



# REPORT ON CONVERGENCE OF SUPERVISORY PRACTICES

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**EBA**

EUROPEAN  
BANKING  
AUTHORITY

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# Abbreviations

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AML	anti-money laundering	IRRBB	interest rate risk in the banking book
BCBS	Basel Committee on Banking Supervision	IT	information technology
BMA	business model analysis	ITS	implementing technical standards
BRRD	Directive 2014/59/EU (Bank Recovery and Resolution Directive)	LDP	low default portfolio
CEBS	Committee of European Banking Supervisors	LGD	loss given default
CFO	chief financial officer	LMS	learning management system
COREP	Common Reporting Framework	LSI	less significant institution
CRD	Directive 2013/36/EU (Capital Requirements Directive)	MDA	maximum distributable amount
CRR	Regulation (EU) No 2013/575 (Capital Requirements Regulation)	MiFID	Markets in Financial Instruments Directive
CTF	counter-terrorist financing	MREL	minimum requirement for own funds and eligible liabilities
DGS	deposit guarantee scheme	NPE	non-performing exposure
EBA	European Banking Authority	NPL	non-performing loan
EEA	European Economic Area	OCR	overall capital requirements
EIOPA	European Insurance and Occupational Pensions Authority	O-SII	other systemically important institution
ERA	Academy of European Law	P2G	Pillar 2 capital guidance
ESAs	European Supervisory Authorities	P2R	Pillar 2 capital requirements
ESMA	European Securities and Markets Authority	PD	probability of default
FINREP	Financial Reporting Framework	Q&A	questions and answers
FinTech	financial innovation and financial technology	RTS	regulatory technical standards
FoLTF	failing or likely to fail	RW	risk weight
GRP	group recovery plan	RWAs	risk-weighted assets
HDP	high default portfolio	SCPS	Standing Committee on Payment Services
ICAAP	internal capital adequacy assessment process	SREP	supervisory review and evaluation process
ICT	information and communication technology	SSM	Single Supervisory Mechanism
IFRS	International Financial Reporting Standard	TSCR	Total SREP capital requirements
IRB	internal-ratings based	SVB	supervisory benchmarking

## Executive summary

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This report provides a summary of the EBA's observations regarding the current convergence of supervisory practices and the EBA's activities carried out in 2018 to promote this convergence in accordance with its mandates as set out in its Founding Regulation and in Article 107 of the CRD.

Based on these mandates, the EBA used the different tools at its disposal to promote supervisory convergence and implement its convergence strategy.

It analysed the information collected on supervisory practices, in particular during bilateral convergence visits, the organisation of peer reviews and its participation in colleges of supervisors. It also developed regulatory products (i.e. supervisory methodologies and procedures for supervisors) in areas where the monitoring of practices had shown a need for additional guidance or where international standards had been updated. With, in particular, the implementation of online training in-house, it expanded its training activities that provide the foundations for a common approach to supervisory practices.

In 2018, the EBA continued to use the bilateral convergence visits that were first introduced in 2016 and are seen as a mutually beneficial tool for both the EBA and the authorities as they allow direct, constructive and in-depth bilateral dialogue on the practical implementation of the Single Rulebook and provide feedback to the EBA policy development process. While in 2016 and 2017, these visits covered the application of the SREP Guidelines, in 2018, they covered the continuum between ongoing supervision, recovery and resolution.

### **2018 assessment of the convergence of supervisory practices**

#### **- *Convergence in ongoing supervision and the supervisory review and evaluation process***

In 2018, a good degree of progress was made by the competent authorities in the implementation of the 2014 SREP Guidelines as well as in taking forward the recommendations and observations made by the EBA during the 2016 and 2017 bilateral convergence visits.

Despite the progress achieved, the EBA has identified areas of the SREP where authorities still face challenges to converge, mainly in the areas of the methodologies for capital adequacy assessments and the articulation of institution-specific additional own funds requirements, and in the link between ongoing supervision, early intervention, and resolution.

Most of the areas identified as being in need of further progress in the 2016 and 2017 convergence assessments have been reflected in the EBA policy work on Pillar 2 that led to the publication of the revised SREP Guidelines in 2018. The convergence work in general and the bilateral visits in particular form an important feedback loop for the Pillar 2 policy work in this respect.

In other supervisory areas, progress has been observed in the supervisory use of benchmarking for the ongoing review and the initial authorisation of internal models as well as on the assessment of remuneration practices, which benefited from the significant monitoring work of the EBA in fostering supervisory convergence.

