EBA BSG 2022 078 Rev 1

Banking Stakeholder Group

2 February 2022

# Banking Stakeholder Group – December 2021 - Draft minutes

## **Agenda Item 1:** Adoption of the minutes of the last meeting and of the agenda

1. The BSG chair informed that the minutes of the joint BoS-BSG of 28 October were sent for comments via written procedure and that the EBA received some minor drafting suggestions. The outcome was communicated via email. Concerning the BSG minutes of 29 October, the EBA received minor corrections.

**Conclusion**

2. The BSG approved the agenda of the meeting and the minutes of 29 October 2021 meeting.

## **Agenda Item 2:** BSG update on the latest developments

1. The BSG chair welcomed a new member to the Committee from the financial services constituency: Yuri Che Scarra.
2. The BSG chair outlined the BSG outputs since the last meeting, namely: i) BSG statement on Sustainable Finance for COP26; ii) the BSG response to EBA Consultation Paper on the Guidelines on the role, tasks and responsibilities AML/CFT compliance officers (EBA/CP/2021/31); iii) BSG Response to EBA Consultation Paper on amending RTS on SCA and CSC under PSD2 (EBA/CP/2021/32); iv) BSG Own Initiative Paper on “Digitalisation: Challenges for consumers”.
3. She also reminded the participants that the BSG was organising a closed-door event on Basel III on 26 January 2022 with high-level speakers from different constituencies.

## **Agenda Item 3:** EBA update on general developments

4. The EBA chairperson provided an update on major developments since the last BSG meeting of 29 October. He started by mentioning the publication of the quarterly risk assessment which showed improvements in EU banks solvency, profitability and liquidity, but where asset price corrections was still a cause of concern. He continued by informing that the EBA published a report summarising the findings arising from the monitoring activities on the IFRS 9 implementation by EU institutions. He explained that the aim of the report was to assist

supervisors in evaluating the quality and adequacy of IFRS 9 Expected Credit Loss (ECL) models, in order to contribute to a high-quality and consistent application of the IFRS 9 standard in the EU. In line with the IFRS 9 Roadmap, the chairperson said that the EBA would continue monitoring and promoting consistent application of IFRS 9, as well as working on the interaction with prudential requirements. Moreover, he also provided some milestones in the execution of the investment firms roadmap, such as the completion of the revision of the i) Guidelines on internal governance and ii) Guidelines on sound remuneration policies for investment firms under the Investment Firms Directive (IFD).

5. The EBA chairperson mentioned the statement publication on the occasion of the COP26, which came alongside that prepared by the BSG. He acknowledged the finalisation of two projects for which the BSG had provided input: the RTS on individual portfolio management of loans and the GL on recovery plan indicators.

6. He informed of the publication of the EBA work programme for 2022 where the EBA outlined its priorities as well as outputs and deliverables for the year.

7. The EBA chairperson also mentioned the publication of a discussion paper on machine learning to be used in the context of internal ratings-based (IRB) models to calculate regulatory capital for credit risk. He explained that the aim of the discussion paper was to set supervisory expectations on how new sophisticated machine learning models could coexist with and adhere to the Capital Requirements Regulation (CRR) when used in the context of IRB models.

8. He also highlighted the publication of the Supervisory Examination Programme (ESEP) for 2022, which identified key topics for supervisory attention across Europe. In detail, he explained that the ESEP was aimed at informing prudential supervisors’ planning processes and shaping their supervisory practices.

9. To conclude, the EBA chairperson mentioned that the EBA was finalising its answer to the call for advice on digital finance to be submitted to the EC by end of January and an Opinion on the scale and impact of de-risking in the EU and the steps competent authorities should take to tackle unwarranted de-risking.

## **Agenda Item 4:** Update on risks and vulnerabilities in the EU

10. EBA staff updated the BSG on: i) recent financial markets developments; ii) on findings, outlook and policy implications described in the latest edition of the EBA Risk Assessment Report (RAR); and publication of the 2021 EU-wide transparency exercise – published alongside the RAR.

