European Banking Authority

# 2025 EUROPEAN SUPERVISORY EXAMINATION PROGRAMME

EBA/REP/2024/14 JULY 2024

# Contents

# Abbreviations

| | |
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| **AI** | artificial intelligence |
| **CA** | competent authority |
| **CRD** | Capital Requirements Directive |
| **CRR** | Capital Requirements Regulation |
| **DORA** | Digital Operational Resilience Act |
| **EBA** | European Banking Authority |
| **ECL** | expected credit loss |
| **EEA** | European Economic Area |
| **ESAs** | European Supervisory Authorities |
| **ESEP** | European Supervisory Examination Programme |
| **ESG** | environmental, social and governance |
| **EU** | European Union |
| **GL** | Guideline |
| **ICAAP** | internal capital adequacy assessment process |
| **ICT** | information and communications technology |
| **IFRS** | International Financial Reporting Standard |
| **IMF** | International Monetary Fund |
| **ILAAP** | internal liquidity adequacy assessment process |
| **IRRBB** | interest rate risk in the banking book |
| **ITS** | Implementing Technical Standards |
| **MiCAR** | Markets in Crypto-assets Regulation |
| **RTS** | Regulatory Technical Standards |
| **SME** | small and medium-sized enterprise |
| **SREP** | Supervisory Review and Evaluation Process |
| **TPP** | third-party service provider |
| **USSP** | Union Strategic Supervisory Priority |

# Executive Summary

1. To fulfil its mandate in driving convergence in supervisory practices across the EU, the EBA sets key topics for heightened supervisory attention annually in its European Supervisory Examination Programme (ESEP). Competent authorities (CAs) are expected to reflect these topics in their priority setting and implement them in their day-to-day supervisory activities to ensure that the concerted efforts of supervisors lead to the appropriate identification, assessment and management of the relevant risks across the European Union (EU).

2. Reflecting on the assessment of the current and expected challenges, this document presents a targeted number of key supervisory topics on which EU traction is needed in the development of 2025 supervisory plans and actions throughout the EU. In line with the previous exercises, the 2025 ESEP does not aim to provide an overarching and comprehensive supervisory examination programme, as that should be developed by CAs, taking into account not only the ESEP but also the structure and specific vulnerabilities of the banking system under their remit and the idiosyncratic dimensions of the individual bank or banking group they supervise, including cross-border considerations, where relevant.

3. Accordingly, the dedicated focus areas in the 2025 ESEP are: 1) testing and adjusting to increasing economic and financial uncertainties; 2) digital challenges, in particular ICT risk management and building operational resilience towards the digital transformation; 3) transition to Basel III and the EU banking package implementation. Some aspects of these topics have already been included in previous years' ESEPs, and the current focus areas build on these previous assessments, as these topics have all gained in prominence in the current operating environment. The specific attention to these key areas in 2025 will contribute to ensuring the financial resilience of EU institutions and, through the implementation of the related policy products, will ultimately lead to a higher level of supervisory convergence across the EU.

4. It is also to be noted that the EBA's founding Regulation stipulates in Article 29(a) that the EBA must identify, at least every three years, up to two priorities of Union-wide relevance (USSPs) which must reflect future Union-wide developments and trends for a cycle of three years ahead. These USSPs, because of their general and strategic character, build a layer of supervisory attention into the convergence work. The ESEP offers refinement of these USSPs in terms of supervisory activities and actions, driving supervisory convergence in prudential supervision.

5. For the 2024-2026 cycle the EBA has selected 1) monitoring financial stability and sustainability in a context of increased interest rates, 2) developing an oversight and supervisory capacity for DORA and MiCAR. The 2024 ESEP covers the topic of interest rate risk and hedging, including the inherent level of IRRBB and volatility. The EBA will strive to provide additional guidance in some areas as needed by supervisors or as identified as a consequence of the EBA scrutiny plans

on the IRRBB to support the assessment of that risk, while IRRBB will be followed up also in 2025 with other EBA tools (e.g. heatmap following the EBA scrutiny on the IRRBB[1]).