- ***Convergence in the continuum between ongoing supervision, recovery and resolution***

Establishing a continuum between ongoing supervision, recovery and resolution is a quite new consideration given the relative novelty of the BRRD. It is clear that significant benefits for convergence can stem from the analysis of the consistency across the various stages of supervision and resolution. The EBA is well placed to identify ways of reaping these benefits and thereby enhance convergence. During the 2018 bilateral convergence visits organised on this topic, the EBA observed in particular that authorities have developed internal procedures specifying the approaches to be followed, for instance when determining whether or not an institution is failing or likely to fail, or when granting waivers or simplified obligations. The implementation of these sets of procedures, which take into account the Single Rulebook, contributes to ensuring the convergence of supervisory practices.

However, key aspects still require improvements. In particular, efforts need to be made to ensure that all the institutions that do not benefit from a waiver have developed a recovery plan. Moreover, the selection and calibration of recovery indicators still have weaknesses that need to be considered and addressed.

The 2018 bilateral convergence visits, as well as the exchanges of views in the working groups, allowed the EBA to build a more comprehensive view on how the BRRD framework is applied to less significant institutions (LSIs) and resulted in the creation of a feedback loop that will inform its policy work.

**Expectations and next challenges**

Monitoring and assessing the convergence in the practical applications of the Single Rulebook, addressed to competent authorities, are necessary ongoing activities in light of their continuous development.

The EBA policy products in the field of supervisory practices aim to address supervisory needs and areas where divergent supervisory practices and/or outcomes have been identified based on past convergence assessments. In 2017 and 2018, the EBA completed policy work of the utmost importance aiming to promote the convergence of supervisory practices among competent authorities. In particular, it published guidelines in various areas such as those developed to reinforce the EU SREP framework and those developed to improve and harmonise the institutions' sound governance arrangements.

EBA products, in particular the guidelines, will provide a reference for future monitoring and assessment of the convergence of supervisory practices. In the coming years, the EBA will pay great

attention to the compliance with these products/guidelines and will carefully monitor their effective implementation by competent authorities.

The EBA will also pursue the follow-up of the recommendations and observations made during the bilateral convergence visits.

In 2019, as mentioned in its convergence plan, the EBA will review the approach applied by the competent authorities to monitor and assess a list of key supervisory topics with a focus on areas in which EBA policy products have recently been developed. The EBA will use the convergence tools at its disposal to conduct this review.

The EBA will continue to engage with colleges of supervisors by promoting the consistent application of the Single Rulebook, particularly in joint decisions on capital, liquidity and recovery plans, and by drawing supervisory attention to the key topics listed in the convergence plan.

The development of the Single Rulebook and its effective and consistent application will remain the core business of the EBA in the coming years, as the EBA is still likely to have a significant amount of regulatory mandates following (i) the endorsement of the CRD V-CRR II-BRRD II package and (ii) the preparation for the implementation of the last elements of the Basel III framework. In 2019, the EBA will compile the inventory of changes to be embedded into future EBA work programmes.

Training is an important component in achieving a common supervisory culture and convergence in practices. In 2019, as in 2018, the EBA will continue extending its training programme for authorities assisting in the implementation of important policy products and will strengthen the EBA online training platform (EBA learning hub) by updating current modules and launching new ones.



## Background and introduction

As established in its Founding Regulation, the EBA is required to actively foster and promote supervisory convergence across the European Union.

The main tasks/mandates of the EBA include contributing to the establishment of high-quality common regulatory and supervisory standards and practices; ensuring the consistent application of the Single Rulebook, in particular by contributing to a common supervisory culture; contributing to the consistent and coherent functioning of colleges of supervisors; and conducting peer-review analyses of the competent authorities in order to strengthen consistency in supervisory outcomes.

The mandate related to the establishment of common supervisory practices, included in the EBA's Founding Regulation<sup>1</sup>, applies also to the supervisory review and evaluation process (SREP). The mandate related to the convergence of the SREP is specifically mentioned in Article 107 of the CRD, which extends the scope of supervisory convergence to supervisory measures.

Based on the mandate included in Article 107 of the CRD, the EBA must report annually to the European Parliament and the Council on the degree of convergence of the application of the SREP and supervisory measures.

The purpose of the annual report on convergence of supervisory practices, prepared in accordance with these mandates, is to cover the main activities undertaken by the EBA, during the past year, to enhance the supervisory convergence.