11. Regarding recent market developments, EBA staff underlined the materialisation of financial markets vulnerabilities amid Omicron spread and EUR repo market issues amid central bank measures.

12. EBA staff outlined the main elements identified in the RAR: despite NPL ratio improvement during the pandemic, the handling of poor-quality loans varied across jurisdictions, in a general context of expected mortgage growth. He confirmed that structural profitability challenges remained whilst operating expenses are rising.

13. EBA staff noted that banks maintained comfortable capital and liquidity buffers: CET1 ratio stood steady at 15.8% since 2020 and buffers were above capital requirements. It was noted

that albeit favorable wholesale funding and increasing deposits, the reliance on central bank funding remained. Concerning ESG bonds, it was said that these substantially increased amounting 20% of the issuances.

14. To conclude, EBA staff said that the RAR included some recommendations around policy implication and measures: the report suggested to have appropriate credit quality of newly originated loans; underscored the need to factor ESG related risks to their business strategies and governance; the need to source alternatives to central bank funding; to maintain prudent capital distribution policies; and to have effective ICT security arrangements. Last yet importantly, the report advocated for a strengthened cooperation between prudential, AML/CFT, FIU.
15. One BSG member advocated for the availability and quality of ESG data for which private and public sector would need to work together. She continued by saying that the finalisation of Basel III will hit jurisdictions with poor quality loans. She noted that asset price increase was of a concern but that it was natural that the excess of liquidity is invested in financial and housing markets.
16. Another BSG member expressed his concern about the inflation pick-up and subsequent rise in interest rates which, in turn, could prompt asset price corrections - several members shared such concerns particularly from a consumer viewpoint. In that context, a BSG member stressed that mortgages could become unaffordable for consumers.
17. EBA staff agreed that the ESG data quality has room for improvement and pointed out that this was identified in the RAR. EBA staff concurred that overvaluations were driven by low rates and monetary policy and reassured that the EBA was closely monitoring the evolution. Regarding rising inflation, EBA staff noted that that interest rate increases were already observed in several CEE countries and in Norway.
18. One member asked whether EBA saw structural underlying factors in the mortgage market as a factor that could explain why households continue to invest in housing despite the uncertainty; and whether EBA saw risks in the phase-out of central bank funding. Another BSG advocated for a more harmonised mortgage market across the EU. She also observed that a continuous renewal of TLTRO would come to an end eventually.
19. EBA staff said that factors explaining the quick recovery of housing markets were increased savings and changes in consumer trends following the pandemic. He said that the phase out of TLTRO was expected to come gradually.
20. Regarding moratoria, one BSG member enquired if there was a deeper insight on the percentage of loans under moratoria and their corresponding stage. EBA staff confirmed that these were reduced dramatically but that high NPL and Stage 2 ratios remained. He clarified that AQ of loans under moratoria and with expired moratoria was evolving in parallel and that a similar trend is observed in PGS loans.
21. On AML risks, one BSG member pointed out that the RAR stated that the pandemic had enticed banks to take on more AML risks and enquired where did the factual data come from. EBA staff said that the report identified risks related to the pandemic such as remote onboarding or also pandemic product related risks (like PGS loans). It was clarified that this information came from dialogue among supervisors and the RAQ.

## **Agenda Item 5:** Presentation of the call for advice review of the macroprudential framework for banking

22. The EBA's risk analysis and stress testing Head of Unit presented the review of the EU macroprudential framework by the European Commission and their successive calls for advice to EBA, ESRB and ECB by March 2022. He explained that the review focused on the overall design and functioning of the buffer framework, missing and obsolete instruments, internal market considerations and global risks. He elaborated that the EBA analysis would focus on the following: simplify and clarify macro-prudential instruments and its procedures; ensure a level playing field (e.g. harmonise the methodology for setting O-SII buffer rates); and ensure that macroprudential tools are appropriate to address new risks such as those derived from environmental, Fintech, cyber and crypto changes.