6. The digital challenges, with a focus on ICT risk management and building operational resilience towards the digital transformation, as one of the key priorities for the 2025 ESEP, aims to be a logical complement of the second topic of the 2024-2026 USSPs.

[1] Heatmap following the EBA scrutiny on the IRRBB Standards implementation in the EU.pdf (europa.eu)

# 1. About the ESEP

## What is the ESEP

7. The ESEP forms part of the EBA's supervisory convergence toolkit which aims to deliver the EBA's supervisory convergence mandate as required by Article 1(5) of the EBA's founding regulation[2] and by Article 107 of the CRD, specifically in the context of the supervisory review.

***The ESEP is a selection of key topics for heightened prudential supervisory attention to***

***1) provide supervisors with a single set of priorities that should be implemented across Europe; and***

***2) drive convergence in the related supervisory work.***

8. The implementation of the ESEP in CAs' supervisory priorities and in their on-site and off-site supervisory work will ensure that these key areas receive the dedicated attention across the EU which is warranted based on their importance in the current environment.

## Identification of the key topics for 2025

9. The selection of the ESEP key topics relies on i) the EBA's risk analysis work on the EU banking sector; ii) the EBA's policy work aiming to further enhance the convergence of supervisory practices, in particular in the context of the SREP; and iii) the practical experience of CAs that helps to ensure that the most pressing items are selected for close supervisory scrutiny.

10. In recent years, the EBA has adopted a more targeted approach in the identification and setting of the annual priorities. Accordingly, three key topics for 2025 were identified, targeting aspects that are considered 'specific' for the upcoming year compared to 'business as usual'. It is equally important that the key topics also reflect significant regulatory developments and facilitate their implementation in line with the EBA's convergence mandates.

11. In 2024, structural changes such as the end of the abundant liquidity in the banking system due to the phasing out of TLTRO III, the higher interest rate environment, and the US banking sector turmoil and Credit Suisse case drove the identification of three key topics for the 2024 ESEP: 1) liquidity and funding risk; 2) interest rate risk; and 3) recovery operationalisation.

12. In selecting the key topics for the 2025 ESEP, the EBA has followed a process of engagement and consultation with the EU competent authorities, while input from its risk analysis work and key

[2] EBA founding regulation

policy developments have been fundamental. The topics that have been identified as key for 2025 include:

i. testing and adjusting to increasing economic and financial uncertainties, informed by a series of intertwined dynamics that intensify volatility in global markets and drive structural changes in the geopolitical landscape, impacting risks attached to financial activities;

ii. digital challenges, in particular ICT risk management and building operational resilience towards the digital transformation, informed by the general increase of ICT/cyber risk, the upcoming implementation of the DORA framework for all EU financial entities, and the persisting challenges in the design and execution of banks' digital transformation strategies; and

iii. transitioning towards Basel III and the EU banking package implementation by ensuring institutions' information systems and capital planning are able to support the revised prudential metrics and corresponding robustness.

13. Section 2 presents the background that drove the selection of these key topics and the relevant expectations towards supervisors. During the year, the EBA may continue to engage with CAs to detail further such expectations, including, where relevant, to reflect the outcome of its policy developments and/or its implementation assessment of the 2024 ESEP.

14. Competent authorities are expected to consider the key priorities set by the 2025 ESEP, but also to organise their supervisory activities based on the structure and specific vulnerabilities of the banking system and the idiosyncratic dimensions of the institutions under their supervisory remit. The EBA will acknowledge quickly changing economic and market conditions, and developments in local markets that may warrant the (re)prioritisation of supervisory tasks.

15. The EBA will use the most appropriate convergence tools at its disposal to conduct the assessment of the implementation of the 2025 ESEP i.e. how these topics have informed the priorities setting and activities of supervisors in 2025. Apart from the usual questionnaire and desk-based review, the EBA may embrace (an) additional tool(s) in the follow-up, as applicable, for example bilateral visits to CAs or peer reviews, which would allow for a more granular and/or dedicated assessment of the consistency of the supervisory reviews and measures as per Article 107 of the CRD. The EBA will also monitor the level of implementation in the work of closely monitored colleges. The observations collected will feed into the overall conclusions on the degree of convergence of supervisory practices for the 2025 cycle.