Supervisory convergence is a process for achieving comparable supervisory practices across competent authorities that are based on compliance with the Single Rulebook and that lead to consistent supervisory outcomes/measures. Consequently, supervisory convergence includes three components (see Figure 1).

Figure 1: Components of supervisory convergence



The report includes an analysis of the degree of, and progress in increasing, convergence in supervisory methodologies and supervisory measures in practice (Sections 2 and 3). The report covers the convergence in ongoing supervision and SREP (Section 2) and the convergence in the

<sup>1</sup> Under Article 81, the first point assessed in the review of the EBA is an evaluation of the convergence in supervisory practices reached by competent authorities.



continuum between ongoing supervision, recovery and resolution (Section 3). Furthermore, the main points regarding the EBA monitoring of the 2018 supervisory colleges are part of the report (Section 4). The report also provides updates on the policy developments concerning supervisory practices (Section 5) and the training activities (Section 6) supporting convergence of supervisory practices. Finally, the report sets out the convergence plan for 2019 (Section 7).

# 1. EBA tools for pursuing supervisory convergence and its monitoring

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1. The EBA has a number of tools to promote supervisory convergence and implement its convergence strategy, built around three main elements:
  - a. regulatory and policy products;
  - b. training;
  - c. monitoring and assessment.
2. The above elements are complementary and are part of a recursive ‘assess-guide-train’ process. Identification of divergent supervisory practices and supervisory outcomes leads to the development of regulatory products, for which the training tool is used to ensure they are consistently applied.
3. Regulatory and policy products represent a powerful convergence tool, which sets common standards for the practices of competent authorities. A significant part of the Single Rulebook is addressed to the competent authorities, covering various aspects of supervisory work. This is supported by the Q&A tool, which provides a common interpretation of the Single Rulebook, in particular where there are day-to-day supervision challenges in the application of the rules to banks’ approaches. In addition to the Single Rulebook, the EBA also has the mandate to develop and maintain an up-to-date Supervisory Handbook setting out supervisory best practices for methodologies and processes on the supervision of institutions in the EU.
4. Training is also a main tool for the EBA to build a common supervisory culture and to foster convergence in supervisory practices. The EBA prepares its training programme in cooperation with authorities. In 2018, the EBA extended its training programme for competent and resolution authorities assisting in the implementation of important policy products. The EBA offered a total of 27 training events to 1687 attendees in 2018 (compared with 16 training events to 985 attendees in 2017). The 10 events organised in the form of online modules and informational webinars contributed considerably to the expansion of the training programme.
5. The other tools, which consist in monitoring and assessing the degree of convergence of supervisory practices, can be grouped into four main categories:
  - a. college monitoring;
  - b. peer reviews;
  - c. desk-based reviews;
  - d. staff reviews of supervisory practices (bilateral convergence visits).

6. College monitoring: The colleges of supervisors play an important role in the efficient, effective and consistent supervision of financial institutions operating across borders. The EBA has a leading role in monitoring the proper functioning of the colleges and in fostering the convergence and the consistency of the application of the Single Rulebook among them. The monitoring of supervisory colleges for the main cross-border European banking groups is an ongoing activity performed throughout the year by the EBA staff. The EBA findings related to this monitoring are summarised in a report on the colleges of supervisors that is published on an annual basis. Considering the improvement observed in the functioning of the colleges over the years, the report related to the 2018 cycle of colleges will focus on the EBA key observations regarding the quality of the contents, in particular of the deliverables.
7. Peer reviews: Peer reviews of competent authorities, conducted by the EBA on a regular basis, are an efficient and effective tool for fostering consistency within competent authorities. The peer reviews aim to assess the implementation and application of the EBA guidelines and technical standards. The peer reviews are conducted by dedicated teams, composed of EBA staff and staff from the competent authorities and coordinated by the EBA Review Panel. This report includes the outcomes of the peer review conducted in 2018 on the application of technical standards related to passport notifications.
8. Desk-based reviews: The EBA can collect information needed to carry out the duties assigned to it. The desk-based reviews combine the EBA stocktakes with open discussions in the EBA's standing committees (particularly the Standing Committee for Oversight and Practices) on different topics. Some of these reviews can be performed by ad hoc teams established on more technical subjects, e.g. the review on RWAs' consistency and benchmarking on remuneration. In general, such reviews help identify commonalities and divergences, emerging issues or inconsistencies in supervisory practices and outcomes.
9. Staff reviews of supervisory practices (or bilateral convergence visits): The staff reviews also contribute to the building of a common supervisory culture and the convergence in supervisory practices. First introduced in 2016 as part of the assessment of the implementation of the common SREP framework, they are a core tool that complements the EBA's direct participation in the colleges of supervisors as they allow a direct and more in-depth bilateral discussion with the authorities. These staff reviews or bilateral convergence visits are seen as a mutually beneficial tool for the EBA and for the authorities. On the one hand, the EBA staff have the opportunity to directly interact with the experts and supervisors of the authorities, gaining insight into their practices and application of the Single Rulebook as well as identifying potential topics/issues to be taken into account in the EBA policy developments. On the other hand, the authorities' staff takes this opportunity to better understand the relevant EBA policy products and to highlight major challenges in the implementation of Level 1 and Level 2 regulations. These bilateral convergence visits are also an opportunity to provide feedback to the competent authorities subject to such reviews.
10. While in 2017, as in 2016, the bilateral convergence visits covered the application of the SREP Guidelines, in 2018, they covered the continuum between ongoing supervision, recovery and

