap for the risk reduction measures package[33]. As part of this roadmap, the EBA outlined its plan for reviewing the SREP GLs in order to reflect the changes introduced by CRD V. Apart from the main objective of aligning the SREP GLs with the requirements of CRD V, the review aims at enhancing the guidance based on observations from the ongoing monitoring and assessment of convergence of supervisory practices, and ensuring consistency with other EBA regulatory products published after the specification of the SREP GLs. In addition, the review will aim to streamline and simplify the guidelines to facilitate their application. The goal is to provide a common set of uniform guidelines that are fit for purpose for the day-to-day work of supervisors.

In aligning the SREP GLs with the requirements of the revised CRD/CRR framework, the EBA has taken into consideration the following areas:

- **Proportionality:** The new framework introduces simple and conservative alternatives for smaller, less complex banks in terms of prudential standards, disclosures and reporting. The aspects of proportionality, especially in the context of the minimum engagement model, will also be revisited in the SREP GLs.

- **Sustainable finance**: The EBA is mandated to assess the potential inclusion of environmental, social and governance (ESG) risks in the SREP review. In October 2020, the EBA published a Discussion Paper on the management and supervision of ESG risks. Feedback to this discussion paper will serve, among others, as an input to considering an appropriate approach to assessing ESG risks within the SREP. Given the timelines for the review of SREP GLs and the complexity of the area of ESG risks, more detailed guidance may need to be provided in a later revision of SREP GLs.

- **AML/CFT:** In accordance with the revised framework, prudential supervisors are expected to supplement the role of AML authorities and actively participate in the fight against ML and TF. As the AML dimension is highlighted in several key prudential instruments, including SREP, this aspect has to be appropriately reflected in the SREP GLs. Considering this topic to be of the highest priority, the EBA published an Opinion in November 2020,

[33] EBA publishes its roadmap on the risk reduction measures package | European Banking Authority (europa.eu)

outlining the expectations for CAs in regard to how to reflect AML/CFT considerations in the SREP. This Opinion serves as a bridge solution to guide the CAs in their assessment processes until the SREP GLs have been finalised.

- **P2R/P2G:** The CRD V confines Pillar 2 capital add-ons to a purely micro-prudential perspective in order to avoid overlaps with the existing macro-prudential tools that aim to address systemic risk. In addition, the conditions for applying P2R to cover specific risks to which a bank is exposed are clarified and the institution-specific nature of those requirements is emphasised. The add-ons are complemented by the possibility for supervisors to express supervisory expectations for banks to hold additional capital under the form of P2G. These revisions must now be appropriately reflected in the SREP GLs.

- **Risk of excessive leverage**: The revised framework includes a binding leverage ratio requirement and an additional leverage ratio buffer for global systemically important institutions (G-SIIs). The risk of excessive leverage should be assessed by CAs as part of the SREP, and the related requirements should be considered separately from P2R/P2G. More detailed guidance in this regard should be provided in the revised SREP GLs.

- **IRRBB/CSRBB**: The framework for interest rate risk in the non-trading book (IRRBB) has been modified, introducing credit spread risk in the banking book (CSRBB), as well as a common standardised approach and a simplified standardised methodology for IRRBB, and adding the net interest income perspective to the economic value of equity (EVE) perspective for the purposes of interest rate risk management, disclosures and prudential supervision. The revised CRD also includes a number of mandates for the EBA to develop guidelines and regulatory technical standards on these topics. The review of the SREP GLs will be carried out to some extent simultaneously with the work on other mandates related to IRRBB and CSRBB. Depending on the final timeline for the development of the technical standards and the revision of the EBA IRRBB Guidelines, the work on the revision of the IRRBB section of the SREP GLs is expected to take place in a future update of the SREP GLs.

In addition to reflecting the changes in the CRD/CRR framework as described above, the EBA is also planning to review other sections of the SREP GLs, in order to align the GLs with other recently developed EBA regulatory products and to enhance the guidance based on current experience. The areas that will be subject to the review include, in particular, the assessment of governance and institution-wide controls as well as the assessment of risks, including credit risk, operational risk, market risk, liquidity risk and funding risk.

The tentative timeline for the revision of the SREP GLs expects the GLs to be completed by the end of 2021. However, as also indicated in the EBA roadmap on the risk reduction measures package, this timeline may need to be adjusted depending a number of factors, including the extent of necessary changes to achieve the objectives of the review.

### 5.1.2 Supervisory risk taxonomy

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

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

In 2020, the EBA mapped each risk category of the Supervisory Risk Taxonomy with the corresponding coverage in terms of legal references (CRD V/CRR II) and regulatory references under Pillar 1 and Pillar 2.

The EBA also discussed the EBA Supervisory Risk Taxonomy with a number of CAs in order to understand how they use the taxonomy in their supervisory tasks, in particular the ICAAP assessment and the overall SREP process. Some of these CAs have a taxonomy which is based on the EBA's, with less granularity in one case, while the others intend to streamline their own taxonomies to take into account the EBA's. Overall it has been found that the use of a taxonomy improves supervisory-consistent internal language in risk definitions, supports CAs in the ICAAP assessment, e.g. facilitating the risk identification process (completeness check) and the understanding of the scope of risk categories, and enhances benchmarking and the ICAAP horizontal analysis. In addition, CAs view the mapping of the EBA risk taxonomy with CRR and CRD requirements as a useful checklist.

In 2021, the EBA will map each risk category of the Supervisory Risk Taxonomy with FINREP/COREP reporting. The deliverables for the work on the Supervisory Risk Taxonomy will feed into the revision of the SREP Guidelines. The EBA Supervisory Risk Taxonomy is now relatively stable, while it remains a living document and will therefore continue to be adapted to legislative and policy developments.