# 2. Key topics for supervisory attention for 2025

## Key topic 1 – Testing and adjusting to increasing economic and financial uncertainties

16. The EBA's risk assessment report[3] stresses that global uncertainties are persistently elevated amid the war in Ukraine and the Middle East crisis, but also tensions for instance in the Caucasus and between China and Taiwan. Trade tensions between the US, Europe and China add to the overall uncertainty. These events do not only take a huge humanitarian toll, but also have a material impact on energy and supply chains which has created inflationary pressures not seen for many decades in Europe.

17. Imposition of financial restrictions, increased uncertainty and cross-border credit and investment outflows triggered by an escalation of tensions could increase banks' debt rollover risks and funding costs. It could also drive up interest rates on government bonds, reducing the values of banks' assets and adding to their funding costs. At the same time, geopolitical tensions are transmitted to banks through the real economy. The effect of disruptions to supply chains and commodity markets on domestic growth and inflation could exacerbate banks' market and credit losses, further reducing their profitability and capitalisation. While there are no significant signs raising concerns at the moment, the quality of banks' assets may start to deteriorate again if geopolitical risks materialise or high inflation coupled with tighter financing conditions challenges the debt servicing capacity of households and non-financial corporations. In that respect, institutions are expected to be prepared to withstand emerging risks and shocks from a financial perspective, including by setting aside the necessary funds to cover expected losses.

**Supervisors should**:

- Assess institutions' ability to have their stress testing and adjusting abilities coherent and at best levels in all areas, given that strategies, risk appetite and business model are being shocked more quickly and more often amid rising geopolitical risks and quickly changing macroeconomic environments. This includes monitoring of deleveraging of exposures towards potentially politically high-risk countries. In this regard, supervisors should assess whether institutions have established an appropriate risk management framework and risk management processes, including risk appetite and stress testing framework, to adequately assess, monitor and mitigate, if needed, the impact of relevant events/developments. In particular, institutions' effort should be supported by appropriate stress testing capabilities[4], consistently deployed including in the

[3] Risk assessment report of the European Banking Authority – December 2023 (europa.eu)

[4] In this context, supervisors should also rely on the EBA Guidelines on institutions' stress testing (EBA/GL/2018/04) as well as on the EBA SREP Guidelines for credit institutions under Directive 2013/36/EU.

context of the internal capital adequacy assessment process (ICAAP) and internal liquidity adequacy assessment process (ILAAP). Supervisors should assess whether institutions' stress testing is well embedded into their governance structure and effectively channelled into management actions, in particular with regard to identified limitations, vulnerabilities and shortcomings detected.

- Assess whether institutions have in place realistic and credible contingency and recovery plans able to react to severe scenarios that may include, for example, further armed conflicts and terrorist attacks, but also major financial market turmoil or severe digital outages, and making extensive use of reverse stress testing.

- Monitor the impact of the rising geopolitical risks and quickly changing macroeconomic environments, especially for certain more vulnerable portfolios (such as corporate real estate, SMEs and leveraged finance) and continue promoting a high-quality and consistent application of the IFRS 9 framework. Enhanced supervisory scrutiny of the expected credit loss (ECL) models adopted by institutions is necessary, including with a view to following up on the main observations and findings highlighted in the EBA's monitoring reports, which represent a good basis to ground future supervisory findings and remedial action requests.

## Key topic 2 – Digital challenges

18. The EBA's June 2024 risk assessment report[5] notes that cyber risks and data security rank the highest among operational risks, followed by conduct and legal risks as well as fraud. Indications are that cyber-attacks have been on the rise, including successful ones. Furthermore, the IMF in its April 2024 Global Financial Stability Report[6] warns that the risk of extreme losses from cyber incidents is increasing, noting that such losses could potentially cause funding problems for companies and even jeopardise their solvency. This evidences the need to continue working towards building defences across the EU financial sector, to strengthen ICT/cyber security and to ensure EU banks will be able to remain resilient through a severe operational disruption.