resolution as well as resolution planning (the latter of which is not in the scope of this report). The 2018 bilateral convergence visits were organised with the authorities of four jurisdictions (three SSM and one non-SSM)<sup>2</sup> and, given the topics considered, allowed to meet both the competent authorities and the resolution authorities in the same visit. They focused on LSIs, which fall directly under the responsibility of the domestic authorities and which are generally not subject to supervisory or resolution colleges monitored by the EBA. The 2018 bilateral convergence visits allowed the EBA to build up a more comprehensive view on how the BRRD framework is applied from the ongoing supervision side and in particular to LSIs. They resulted in the creation of a feedback loop that will feed into the EBA's policy work.

11. The discussions with the supervisory and resolution authorities in the selected jurisdictions concentrated in particular on the following topics:
  - a. recovery planning for LSIs — overall status, improvements and challenges; approach to simplified obligations;
  - b. recovery planning — selection and calibration of recovery indicators, coverage of entities in group recovery plans (GRPs);
  - c. the application of early intervention measures — process and experience;
  - d. the approach used for the determination of failing or likely to fail (FoLTF);
  - e. the cooperation and exchange of information between competent authorities and resolution authorities.
12. In 2018, the EBA applied the above-mentioned tools and relied on relevant sources of information to conduct its convergence assessment of different aspects of supervisory practices, the outcomes of which have been included in this report.
13. This report, which is based on the information obtained through the ongoing activities of the EBA, covers in particular the assessment of convergence and the EBA activities to promote and support such convergence in several areas, namely:
  - a. the SREP practices;
  - b. the internal governance, in particular on specific aspects such as remuneration;
  - c. the internal models;
  - d. the continuum between ongoing supervision, recovery and resolution.

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<sup>2</sup> In 2017, the EBA organised bilateral convergence visits with 11 competent authorities (3 SSM and 8 non-SSM authorities).

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

### 2.1 Status of the implementation of the SREP Guidelines

**In 2018, a good degree of progress has been made by competent authorities in the implementation of the SREP Guidelines as well as in taking forward the recommendations and observations made by the EBA during 2016 and 2017. There are, however, challenges remaining, primarily in the areas of the methodologies for capital adequacy assessments and the articulation of institution-specific additional own funds requirements, and in the link between the ongoing supervision, early intervention, and resolution.**

**Many of the aspects that were identified in the 2016 and 2017 convergence assessments have also been reflected in the EBA policy work on Pillar 2 that led to the publication of the revised SREP Guidelines in 2018. The observations from the convergence assessments led to the clarification of the scoring framework and of the use of viability scores, the guidance on the use of stress testing in capital adequacy assessments and to a more detailed explanation of the interaction between the different SREP elements. The convergence work in general, and including the participation in colleges as well as the extension of bilateral visits, forms an important feedback loop for the Pillar 2 policy work in this respect.**

14. The supervisory practices in the SREP form a key focus of the EBA convergence monitoring and assessment, as this brings together outcomes of all supervisory activities within the ongoing supervision of the institutions. The EBA has set out the comprehensive common European SREP framework in its Guidelines on common procedures and methodologies for SREP (SREP Guidelines)<sup>3</sup>. The SREP Guidelines provide a common framework for the supervisory assessment of an institution's viability while focusing on the assessment of its business models and strategy, internal governance and institution-wide controls, risks to capital and capital adequacy, risks to liquidity and funding, and liquidity adequacy. The guidelines also set out the common approach to the determination and articulation of the total SREP capital requirements (TSCR) and institution-specific liquidity requirements.
15. For the present convergence work reference is made to the SREP Guidelines that were published in 2014<sup>4</sup>. At the same time, the outcomes of the convergence assessments have fed