23. A BSG member perceived as missing the level of application in virtue of consolidated, sub-consolidated or solo basis on the O-SII buffer. He underlined that this was relevant for the interaction between MREL and capital requirements.

24. Another member welcomed the review and its timing and invited the EBA to help set principles so that the counter cyclical buffer (CCyB) could become more measurable and predictable.

25. One BSG member explained that with the Maximum Distributable Amount (MDA) provision, the CRD offers a complex but clear and proportionate mechanism to reduce distribution progressively as losses increased. She explained that the framework was ignored by supervisors who imposed full retention of earnings above the trigger where the MDA would be reached. She advocated for a revised definition of each buffer to ensure full clarity and avoid overlaps in the new framework. In particular, she called for a clear distinction between idiosyncratic buffers and systemic buffers.

26. The EBA head of unit confirmed that the EBA aimed to provide more clarity and more harmonisation on O-SII buffers (as already set out in the EBA report on the calibration of buffer rates, published in late 2020) and opined that it was premature to conclude on the MREL interaction with buffer usability. He concurred with the calls to review the CCyB in relation to the indicators used for its activation/release.

27. One member was of the view that further clarity was necessary on the usability of buffers. He pointed out that even with positive/high CCyB, banks were reluctant to use them given the expectation that the buffer would be immediately required back at normal levels after crisis.

28. The EBA head of unit agreed that there was no guidance on the restore process of the buffers. He noted that systemic risk buffers should be used on structural risks even though guidance was missing in this regard. He also remarked that with the CRD6, some clarifications will be brought forward that should ease the calculation of banks' overall buffer requirements.

## **Agenda Item 6:** BSG Own Initiative Paper on Digitalisation: Challenges for consumers

3. A BSG member presented their own initiative paper which reminded of the priorities of the EC's digital finance and the retail payments strategies which are closely interlinked. She outlined the main challenges of digital financial services from a consumer viewpoint and she called for clarity on the responsibilities of supervisory authorities and adequate complaint mechanisms for consumers.

4. She stressed the issues of financial and digital exclusion of consumers and in particular vulnerable ones such as elderly and younger population and the need to take into account the economic conditions of individuals to access digital services. The BSG presentation also touched upon the risks of exclusion created by a cashless society and the need to ensure a balance transition facilitating a sufficient network of ATM and to provide mechanisms to give consumers the security of custody of their digital economy together with barriers against cyber-crime. The paper also insists on the need for regulatory systems in charge of auditing the quality of the processes and guaranteeing regulatory compliance.
5. The BSG paper also elaborated on the challenged for consumers stemming from the AI regulation proposal from the EU Commission in which it considers that there are limited range of AI uses and aspects covered and an omission of consumer aspects.
6. The Head of the EBA's Conduct, Payments and Consumers (COPAC) welcomed the paper and noted that the majority of the issues raised were already being addressed by the Commission. He focused on those explicitly linked to the EBA's work. Concerning financial inclusion as a result of digitalisation, the head of unit started by clarifying that the EBA does not have mandate in this area and any work on this front would be of own initiative. He however informed that the EBA was aware of instances of financial exclusion in relation to the application of the PSD2 requirements. He explained that concretely some banks had decided to comply with requirements under PSD2 and the EBA's Technical Standards by requiring customers to use, and therefore own, a smart phone. It was clarified that this was not a requirement under the PSD2 or the RTS but was a choice of banks that had led to the unintended policy consequences with some customers at risk of being financially excluded. He concluded by informing instances of that kind were being considered on the ongoing work by the EBA in virtue of the EC's call for advice on the review PSD2.
7. Concerning the AI proposal by EC, the EBA head of unit predicted little steps to be taken by the EBA or the ESAs on this front also to avoid duplication of tasks. He however informed that the EBA would continue monitoring the file.
8. Regarding consumer education, he explained that the EBA was mandated to coordinate in the area of financial education and literacy but had not a mandate with regards to convergence.