19. At the same time, the new legislation on digital operational resilience (DORA) becomes applicable from 17 January 2025 onwards, setting harmonised requirements across the EU financial sector and developing a Single Rulebook and system of supervision to also cover digital operational resilience. DORA strengthens the mandates of competent authorities to enable them to supervise more specifically the management of ICT risk in the financial sector in order to protect the integrity and efficiency of the internal market and to facilitate its orderly functioning.

20. DORA covers four key pillars: ICT risk management, ICT-related incident reporting, digital operational resilience testing and ICT third-party risk management. With this in mind, and also the expectation for all EU financial entities to be compliant with the legal requirements from January 2025 onwards, dedicated supervisory focus and efforts are needed from competent

[5] Risk assessment report - July 2024 | European Banking Authority (europa.eu)

[6] Global Financial Stability Report, April 2024 (imf.org)

authorities to assess compliance with DORA, in particular in the areas of the four key pillars. Recognising that DORA significantly increases the expectations towards institutions and supervisors, the 2025 ESEP focuses on specific elements per key pillar that have been identified as essential to be met already in 2025.

21. Furthermore, the digital transformation, that was included among the key priorities in the 2023 ESEP, remains high on the agenda of the EBA and competent authorities. The EBA's 2023 supervisory convergence report[7] confirmed that an area of improvement for institutions is the competencies of board members regarding digital topics and the monitoring of the success of the digital transformation, as compelled also by intensifying competition from non-bank players and the development of new powerful tools (e.g. AI). The digital transformation requires changes in IT systems and new investments. It could also impact the business model of institutions and require a better analysis and management of the risks related to ICT.

**Supervisors should:**

- Assess financial entities' plans and actions towards ensuring effective and prudent management of ICT risk, including a well-documented ICT risk management framework which encompasses a digital operational resilience strategy and related policies.
- Assess (i) whether financial entities classify ICT-related incidents and cyber threats in accordance with the related DORA technical standards, and (ii) whether financial entities are able to report in a timely manner major ICT-related incidents to their competent authorities.
- Review the adequacy and scope of the financial entities' digital operational resilience testing programme and assess the preparedness of significant banks to perform threat-led penetration tests in accordance with DORA requirements, including relevant technical standards.
- Ensure that the register of information in relation to all contractual arrangements on the use of ICT services provided by ICT third-party service providers and timely submission to competent authorities is in place, compliant with relevant technical standards and effectively used for monitoring ICT third-party risk.
- Assess the ability of the management function to collectively develop and drive the institution's digital strategy and the impact of the transformation on the institution's business model and risk profile.

**Relevant regulatory products for Topic 2 – ICT risk / operational resilience**

*The ESAs have published a number of regulatory products to supplement the DORA regulation. The first batch of these products was published in January 2024 and includes final draft RTS on: the ICT risk management framework, the simplified ICT risk management framework, the criteria for the classification of ICT-related incidents, and the policy on ICT services supporting critical or*

[7] 2023 Convergence Report.pdf (europa.eu)

*important functions provided by ICT third-party service providers (TPPs). It also includes final draft ITS on the register of information.*

*The second batch of related policy products is expected in July 2024 and includes (among others) final draft RTS on: reporting of ICT-related incidents, subcontracting of critical or important functions and threat-led penetration testing, as well as final draft ITS on the content, timelines and templates for incident reporting, and Guidelines on aggregated costs and losses from major incidents.*

*All the supplementary legislation is expected to become applicable from 17 January 2025 (DORA application date) and it will supersede any overlapping existing sectorial guidance.*

## Key topic 3 – Transitioning towards Basel III and the EU banking package implementation

22. The banking package that implements the Basel III framework in the EU includes a full revision of the CRR and CRD with regard to the prudential metrics and encompasses various innovations in the prudential framework for credit institutions. Supervisors are expected to guide, facilitate and assess institutions' transition to the revised regulatory framework by focusing in particular on how information systems and capital planning are able to support the revised prudential metrics and corresponding robustness.