<sup>3</sup><https://eba.europa.eu/documents/10180/2282666/Guidelines-on-common-procedures-and-methodologies-for-SREP-and-supervisory-stress-testing--Consolidated-version.pdf/fb883094-3a8a-49d9-a3db-1d39884e2659>

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

into the revision of these guidelines, with the revised SREP Guidelines being published in July 2018 for application as from 1 January 2019<sup>5</sup>.

16. In general the SREP process and overall methodology implemented by the competent authorities were found to be largely in line with the SREP Guidelines although to different extents. The main areas where there was still room for improvement were the approach to the application of SREP scoring, in particular the use of viability scores; the use of stress testing in the capital adequacy assessment and the setting of Pillar 2 capital requirements (P2R); and the approaches to the determination of TSCR.
17. In the 2017 round of assessments, improvement with regard to the SREP process mainly stemmed from the categorisation of institutions and from defining the supervisory engagement model of the authorities.
18. In 2018, further improvement extended to the refinement of the scoring of individual risks to capital (credit, market, operational risk, interest rate risk in the banking book (IRRBB), etc.) and liquidity (liquidity risk and funding risk). However some challenges were observed with the roll-out of such individual risk scores for smaller and non-complex institutions. Whereas all risk areas are generally assessed in a structured way and included in the overall capital and liquidity scores, for smaller and non-complex institutions risk scores are not always applied at the granular level of underlying individual risks to capital and liquidity, in view of a proportionate approach applied by the authority.
19. Also, good practices were observed such as the introduction of quality assurance in the SREP process in the form of horizontal reviews within authorities to ensure a consistent assessment within the same category of banks.
20. The viability scoring concept was introduced with the SREP Guidelines that were published in 2014 as an indication of the risk to the institution's viability and its proximity to the point of non-viability, thus providing the link between ongoing supervision under SREP and early intervention and resolution. From the 2016 convergence assessments, it appeared that the implementation of the use of viability scores would take time as competent authorities needed to adapt their framework and tools to accommodate the practice. In 2017, it was observed that more authorities incorporated the viability scoring into their frameworks. Also, the observations from the convergence work led the EBA to further clarify the viability scoring in the revision of the SREP Guidelines. In 2018, further improvements were noted in the actual implementation of viability scoring in the SREP frameworks, with competent authorities developing methodologies for determining viability scores and aggregating them into the overall SREP score. Challenges remain as regards the procedural aspects and assessment criteria as well as the link with the actual determination of the 'failing or likely to fail' (FoLTF) status of an institution.

<sup>5</sup> <https://eba.europa.eu/documents/10180/2282666/Revised+Guidelines+on+SREP+%28EBA-GL-2018-03%29.pdf/6c2e3962-6b95-4753-a7dc-68070a5ba662>

### Detailed observations on capital adequacy assessment

21. Whereas notable improvements in the capital adequacy assessment and total SREP capital requirements' (TSCR) determination process were observed, there is still room for further convergence, in particular in the following areas:
  - a. Interplay between the TSCR and the restrictions on distributions. The role of TSCR and, in particular, the legally binding P2R in the context of triggering the restrictions and factoring into the calculation of the maximum distributable amount (MDA) under Articles 141 and 142 of the CRD is explained in the EBA Opinion on the MDA<sup>6</sup>.  
In its 2016 convergence report, the EBA reported that a few authorities did not fully follow the MDA Opinion, as TSCR was not applied in a legally binding and directly enforceable form, or MDA calculations disregarded P2R. In 2018, the EBA performed a follow-up with the relevant authorities. It was observed that for a few authorities the legally binding nature of P2R and the communication of the TSCR as a legally binding requirement remain issues. In so far as the P2R has no formal legal status, it will not affect the level at which the automatic restrictions on distributions linked to the combined buffer requirement come into effect. Or the P2R is imposed as a legally binding measure but the MDA framework does not take into account P2R for triggering the MDA calculation. Where legislative changes are planned to ensure the binding nature of the P2R, the communication of the TSCR as a legally binding requirement and the inclusion of P2R for triggering the MDA calculation, their actual implementation takes time as a result of the legislative process.
  - b. Supervisory benchmarks. The development of supervisory benchmarks to help in assessing capital needs and determining institution-specific prudential requirements and to challenge banks' internal capital adequacy assessment processes (ICAAPs) still proves challenging as a result of the particular nature of Pillar 2 risks. Despite these challenges, the EBA also observed some positive developments in this area, with a number of authorities developing supervisory benchmarks for credit concentration risk, credit risk and IRRBB. Some authorities also provide guidance for banks and in particular smaller institutions on methods and benchmarks for the ICAAP calculation for the most important risk areas.
22. Following the extensive policy development work leading to the introduction of a common approach to using outcomes of stress tests in the capital adequacy process, resulting in the setting of legally non-binding Pillar 2 capital guidance (P2G) as explained in the EBA Pillar 2 Roadmap<sup>7</sup>, the concept of P2G was introduced in the revised SREP Guidelines in 2018. The