## **Agenda Item 7**: EBA presentation on the Work Programme 2022

29. The EBA Executive Director provided the context that shaped the preparation of the EBA's work programme for 2022. He said that in order to foster synergies and efficiencies, the 2022 work plan had a reduced number of activities (streamlined by 30% compared to 2021) and benefitted from an adjusted organisational structure. The Executive Director outlined the main priorities - the so-called vertical priorities, namely: i) monitor and update the prudential framework for supervision and resolution; ii) revisit and strengthen the EU-wide stress testing framework; iii) banking and financial data: leverage EUCLID; iv) Digital resilience, Fintech and Innovation: deepen analysis and information sharing; and AML/CFT: contribute to a new EU infrastructure. He also introduced the horizontal priorities – of cross-cutting nature: i) ESG: provide tools to measure and manage risks; and ii) COVID-19: monitor and mitigate the impact. EBA staff took the floor to elaborate on the different deliverables expected under the different EBA activities and reminded of the importance of the BSG input to the EBA consultations. To

conclude, EBA staff underscored some of the planned upcoming consultations and said would continue keeping the BSG informed in advance on its public consultations.

30. A BSG member proposed to have a discussion at an upcoming BSG meeting on the EBA work in providing tools to measure and manage ESG risks. He suggested to have an exchange of views on the first experiences in view of the data access issues identified.

31. One BSG member enquired on the call for advice on securitisations. The EBA chairperson provided the main details for the call for advice and informed that there would be an industry outreach in 2022.

## **Agenda Item 8:** EBA presentation on the LCR report (A-point)

32. EBA staff presented the report whose objective is to monitor banks' short-term liquidity risk profiles on an annual basis. The report was divided in 5 main sections: i) analysis of the LCR and its components; ii) analysis of the LCR by business models; iii) LCR analysis of currency mismatch; iv) LCR impact on lending; and v) the unwind mechanism of the LCR. EBA staff confirmed that the sample contained 298 banks from 27 EU Member States plus two EEA/EFTA countries which tallied to 88.5% coverage of the total assets of the EU banking sector.

33. EBA staff explained that whereas weighted EU average LCR stood at 176%, with only one bank with LCR shortfall for the first half of 2021, a significant increase in LCR was observed for the second half of the year. It was further explained that this was driven by the increase in net cash outflows from GSIIs/OSIIs that partially offset the increase in the banks' holdings of high quality liquid assets (HQLAs) justified by the additional liquidity extended by the ECB and other EU central banks. The increase in outflows was driven by an increase in outflows from non-operational deposits.

34. EBA staff expanded on the trends in relation to business models. Retail-oriented banks had the highest LCR level whereas universal banks showed the lowest LCR. Cooperative banks, mortgage banks and savings banks, showed the highest share of outflows to retail deposits. For cross-border universal banks and local universal banks, the share of wholesale funding was also important but also had an important share of retail deposits. Public banks, custodian banks and pass-through banks did not have outflows related to retail deposits.

35. EBA staff touched upon mismatches in the LCR, highlighting that as of June 2021 the average LCR USD was 88.6%, significantly below the LCR all currencies for the same sample (158%).

## **Agenda item 9:** EBA IFRS9 monitoring report

36. EBA staff presented the findings of this report which aimed to assist supervisors in evaluating the quality and adequacy of IFRS 9 Expected Credit Loss (ECL) models, in order to contribute to a high-quality and consistent application of the IFRS 9 standard.

37. The EBA analysis identified that the level of judgement embedded in the standard left open the possibility to use a wide variety of practices which would merit further scrutiny by the EBA. As for staging assessment, deserved attention was needed to the combination of absolute and relative thresholds, and approaches implemented on the Significant Increase in Credit Risk (SICR) assessment, where there is a very limited use of the notion of collective assessment for

borrowers with common characteristics, which is unexpected in the context of an environment of high economic uncertainty, such as the COVID-19 crisis.