## 5.2 Ongoing supervision

### 5.2.1 Revised joint guidelines for assessing the suitability of members of the management body and key function holders

Following the amendment of Directive 2013/36/EU by Directive 2019/878/EU (CRD V) and the publication of the EBA's 10-point action plan on dividend arbitrage trading schemes (see also Chapter 4.2.3.), the EBA updated, jointly with European Securities and Markets Authority (ESMA), the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders issued on 26 September 2017. The update also considers further changes to Directive 2013/36/EU that are included in Directive 2019/2034/EU (IFD) and will be implemented by 26 June 2021. Both credit institutions and investment firms will be subject to the revised guidelines.

In order to ensure robust governance arrangements, it is of the utmost importance that the members of the management body and the key function holders within an institution are suitable for their position. The management body has the overall responsibility for the institution and therefore its collective composition must be appropriate and reflect an adequately broad range of experience. This is true not only for the management body in its management function, but also in its supervisory function, which oversees the management function.

Institutions should also take into account the diversity of the management body. More diverse management bodies can help to improve decision-making on strategies and risk-taking by incorporating a broader range of views, opinions, experiences, perceptions, values and backgrounds. A more diverse management body reduces the phenomena of 'group think' and 'herd behaviour'. The issue of diversity is not limited to gender - it also concerns the age, professional and educational background, and geographical provenance of the members of the management body. All those factors are important aspects of the composition of the management body. A diverse management body facilitates good decision-making.

While the previous guidelines already achieved a good level of harmonisation, the revised Guidelines aim at further harmonising the assessment of suitability within the EU banking and securities sector, in particular, with regard to the assessment of suitability in the context of existing money laundering risks. The main revisions that have been consulted on in the consultation paper, published on 31 July 2020, concern the scope of application, the explicit inclusion of money laundering or terrorist financing and the increased risk thereof in connection with the institution that has been linked to the assessment of the suitability of the members of the management body (Article 91 of the CRD V).

Where competent authorities have reasonable grounds to suspect that money laundering or terrorist financing is being or has been committed or attempted, or if there is increased risk of such actions in connection with an institution, CRD V requires that the suitability assessments take account of those facts. In particular, in such situations, the management body must have a high level of competence and relevant experience in this area, to be able to ensure that there are strong controls that ensure compliance with the requirements under the Anti Money Laundering Directive in light of the additional exposure of the institution. However, in all institutions the management body is responsible overall for ensuring that the institution complies with such requirements and therefore the anti-money laundering aspect is relevant for the suitability assessment of all members of the management body in all institutions. The guidelines also aim to ensure that tax offences, including those committed through dividend arbitrage schemes, are considered in the assessment.

The other changes relate to requirements for board composition, criteria for assessing the independence of mind of members of the management body and the suitability assessment in the context of early intervention. In this context, the revised guidelines confirm, in line with CRD V, that being a member of affiliated companies or affiliated entities does not in itself constitute an obstacle to acting with independence of mind.

### 5.2.2 Revised GLs on internal governance

Following the amendment of Directive 2013/36/EU by Directive 2019/878/EU (CRD V) and the publication of the EBA's 10-point Action plan on dividend arbitrage trading schemes (see also Chapter 4.2.3.) the EBA updated its guidelines on internal governance issued on 26 September 2017. The update also considers further changes to Directive 2013/36/EU that are included in Directive 2019/2034/EU (IFD) and will be implemented by 26 June 2021. The guidelines aim at ensuring sound governance arrangements.

After the implementation of the IFD, the governance provisions of the CRDV will no longer apply to all institutions. The EBA is mandated to issue separate Guidelines on remuneration policies for investment firms that were published for consultation on 17 December 2020. The framework for investment firms is largely consistent with the framework for credit institutions.

The main revisions of the Guidelines under CRD V, published for consultation on 31 July 2020, concern requirements that foster diversity and ensure equal opportunities for both genders, specific requirements regarding loans to members of the management body and their related parties and requirements to tackle risks in the context of money laundering or terrorist financing.

In line with the requirement to have a gender neutral remuneration policy, the guidelines on the code of conduct have been revised. Institutions should take measures that, in line with the European Charter of Fundamental Rights and the Treaty on the Functioning of the European Union, ensure there is no discrimination and that there are equal opportunities for staff of male and female gender. The guidelines take also into account the EBA's diversity benchmarking report, which found that a significant proportion of institutions (2018: 41.61%) had still not adopted a diversity policy, the representation of women in management bodies in their management function was at only 15.13%, while their representation in management bodies in their supervisory function reached 24.02%. Ensuring equal opportunities and career progression will help to increase the pool of female candidates for positions in senior management and within the management body.

Loans to members of the management body and their related parties are a specific source of actual or potential conflicts of interest and specific requirements have been explicitly included in Article 88(1) of Directive 2013/36/EU regarding such loans. The draft guidelines specified additional requirements for these loans, taking into account the respective provisions under the Shareholder Rights Directive. To ensure proper internal controls on such loans and to enable competent authorities to review the compliance of institutions, additional documentation requirements have been included in the guidelines.

As part of the management of conflicts of interest, similar requirements as for related party loans should also apply to other transactions. Decision-making on loans or transactions should be objective and not be influenced by conflicts of interest. The arm's length principle safeguards independent and objective decision-making and ensures there are appropriate conditions for such loans or transactions.

Involvement in money laundering and terrorism financing and inappropriate controls in that area or with regard to compliance with tax laws can lead to reputational and operational risks. The link between money laundering and terrorism financing risks and prudential risks has been clarified in the guidelines. The revised guidelines stress that identifying, managing and mitigating money laundering and financing of terrorism risk is part of sound internal governance arrangements and the risk management frameworks of credit institutions.