<sup>6</sup> Pursuant to Article 141 of the CRD, upon breaching the combined buffer requirement, banks face distribution restrictions in relation to common equity capital, additional tier 1 instruments and variable remuneration, as determined by the calculated MDA. The EBA Opinion on the MDA clarified that the MDA should be calculated taking into account the stacking order of capital requirements with Pillar 1 and Pillar 2 capital requirements that should be met at all times beneath the combined buffer requirement. In the Opinion the EBA also asked the European Commission to review Article 141 of the CRD to avoid there being differing interpretations and to ensure greater consistency of the MDA framework with regard to the stacking order described in the Opinion and in the SREP Guidelines.

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

<sup>7</sup> <https://eba.europa.eu/documents/10180/1814098/EBA+Pillar+2+roadmap.pdf>



guidelines outline how competent authorities should establish and set P2G based on supervisory stress-test results. The setting of P2G will be a particular area of focus for the EBA convergence work in 2019.

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

23. In 2018, the EBA put an early focus on the continuum between ongoing supervision, recovery and resolution and observed significant room for further convergence in this.
24. The outcomes of the convergence assessments as regards the continuum between ongoing supervision, recovery and resolution have fed into the revision of the SREP Guidelines<sup>8</sup>. The revised guidelines also reflect the guidelines published by the EBA explaining how SREP outcomes can be used for the purposes of early intervention and recovery and resolution (Guidelines on triggers for use of early intervention measures (EBA/GL/2015/03) and the Guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail (EBA/GL/2015/07 —FoLTF Guidelines)), as well as the progress made on enhancing the framework for the assessment of institutions' recovery plans in the EBA Supervisory Handbook.
25. An area where increasing convergence is observed is the implementation of viability scores that provide a link between the ongoing supervision under SREP and early intervention, recovery and resolution.
26. In terms of good practices, we observed some authorities developing new monitoring indicators and limit systems in the framework of the viability assessment. Some authorities extended peer group comparisons having regard to risks dashboards that consider all data sources, starting with COREP/FINREP, market-based indicators and adding MREL-related indicators. Their system can also highlight material changes and anomalies.
27. Such structured systems of warning signals and triggers are in particular useful in highlighting potential concerns and in requiring further supervisory action that could lead to the use of early intervention measures in line with the SREP Guidelines and the EBA Guidelines on triggers for use of early intervention measures (EBA/GL/2015/03)<sup>9</sup>.
28. Furthermore, in a few cases authorities still need to fully implement the EBA FoLTF Guidelines<sup>10</sup> and provide the framework to allow the use of SREP scores for making a judgement regarding the viability or failure of an institution and, therefore, for being used as triggers for early intervention and determination of FoLTF status. The EBA has also observed some positive progress in this area, such as authorities implementing automated monitoring of key risk