38. With specific reference to ECL parameters and model inputs, it was said that the IFRS 9 12 month PD estimates and variability generally increased during the pandemic, due to the incorporation of forward looking information (FLI) and their point in time nature. The report observed differences in the approaches used for the incorporation of FLI, which could have some impact on the severity of the assumptions underlying the scenarios used for the ECL modelling, and which would also deserve further consideration from supervisors.

39. Regarding classification and measurement, a wide array of practices were observed in the context of the IFRS 9 business model assessment, where also further scrutiny and guidance was deemed necessary. In terms of recognition and derecognition of financial instruments, the report observed some discrepancies in the derecognition of financial assets (like high percentages of recoveries after write offs) and/or recognition of accrued interest.

40. Furthermore, the EBA observed that a limited number of institutions made use of the IFRS 9 amended transitional arrangements introduced by the ‘quick fix’ of the Capital Requirements Regulation (CRR), representing a CET1 benefit of 119 bps as of December 2020.

41. The COVID-19 pandemic resulted in extraordinary circumstances that pushed IFRS 9 models outside their ordinary working hypothesis, thereby increasing the use of overlays at the level of IFRS9 risk parameters or directly at the level of the final ECL amount. EBA staff outlined as next steps the continued monitoring of the use of overlays across EU institutions in order to understand whether (and to what extent) institutions will adjust their ECL models to incorporate the effects currently captured via overlays/manual adjustments, how many of the overlays will be maintained and for how long.

## **Agenda item:** AoB

42. One BSG member requested to have in a future meeting a presentation of the main findings of the EBA report highlights shortcomings in the application of its Guidelines on the remuneration of sales staff .

## List of participants:

### Consumers

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| Monica | Calu | Asociatia Consumers United/Consumatorii Uniti | Romania |
| Tomas | Kybartas | The Alliance of Lithuanian consumer organisations | Lithuania |
| Vinay | Pranjivan | Associação Portuguesa para a Defesa do Consumidor | Portugal |
| Patricia | Suárez Ramírez | Asufin | Spain |
| Martin | Schmalzried | Confederation of Family Organisations in the EU | Czech Republic |

### Employees' representatives of financial services

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| Andrea | Sità | UILCA Italian Labor Union - credit and insurance sector | Italy |

### Financial institutions

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| Eduardo | Avila Zaragoza | BBVA Group | Spain |
| Yuri Che | Scarra | UBS | Italy |
| Sèbastien | De Brouwer | European Banking Federation | Belgium |
| Erik | De Gunst | ABN AMRO Bank | Netherlands |
| Søren | Holm | Nykredit Realkredit | Denmark |
| Christian | König | Association of private Bausparkassen | Germany |
| Julia | Kriz | Raiffeisen bank International AG | Austria |
| Johanna | Lybeck Lilja | Nordea Bank | Sweden |
| Vèronique | Ormezzano | BNP Paribas | France |
| Maria | Ruiz de Velasco | SIBS | Spain |
| Sebastian | Stodulka | European Savings and Retail Banking Group (ESBG) & World Savings and Retail Banking Institute (WSBI) | Austria |

### Representatives of SMEs

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| Constantinos | Avgoustou | Founder and Non-Executive Director of several enterprises | Cyprus |

### Top-ranking academics

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| Rym | Ayadi | City University of London, Business School and CEPS | EU |
| Concetta | Brescia Morra | University Roma Tre | Italy |
| Edgar | Löw | Frankfurt School of Finance & Management | Germany |
| Monika | Marcinkowska | University of Lodz | Poland |

### Users of Banking Services

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| Alin Eugen | Iacob | Association of Romanian Financial Services Users | Romania |
| Poul | Kjær | Copenhagen Business School | Denmark |

**EBA Directors**

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| Chairperson | Jose Manuel Campa |
| Executive Director | Francois-Louis Michaud |

**EBA staff**

Philippe Allard; Dirk Haubrich; Angel Monzon; Andreas Pfeil, Marina Lopez; Simone Casellina; Christian Moor; Erika Solé.