Institutions' management bodies should develop, adopt, adhere to and promote high ethical and professional standards. Such standards should contain internal principles on acceptable and unacceptable behaviours linked, in particular, to misconduct and financial crime, including tax crimes through dividend arbitrage schemes.

### 5.2.3 Revised GLs on sound remuneration policies

Following the amendment of Directive 2013/36/EU by Directive 2019/878/EU (CRD V), the EBA updated its guidelines on sound remuneration policies, issued on 21 December 2015. The update also considers further changes to Directive 2013/36/EU that are included in Directive 2019/2034/EU (IFD) and will be implemented by 26 June 2021.

The remuneration provisions under CRD V will, after the implementation of the IFD, only apply to institutions that are subject to the CRD, while a new prudential framework has been established for investment firms. Under the framework for investment firms, specific requirements have been adopted for investment firms unless they are small and not interconnected. The EBA is mandated to issue separate Guidelines on remuneration policies for investment firms that were published for consultation on 17 December 2020. While the remuneration framework for investment firms is similar, to a large extent, to the framework for credit institutions, differences still exist. In particular, investment firms are not subject to a strict limit for the variable remuneration (bonus cap) of their staff that have a material impact on their risk profile or the assets they manage.

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

The Guidelines on gender neutral remuneration policies take into account Article 157 of the TFEU and the European Charter of fundamental rights and aim at ensuring that institutions comply with the principle of equal pay for equal work or equal value of work. The guidelines also provide for some metrics that will allow the EBA to benchmark the existence of a gender pay gap. The EBA will follow up on institutions’ practices with a report to be published within two years after the issue of the guidelines and will also update the Guidelines on remuneration benchmarking.

In its Opinion on the application of the principle of proportionality to remuneration provisions in Directive 2013/36/EU (EBA/OP/2015/25) the EBA stressed the need to ensure a harmonised and consistent approach across the EU regarding the proportionate application of remuneration requirements and recommended the introduction of waivers for the requirements to pay out a part of the variable remuneration for identified staff deferred and in instruments, and the possibility of also using share-linked instruments for listed institutions to ensure a more proportionate application of those requirements.

The recommended derogations introduced in CRD V allow Member States to set thresholds for small and non-complex institutions and for staff receiving a low amount of variable remuneration, that lead to a disapplication of the requirements to pay out a part of the variable remuneration to identified staff under deferral arrangements and in instruments. The guidelines provide further details on how waivers should be applied by small and non-complex institutions and to staff that receive only a low amount of variable remuneration.

The guidelines clarify the application of the CRD requirements in a group context. In cases where a specific remuneration framework applies to a subsidiary (e.g. under IFD, MiFID, AIFM or the UCITS Directive) the remuneration framework under CRD, including the bonus cap, shall not apply to this subsidiary, unless the Member State makes use of the national derogation option provided in Article 109(6) of the CRD. Further, where the requirements under Articles 92, 94 and 95 of the CRD are not applied on a consolidated basis, subsidiaries remain subject to Article 74 and the requirement to have gender neutral and risk-aligned remuneration policies.

### 5.2.4 IFRS 9 Benchmarking

The EBA continues to work on monitoring the implementation of IFRS 9, initiated in 2016 (before the first application of this accounting standard, on 1 January 2018 for most institutions). This work seems even more key in the context of the supervisory monitoring of the current crisis. In this regard, it is worth noting that a new qualitative survey on IFRS 9 implementation was launched in September with the aim of collecting additional information on selected areas of interest, including accounting aspects expected to be impacted under the current COVID-19 scenario. This qualitative assessment will be complemented with the quantitative information resulting from the monitoring of the EBA IFRS 9 indicators for the COVID-19 period. The publication of a report with the main observations is currently planned for Q2 2021.

In July, the EBA also launched the second phase of the IFRS 9 Benchmarking exercise, which has gained increased relevance in the COVID-19 crisis given the more extensive use by EU institutions of the level of judgment and flexibility embedded in the accounting standards. In light of the COVID-19 pandemic, the templates used for this exercise have been revised in order to collect information on the implications of the COVID 19 crisis and of government support measures on the estimation of the ECL amount and IFRS 9 parameters (e.g. PD and LGD). As per the first phase of this exercise, the information collected during this second phase was used as a basis for proposing some amendments to the EBA ITS on supervisory benchmarking, as presented in the consultation paper published in December 2020.

# 6. Training as a convergence tool

Table 1 : Overview of the training events the EBA provided for EU Competent Authorities in 2020

| No. | Title | Date | Host | Attendees |
|---|---|---|---|---|
| 1 | Crypto-assets for supervisors | On a continuous basis | online | 277 |
| 2 | Updated Loss Absorption Capacity – MREL and TLAC | On a continuous basis | online | 59 |
| 3 | SREP | 15 – 19 June 2020 | online | 81 |
| 4 | Recovery planning | 6 – 17 July 2020 | online | 40 |
| 5 | Outsourcing to the Cloud | On a continuous basis | online | 44 |
| 6 | EBA online workshop on ICT and security risk management Guidelines | 3 July 2020 | Webex | 319 |
| 7 | EBA mandates under the Investment Firms Directive and Regulation | 3 September 2020 | Webex | 111 |
| 8 | Basel III and CRD/CRR: latest updates and implementation | 8, 10 and 15 September 2020 | Webex | 177 |
| 9 | IFRS 9 | 20 October 2020, | Webex | 242 |
| 10 | Securitisation markets, regulatory framework, funding and capital relief | 24 - 26 November 2020 | Webex | 199 |
| 11 | Workshop on RegTech<br>*Only for competent authorities from SGIP and RegTech Drafting Team.* | 15 December 2020 | Webex | 106 |
| **Total** | | | | **1627** |

*Overview of training provided in 2020*

## a. Virtual seminars

In 2020, the EBA training team, amidst the COVID-19 pandemic and the subsequent closure of the EBA offices, successfully delivered a total of 11 trainings to 1627 participants representing all competent authorities including agencies such as the ECB and Single Resolution Board. Following the closure of the EBA offices in March 2020, the external training team has had to reorganise its trainings to accommodate the new teleworking policy without compromising the quality of the trainings offered. Most EBA seminars and residential trainings have had to be amended to allow for conversion into virtual seminars and online trainings.