23. For example, with regard to credit risk, the new framework enhances the risk sensitivity of the Standardised Approach and puts in place adequate safeguards for internal modelling to reduce undue variability of model outcomes. To ensure a smooth operational implementation of the banking package, the EBA encourages institutions and competent authorities to engage in an active dialogue to discuss the details of the targeted model landscape that will be used after CRR III implementation from 1 January 2025 onwards.

24. In addition, the CRR introduces a new Standardised Approach for operational risk and eliminates the possibility of using an advanced measurement approach. The policy guidance the EBA provides, in line with the mandates it received, covers the elements necessary for the calculation of the capital requirements, specifically concerning the business indicator, the establishment and maintenance of the operational risk loss database, and the requirements related to the governance and the risk management framework for operational risk.

25. Risk data aggregation and institutions' information systems, which have been included in previous years' ESEPs, become even more crucial in light of the new EU regulatory package implementation. The EBA's 2023 supervisory convergence report underlined that, even though institutions' overall capabilities have in general increased in recent years, a significant proportion of banks have not reached full compliance with supervisory expectations, which

continue to grow. Thus, improvements in institutions' risk data aggregation capability and quality of data need to progress further and require special attention.

**Supervisors should:**

- Assess institution's ability to understand, calculate and comply with the regulatory requirements of the banking package that implements the Basel III framework in the EU, given that it encompasses a number of innovations in the area of credit risk, market risk, operational risk, reporting and disclosure, governance and ESG.

- Review institution's capital planning abilities, in particular the capital adequacy of banks and banks' capital management processes. Supervisors should assess institutions' ability to fulfil all of their capital-related regulatory and supervisory requirements and demands and to cope with other external financial constraints on an ongoing basis, including by projecting and assessing regulatory changes and challenges from the implementation of the new regulatory package.

- Assess institutions' ability to design, build and maintain data architecture and IT infrastructure which fully support their risk data aggregation capabilities and risk reporting practices – not only in normal times but also during times of stress – in line with the EBA SREP GLs and Basel Principles. Furthermore, supervisors should consider escalating their actions and measures in the event of longstanding material deficiencies in risk data aggregation and risk reporting, in particular when insufficient progress is identified in closing gaps with respect to supervisory expectations and compliance with the regulatory framework.

- Engage in a thorough dialogue with institutions to assess their management's ability to clearly identify and ensure the quality of target data and the resulting requirements for data and IT governance, processes and systems in light of the implementation of the new regulatory package. For example, with regard to credit risk, supervisors should assess institutions' ability to produce data that will enable them to make a thorough assessment of their rating systems, the possibility to move to less sophisticated approaches for a type of exposure or for one or more exposure classes and the implementation of the new requirements regarding credit risk mitigation. With regard to operational risk, data aggregation capabilities of institutions are expected to be assessed with regard to the calculation of the capital requirements, specifically concerning the business indicator and the establishment and maintenance of the operational risk loss database.

# 3. Further considerations

26. Climate-related and broader ESG risks are increasingly in banks' and supervisors' focus given the increases in relevant risk drivers such as intensification of extreme weather events translating into higher physical risks, or higher risks of disorderly transmission, for example due to geopolitical tensions. Thus, it is important that CAs continue to monitor institutions' efforts to appropriately reflect ESG risks in their business strategies, governance and risk management processes. The EBA also gives greater consideration to tackling climate-change-related risks – transition and physical – through adequate methodologies, data and scenarios while improving its stress test approach.

27. EU/EEA banks' liquidity has in broad average terms remained good in recent quarters, despite TLTRO repayments and other challenges. However, monitoring the evolution of EU banks' liquidity indicators remains particularly relevant amid the current environment of higher interest rates as well as the gradual removal of excess liquidity by central banks, e.g. through the expected maturity of TLTROs and the announced unwinding of past asset purchases. Furthermore, funding should be managed cautiously, using windows of opportunity for debt issuances. Keeping a diverse funding mix has become even more important now than in the past. Supervisors are expected to proactively accompany banks in their respective measures.

28. Finally, the institution-specific nature of the SREP should guide supervisors in the bank-specific supervisory review, where all material idiosyncratic risks should be assessed.

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