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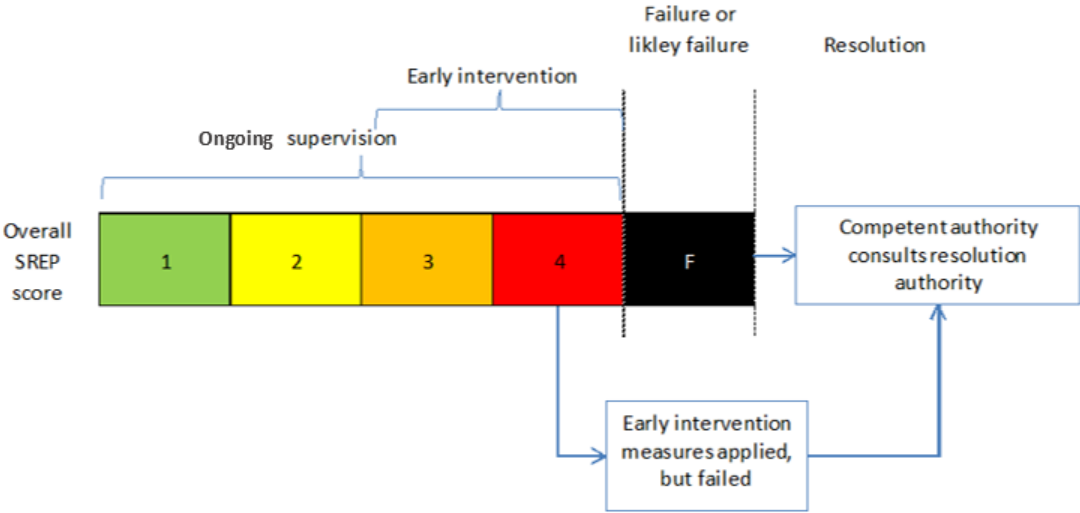
<sup>8</sup> <https://eba.europa.eu/documents/10180/2282666/Revised+Guidelines+on+SREP+%28EBA-GL-2018-03%29.pdf/6c2e3962-6b95-4753-a7dc-68070a5ba662>

<sup>9</sup> <https://eba.europa.eu/documents/10180/1067473/EBA-GL-2015-03+Guidelines+on+Early+Intervention+Triggers.pdf/f6234078-a8cb-40a1-88f1-f22d446ca394>

<sup>10</sup> [https://eba.europa.eu/documents/10180/1156219/EBA-GL-2015-07\\_EN\\_GL+on+failing+or+likely+to+fail.pdf/9c8ac238-4882-4a08-a940-7bc6d76397b6](https://eba.europa.eu/documents/10180/1156219/EBA-GL-2015-07_EN_GL+on+failing+or+likely+to+fail.pdf/9c8ac238-4882-4a08-a940-7bc6d76397b6)

indicators and organising crisis simulation exercises to test communication lines and the flow of actions between supervisory and resolution authorities, in case an institution would be considered to be ‘failing’.

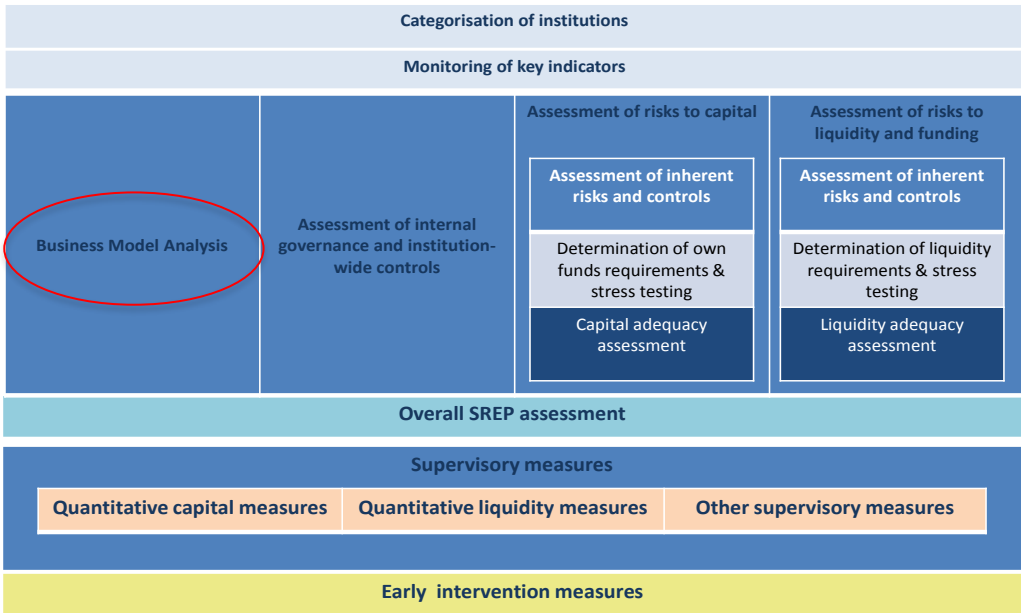
Figure 2: SREP: link between ongoing supervision, early intervention and resolution



## 2.2 Focus on specific SREP element: business model analysis

**The implementation of the business model analysis component of the common SREP framework remains a point of particular attention for the EBA.**

Figure 3: Business model analysis in the common SREP framework



29. The 2014 EBA SREP Guidelines introduced business model analysis (BMA) as one of the main SREP elements requiring competent authorities to form supervisory views on business and

strategic risks by assessing the institution's business model viability and sustainability. This component of the SREP is important for embedding a forward-looking perspective in supervisory work, linking together all the other components.