All four virtual seminars and five instructional videos were well received by the participants who praised the high level of professionalism demonstrated in the organisation of the trainings and the assistance received from the team on all technological queries. Contrary to physical trainings which are capped for security reasons, virtual trainings accommodated twice as many participants. This was the case with EBA's joint annual training with the Basel FSI on 'Basel III and CRD/CRR: latest updates and implementation' held on 8, 10 and 15 September 2020 via Webex. The high interest in the 2020 training can be attributed to the relevance of the topics, which focused on increasingly important issues such as AML, buffer usability and banks' dividends in COVID-19 times and climate and environment related risks in prudential supervision. The panel-like format of the virtual training allowed for a more interactive experience between experts and participants.

Further, the virtual trainings enabled a wider reach to an increased number of candidates. The EBA webinar on IFRS 9 held on 20 October 2020 via Webex enabled more candidates from Bosnia and Herzegovina, North Macedonia and Montenegro to participate who would otherwise have been constrained by delayed visa applications and limited budgets in the case of residential trainings.

Through the EBA training on 'ICT and security risk management Guidelines – supervisory approach' held on 3 July 2020, participants acquired first-hand knowledge of a common understanding of the guidelines from experts and the necessary guidance for implementing them.

As the development of the relevant regulations were ongoing during the EBA virtual training on 'EBA mandates under the Investment Firms Directive and Regulation' on 3 September 2020, EBA experts opened the floor to participants at the end of the event for the more complicated questions.

The EBA training team piloted the virtual workshop on RegTech held on 15 December 2020 via Microsoft Teams to test its capabilities as a conferencing tool for future EBA trainings. Participants were keen to register and followed the seminar for the latest insight into aspects on RegTech governance and AML/CFT and ICT security.

The training team further exploited the possibilities available on the EBA's learning management system (LMS) by integrating Webex into LMS as a teleconferencing tool and successfully recorded the Policy Research training for future reference. This enables staff of competent authorities to more easily find the entire offer of EBA courses on one page, register for new courses and keep updated on their progress.

Additional trainings provided by the training team include: the EBA virtual event 'Oversight framework under the DORA proposal' held on 23 October 2020 with 66 participants from 23 authorities, 'Challenges in AI adoption' held on 29 October 2020 with 677 attendees from more than 300 different institutions, the EBA's largest virtual event to date and the annual EBA research workshop 'New technologies in the banking sector – impacts, risks and opportunities' with 376 participants from 93 institutions.

In November 2020, the training team devised a survey to identify and assess the training needs of digital financing experts in each competent authority. This was to assist the Joint Committee Contact Group on Technological Innovation and Cybersecurity with coordinating the European Supervisory Authorities (ESA) work in the area of innovation, ICT and cybersecurity and at the same time further promote the ESAs' joint efforts in cross-sectoral trainings on the topic of digital finance and technology.

### b. Online trainings (instructional videos)

In addition to the virtual seminars provided in 2020, the EBA training team offered five online trainings for CA staff, the first of which was the online training on 'Crypto-assets' rolled out on 14 January 2020. Of the 277 registrees from 29 authorities who enrolled and participated in the training, 90% rated the course positively and 90% agreed to recommend it to their colleagues.

In June and July 2020, the EBA's online training courses on 'Supervisory Review and Evaluation Process' and 'Bank Recovery Planning' gained renewed popularity following an update of their content, through which participants were able to apply the acquired knowledge to integrated case studies. Following the update to the banking package, CRRII and BRRD2, the online course on the equally popular 'Loss Absorption Capacity – MREL and TLAC' was also updated to reflect the recent changes.

On 13 October 2020, the EBA's self-paced training on 'Outsourcing to the cloud', an introduction to what outsourcing is and how it can be used in the financial services sector, went live and is currently offered on a continuous basis on the EBA's online training platform. The content focuses on the associated risks and benefits and what supervisors must consider in their everyday tasks. The learning platform currently has 44 users from 12 different authorities enrolled in the module on 'Outsourcing to the Cloud'.

### c. Upcoming trainings

The EBA training team is currently developing additional online training modules on the 'Breach of Union Law process' to be rolled out in Q1 2021 and on a joint project with the SSM on 'Supervisory Reporting: COREP & FINREP' which will be hosted on the EBA Learning Hub and delivered jointly with SSM colleagues.

On 15 December 2020, the training team distributed the EBA training plan 2021 to all authorities and published it in the Training Newsletter where all upcoming trainings are advertised.

# 7. The implementation of the Union-wide Strategic Supervisory Priorities (USSP) and their interaction with the EBA 2021 Convergence Plan

The revised EBA Regulation stipulates that according to Article 29(a), the EBA shall identify, at least every three years, by 31 March, up to two Union-wide Strategic Supervisory Priorities (USSP) which reflect future developments and trends. Competent authorities shall take the priorities into account when drafting their work programmes and notify the EBA accordingly.

In 2020, the EBA identified the priorities of business model sustainability and adequate governance structures in light of the COVID-19 pandemic for their integration into the 2021 work programmes of competent authorities. According to the outcome of the notification procedure, there was a broad consensus in CA responses that the USSP are highly relevant, and even more so in the context of the pandemic. The responses of the CAs, in particular with regard to the focus points under each of the USSP, as well as the supervisory activities and actions they are implemented through, reflect close interlinkages with the EBA's yearly Convergence Plan.

## Implementation of the USSP and their interaction with the 2021 Convergence Plan

CAs considered the USSP when drafting their work programmes for the year 2021 and both EBA USSP constitute an integral part of core supervisory activities. Under the EBA USSP of business model sustainability, competent authorities reported that they focus particularly on the issues of credit risk management, asset quality deterioration and adequate provisioning. Moreover, supervisory attention is paid to cost efficiency and heightened competition as result of the low interest rate environment and accelerated digitalisation. In this context, CAs scrutinise the impact of digitalisation on business model transformation and operational and financial resilience. On business model sustainability, competent authorities put emphasis on the assessment of banks' profitability – also in light of the COVID-19 pandemic – during the ongoing SREP exercise, which is often complemented by onsite examination activities.

The second EBA USSP of adequate governance structures is not always considered a stand-alone priority and more CAs consider that governance processes in particular are part of horizontal and multi-annual priorities. Risk controls and operational risk management are subject to heightened supervisory attention, in particular, IT infrastructure and availability of adequate data as well as the overall effectiveness of the regulatory framework. The culture of sound and effective governance is reflected not only in on-going (prudential) supervision and onsite inspections, but also in licensing. Another particular area of attention in this regard is the adequacy of governance arrangements against the background of ML/TF risk.

The selection of the key topics for supervisory attention for 2021, as included in the next chapter of this report, was closely aligned with the USSP in order to ensure that the supervisory work undertaken on a day-to-day basis and at an operational level is driven by strategic and long-term priorities. In particular, bank's business models as such became a dedicated key topic for 2021, but various aspects of BM sustainability under the USSP are closely linked with the other key topic, asset quality and credit risk management, in the sense that the impact of potentially deteriorating asset quality will impact the profit and loss statement. An adequate governance structure is an overarching element that manifests in bank approaches to all the priority areas. The effective corporate governance arrangements and adequate involvement and oversight of the management body, is a prerequisite for the sound management of all risks, including credit risk and ICT risks, as described in the 2021 Convergence Plan.

The outcome of the notification exercise confirms that the USSP drive supervisory attention towards the strategic areas and that supervisory plans and ultimately supervisory activities and actions are benefiting from the substantial synergies between the USSP and the 2021 Convergence Plan.

# 8. EBA 2021 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 culture[34].

The EBA is also mandated to follow the degree of convergence of supervisory practices across the EU, in line with Article 107 of Directive 2013/36/EU (the Capital Requirements Directive, CRD), and to report its observations on a yearly basis to the European Parliament and the Council.

Supervisory convergence is a process whereby (i) common rules (Single Rulebook) 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 SREP purposes (comparability), which leads to consistent supervisory outcomes/measures (consistency).

The EBA drives this process by establishing a yearly convergence plan, which identifies key topics for heightened prudential supervisory attention. These aim to:

i. inform CA processes for selecting supervisory priorities for the upcoming year;

ii. influence the supervisory practices of CAs on the selected topics and, in particular, draw the CAs' attention to the consistent implementation of the related policy products.

The 2021 Convergence Plan is driven by the clearly exceptional circumstances caused by the COVID-19 pandemic that have led supervisors to rethink, and if necessary, refocus their short and medium term priorities. This is essential to capture, to the greatest extent possible, the effects of the pandemic and crisis on the banking sector as well as to ensure that banks navigate through this crisis by taking effective measures subject to supervisory scrutiny.

CAs are actively involved in the selection of the key topics, which takes place in the relevant sub-committee and sub-group and endorsed by the BoS.

All CAs are expected to consider these key topics when developing their 2021 supervisory priorities and SEPs for the credit institutions that they supervise and are invited to involve not only line supervisors in these discussions but also policy and risk experts[35].

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 practices. The EBA will

[34] EBA founding regulation Article 8.1.b and 29

[35] Or specialist functions

review the approach applied by the 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 questionnaire and desk-based review. 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. The EBA, through its participation in supervisory colleges, will monitor how the key topics are to be reflected in the colleges' work.

The convergence plan is published together with and as an integral part of the convergence report for the preceding year, although, as for the previous year and in order to ensure it is properly taken into account in the implementation of supervisory policies, a timely sharing with the supervisory community will be ensured well in advance of the publication.

The EBA will develop, as in previous years, objective elements or attention points per key topic with the involvement of the relevant sub-group i) to support CAs in focusing their attention in relation to each key topic, ii) to contribute to comparable supervisory practices across the EU, and iii) to facilitate the objective assessment at the end of the year by the EBA.

## Selection of the key topics

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 practical experience and observations provided by CAs.

The outbreak of the coronavirus disease (COVID-19) and its global spread in 2020 has brought about unprecedented challenges in society and had an inevitable impact on the EU banking sector. Uncertainties about the medium- and long-term implications of the COVID-19 pandemic are still very high, but the main vulnerabilities and risks could already be identified in 2020, which led the EBA to select priorities that are the most relevant in the context of the aftermath of the pandemic and would warrant supervisory scrutiny in 2021. The overwhelming majority of supervisory attention will be focused on better understanding the true extent of the main risks entailed by the pandemic and their prospective crystallisation. The prioritisation of the topics thus corresponds to these efforts by providing common directions and focus areas for EU supervisors for their work in 2021. Furthermore, there is clear interaction between the key topics[36] that supervisors are encouraged to explore when devising the SEPs for institutions.

[36] E.g. between ICT and security risk/operational resilience and business model (including strategy) or asset quality, profitability and

At the same time and to the extent possible, the 2021 Convergence Plan ensures a continuum in the supervisory work from 2020, as more of the priority areas included in the 2020 Convergence Plan, such as information and communication technology (ICT) risk, profitability or capital and liability management, have been preserved in 2021 with some new or additional aspects in focus.

While the development of the yearly convergence plan and its follow-up creates a feedback cycle, the evaluation of the progress in convergence in the previous cycle and the development of the priorities of the next cycle differ in timing. Therefore, if conclusions from the current (2020) cycle[37] and from the initial implementation of the 2021 cycle warrant any potential refinement of the 2021 Convergence Plan, this will be ensured during the integration of the 2021 Convergence Plan into the 2020 Convergence Report.

## Key topics identified for the 2021 Convergence Plan for prudential supervisory purposes

### 1. Asset quality and credit risk management

The severe recession across Europe amidst the lockdown measures to tackle COVID-19 hit various sectors and caused financial difficulties for borrowers. Despite the unprecedented volumes of support measures offered by fiscal and monetary authorities, asset quality is expected to deteriorate, with further difficulties for borrowers to repay their debt. It should be noted that the legislative and non-legislative loan moratoria, and further policy measures such as loan guarantee schemes, are of a temporary nature and banks are likely to face deteriorating asset quality with increasing non-performing loans (NPLs) and rising cost of risk. Thus, the impact of the COVID-19 pandemic on asset quality will be a key point of attention in 2021, both for banks and supervisors.

Under these exceptional circumstances, it is crucial that banks adequately measure credit risk and have appropriate procedures for identifying credit quality deterioration. Identification, measurement and monitoring of credit risk and defaulted exposures is necessary for supervisors to have a clear picture of the true level of credit risk embedded in banks' books. The implementation of the final Guidelines specifying the application of the definition of default across the EU and Commission Delegated Regulation (EU) 2018/171 on the materiality threshold for credit obligations past due will enhance this process and respective supervisory oversight. These regulatory products, which are expected to be implemented at the latest by end-2020, harmonise the definition of default across the EU, thus contributing to improving consistency in the measurement of credit risk and ultimately enhancing the comparability of risk estimates and own funds requirements.

Banks' preparedness for the timely identification of clients with increasing credit risk and the effective management of those clients will warrant heightened supervisory attention in 2021.

capital management.

[37] Expected to be available at year-end or early next year

Adequate provisioning of NPLs will be important in light of the deteriorating macroeconomic environment in order to ensure that banks' financial statements reflect a true and fair view of the quality and value of their loan portfolio. Supervisors need to understand whether the provisioning policy has been updated to address current market challenges and there will be a need to cover the IFRS 9 aspects and potential changes to the models across banks, in particular, from a quantitative perspective (e.g. adaptations made to the downturn conditions, link with stress tests). After the identification, measurement and monitoring of credit risk, it is also important to achieve effective credit risk management. CAs should understand and focus on banks' capabilities to manage the increasing credit risk stemming from the crisis and review whether they have taken appropriate measures to mitigate the impact of the COVID-19 outbreak, including debt moratoria, forbearance measures, active NPL reduction strategies and effects on asset quality. The Guidelines on management of non-performing and forborne exposures provide supervisors with the necessary and effective tools to oversee the management of NPEs by banks and ensure their timely recognition and provisioning as well as promoting supervisory convergence in the treatment of NPEs across EU banks. Therefore, CAs are expected to closely follow the relevant provisions of these Guidelines in 2021.

Banks' credit risk management as part of the broader risk management framework should demonstrate their ability to identify and understand credit risk, through the ICAAP and stress testing procedures, as well to take adequate mitigating measures. The resilience of banks to economic shocks and their exposures to the most vulnerable sectors should also be in the forefront of their risk management activities in 2021.

It is important that banks have effective and reliable tools to monitor and report the ongoing impact of the crisis to their management bodies. Ineffective and inadequate processes and tools may result in the management bodies receiving unreliable information and/or with a time delay that would hinder the efficient management of credit risk.

In the context of credit risk, it is vital that credit institutions have robust and prudent standards for credit risk taking, so supervisors should therefore work with institutions to improve loan origination practices in line with the EBA's GLs on loan origination and monitoring this in a pragmatic and proportionate manner. These lending standards and practices in the current COVID-19 circumstances may include additional flexibility, for instance by recognising the measures put forward by governments to mitigate the impact of the COVID-19 pandemic, including various public guarantees and their conditions. The Guidelines will apply from 30 June 2021, with institutions benefitting from a series of transitional arrangements.

The EBA also expects CAs to be vigilant about new types of misconduct related to COVID-19 measures, in particular the potential misuse of guaranteed loans or fraudulent applications.

In 2021, the EBA will review the approach followed by CAs to monitor the evolution of credit institutions' asset quality and to scrutinise their credit risk management.

## 2. ICT and security risk, operational resilience

Information and communication technology (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. The increasing digitalisation of the financial sector and increasing interconnectedness through telecommunications channels with other financial institutions and third parties renders banks' operations vulnerable to external security attacks. This is especially true in the COVID-19 context, as supervisors have observed increased cybercrime activity during the outbreak, targeting potential vulnerabilities in the context of increased remote working.

The pandemic has honed the focus on ICT risk management and activated institutions' business continuity plans. The transition to the 'new normal' is expected to be gradual, along with the expected revision of business continuity plans (BCPs) by institutions in order to reflect the actual experience of the pandemic scenario and the lessons learnt for the longer term. These challenges raise the need for supervisory attention to ensure the appropriateness and compliance of institutions' activities. These operational changes, in conjunction with the application of the EBA ICT and security risk management Guidelines, which apply from 30 June 2020, are expected to affect ICT supervisory practices in 2021. These Guidelines set requirements for financial institutions in the EU in relation to the mitigation and management of their ICT and security risks, which forms part of operational resilience.

In recent years, financial institutions have been increasingly interested in outsourcing business activities to improve their flexibility and efficiency, as well as to 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. CAs should monitor and seek assurance on the level of compliance of their third party providers with the financial institution's security objectives, measures and performance targets. In the context of COVID-19, the revised Guidelines on outsourcing remain an attention point with specific provisions for governance of outsourced activities and the related supervisory expectations and processes.

In 2021, the EBA will continue to monitor developments in technology, generally, and ICT and security risk and business continuity, in particular. The EBA will integrate the outcomes of this assessment into its yearly convergence assessment.

## 3. Profitability and business model

Since Q4 2019, profitability levels have remained subdued due to the low interest rate environment and the challenges for banks to reduce their operating expenses. The slowdown of economic activity will probably negatively affect net interest income and net fee and commission income in the upcoming months while income from trading may recover. The containment measures had a significant impact on borrowers' ability to repay their debt which will also be reflected in higher provisioning needs and a probable increase in defaults, that pose additional challenges for banks to manage. While digital channels present an opportunity, investment in these channels is a prerequisite. As such, the consolidation of the sector might become even more relevant.

Generating income to support investments in general, and investments in technology, in particular, is vital to ensure the long-term sustainable operation of banks. The pandemic appears to have fast-forwarded digital transformation strategies within institutions (e.g. heavy reliance on digital and remote solutions to perform daily operations and deliver services to customers), along with an increased shift towards digitalisation projects to allow outreach to both retail and business customers and offer digital services and solutions. While this has an overlapping element with ICT risk management and operational resilience, supervisory attention should also focus on the implementation of digitalisation strategies and their impact on business models and governance and internal control implications.

Profitable operation has been the subject of ongoing supervisory attention in recent years and supervisors have been looking into banks' business models and strategies to see whether they are viable/sustainable. As a result of the COVID-19 pandemic, macroeconomic and market conditions deteriorated further, making it even more difficult for EU banks to ensure sustainable operations in the long-run. With the inclusion of this topic in its 2021 Convergence Plan, the EBA expects the profitability and sustainability of banks' business models to be subject to supervisory dialogue with the firms as part of the 2021 SREP assessments. Banks' strategic plans will be subject to supervisory scrutiny with a particular focus on assessing COVID-19 and Brexit implications. This will allow CAs to better understand credit institutions' income generating capabilities under the current circumstances and their potential due to measures taken by the institutions to improve/preserve profitability and address a potential increase in pressure on interest margins and from more negative-yielding assets as well as lower demand, including changes in the revenue mix (e.g. with the aim of increasing fee income), cost reduction measures (e.g. measures to reduce staff costs) and M&A (e.g. search for revenue and/or cost synergies).

It is vital to also understand whether (some of) the measures might, in the short term, increase profitability but at the same time increase risks in the mid-to-long term (e.g. reductions of personnel might result in elevated conduct risk, reduced IT investment might negatively affect the resilience of IT systems, etc.).

The ongoing efforts of banks to ensure profitable operation in the short and medium term could be hindered by the unfavourable economic conditions caused by the pandemic. Therefore, banks should also be prepared for situations when actions taken in the 'business as usual' context fail to restore profitable operation and thus they need to activate the recovery options described in their recovery plan. In regard to activating recovery options, it is important that the recovery indicator framework, including profitability indicators, properly reflect the pace of deterioration. Profitability indicators should particularly capture income-related positions that could lead to rapid deterioration (e.g. losses impacting on the own funds). In this regard, supervisors will monitor whether institutions experience trigger breaches, due to the deteriorating market and financial conditions, and whether they activate proper escalation and inform the supervisor promptly.

In 2021, the EBA will review the approach followed by the CAs to monitor and assess credit institutions' earnings-generating capacity and the actions/arrangements that institutions have taken to increase their adaptation to a clearly challenging environment.

## 4. Capital and liability management

While banks entered the COVID-19 crisis in better shape and with larger capital buffers than in the Global Financial Crisis of 2008-2009, the likely deterioration of asset quality will presumably result in an increase in credit RWAs and in an erosion of capital. In this regard, the capital relief measures initiated in 2020, including the usability of the buffers as well as the possibility for banks to operate temporarily below Pillar 2 guidance are expected to be preserved over the course of 2021 to ensure an additional temporary solution for absorbing losses.

Given the increased cost of risk reported by the banks in 2020 and the heightened uncertainty about the macroeconomic path, the availability of sufficient capital has been and continues to be the focus of both investors and supervisors. Supervisors will continue to assess whether the own funds held by the banks, considering their quantity and quality, provide sound coverage of the risks to which the institution is or might be exposed. In the aftermath of the pandemic, risks, in particular those put forward in the EBA 2021 Convergence Plan, have the potential to deteriorate significantly in individual banks' risk profiles, exacerbated by the prospective macroeconomic conditions (e.g. rapid evolution, potential for crystallisation). Therefore, the capital adequacy assessment should consider the latest available information from the assessment of the various risks and SREP elements in order to capture the true level of risks and their coverage with available capital.

Forward-looking capital planning should be a key supervisory focus point in 2021 and supervisors should form a view on the adequacy of credit institutions' own funds in stressed conditions, considering the various relief measures in place at the time of the assessment. As part of the assessment of a firm's capital planning, supervisors will assess dividend policies and share buyback considerations, as these should take into account current and expected challenging economic and financial conditions in order not to jeopardise the sound capitalisation of the banking sector. Supervisors will also continue to assess firms' crisis management activities, including whether recovery scenarios are revisited and whether recovery options are implementable in the context of the COVID-19 pandemic.

Beyond own funds, CRR II has introduced the concept of TLAC, which 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 the BRRD II.

CAs must coordinate with RAs to require and verify that all banks have 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 a breach of capital requirements, and CAs must engage with institutions about the viability of their funding plans to meet MREL.

Supervisory activities targeting the monitoring and assessment of the sector's capital adequacy and its performance over the course of 2021 will be reviewed by the EBA. The EBA will also assess how CAs, in cooperation with RAs, will engage with CIs to ensure that TLAC and MREL are gradually accumulated and possible shortfalls are eliminated.

## Remarks

While there are various areas that will warrant the attention of EU prudential supervisors in 2021, the convergence plan put forward a handful of key items that, in the view of the EBA, will be the key driving forces of banks' risk profiles in 2021. Therefore, reflecting these items in the supervisory priorities and examination programmes is vital. It is equally important to channel institution-specific considerations into the SREP assessment and give heightened attention to relevant risks and/or risks controls, although these are not mentioned in this convergence plan. In particular, for some institutions with considerable trading and investment activity, market risk could also be a dedicated attention point, as volatility on the financial markets could be exacerbated by fears over future uncertainty (e.g. a second wave).

Similarly, ML/TF risk or conduct risk will continue to be of interest to prudential supervisors and they will closely cooperate with their AML/CFT supervisor and conduct supervisor counterparts. The EBA currently undertakes considerable policy development in this regard, as part of the implementation of the Council AML Action Plan on the prudential side. This is to ensure that AML/CFT-related aspects are factored into the prudential supervisory process, as well as to further strengthen the information exchange and collaboration between prudential and AML supervisors. Concerning conduct risk, the implementation of the Action plan on dividend arbitrage trading schemes in the context of the internal governance framework is ongoing at the EBA, while CAs are to exchange on the topic in supervisory colleges.

# 9. Key tasks for supervisory colleges for 2021

## 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 its entities.
Given that the regulatory framework sets 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 enhanced cooperation that the EBA observed in 2020 and 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 2021 Convergence Plan

The key topics for supervisory attention were shared with the supervisory community early on[38] in order to ensure that CAs (also in supervisory colleges) can consider these key topics when developing their 2021 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 within the college framework, the EBA complemented the 2021 Convergence Plan with objective elements/attention points and highlighted the relevant aspects to be discussed and/or explored in the supervisory college context.

The consolidating supervisor will take a leading role to ensure that

- the key topics and related objective elements are embedded in colleges' SEPs[39]/work in 2021 through college discussions, including an overview presentation at college meetings, and in onsite and/or offsite activities, including joint activities, where the latter are relevant;
- reflected in colleges' deliverables, in particular in the group risk/liquidity risk assessments, as well as in the respective joint decisions for further action, if the latter is warranted by the outcome of the supervisory risk assessment.

The EBA will review the approach applied by the 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

[38] November 2020.

[39] Supervisory examination programme

particular the monitoring of colleges, questionnaires and the bilateral convergence visits, if and as appropriate.

### Topical tasks requiring the attention of supervisory colleges in 2021

Supervisory colleges are expected to continue to pay attention to specific matters of importance. These topical items are in continuum from 2020 because they are relevant in 2021, either because continued supervisory interaction is warranted on the topic or potentially because they have not been addressed by colleges in 2020 in an adequate manner.

Supervisory colleges intensified cooperation and information exchange during 2020 and shared information in a multilateral setting on the implications of COVID-19 on the banking group and its subsidiaries/branches. The EBA urges colleges to continue this close cooperation and information exchange in regard to public and private payment moratoria, including the phasing out of these measures, buffer reliefs and their potential usage, dividend policies and remuneration, as well as coordinating supervisory activities and actions in this regard.

- CAs are to ensure effective communication in regard to the 2021 stress test exercise.
- In line with the action plan on dividend arbitrage trading schemes 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 the 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 must update their WCCA, including the terms of UK's participation in 2021 and onwards.

# Annex: 2021 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 Finance Group |
| **DE** | Deutsche Bank |
| **DE** | Clearstream Financial Holding Group |
| **DE** | Commerzbank AG |
| **DE** | DZ Bank AG Deutsche Zentral-Genossenschaftsbank |
| **DE** | ProCredit Group |
| **DK** | Danske Bank |
| **DK** | Saxo Bank A/S |
| **EL** | Alpha Bank, S.A. |
| **ES** | BBVA |
| **ES** | Grupo Santander |
| **ES** | Banco de Sabadell, S.A. |
| **FI** | Nordea |

| EEA home country | Name of cross-border banking group |
|---|---|
| **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 |
| **PT** | Banco Comercial Português, SA |
| **PT** | Finantipar Group |
| **SE** | Skandinaviska Enskilda Banken (SEB) |

| EEA home country | Name of cross-border banking group |
|---|---|
| **SE** | Handelsbanken |
| **SE** | Swedbank |
| **SI** | Nova Ljubljanska Banka (NLB) |
| **45** | **Total number of colleges for EEA banking groups** |

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

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