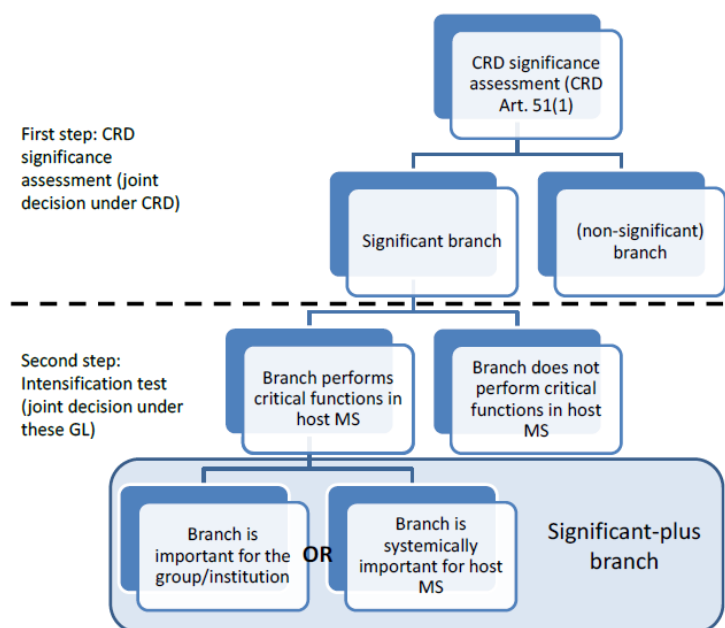
30. In 2017, the EBA found that competent authorities had broadly implemented the common approach to BMA, as outlined in the SREP Guidelines and in the Supervisory Handbook module on BMA, in their methodologies and practices. In some cases, the EBA noted that there were differences in the BMA approaches adopted by the competent authorities, notably in setting the focus and scope of their analyses. In some cases, the BMA was limited only to the consolidated level and authorities did not take account of the assessment of material business/product lines or the geographies in which institutions operate; furthermore, the EBA observed some lack of structure in the approach to the quantitative analysis, including the analysis of the institution's own financial forecasts and the selection of peer groups for BMA purposes.
31. During the follow-up in 2018, some good practices were observed with regard to the identification and assessment of material business lines, product lines and entities as part of the preliminary analysis for the BMA, such as the use of analytical tools to analyse and compare key ratios and profitability drivers across institutions. Peer group analysis was also included in the BMA, with the identification of peers based on the institutions' geographical presence, balance sheet size and calibrated balance sheet ratios as well as on qualitative inputs.
32. It was also noted that progress was made by authorities in documenting their BMA scoring approach to provide the supervisors with clear guidance and ensure consistency across institutions.
33. Areas where there is still room for improvement include the following:
  - a. the use of the information gained from the BMA in the context of supervisory colleges, where information on the BMA from supervisors of subsidiaries and branches should serve as an input to the overall group risk assessment, in particular as regards the key vulnerabilities in the cross-border or group context;
  - b. the definition of peer groups for BMA purposes, taking into account the relevant businesses and product lines of other institutions competing for the same source of income/customers and the use of an automated and integrated data analysis system to support peer comparisons.

## 2.3 Branch supervision

34. Prompted by the increasing demand to establish branches across the European Union, the EBA published in November 2017 its final own-initiative Guidelines on the supervision of significant branches.

35. These guidelines aim to facilitate cooperation and coordination between competent authorities involved in the prudential supervision of significant branches of EU institutions established in another Member State. They mainly focus on the largest and systemically important branches, the so-called ‘significant-plus’ branches, which require intensified supervision. The guidelines apply from 1 January 2018.
36. To assess whether or not a branch that has been designated significant in accordance with Article 51 of Directive 2013/36/EU and that is providing critical functions within the meaning of the BRRD should also be classified as ‘significant-plus’ for the purposes of these guidelines, competent authorities should carry out a common assessment (or ‘intensification test’) and endeavour to reach a joint/common conclusion on its outcomes.
37. Essentially, a branch that is significant under Article 51 of Directive 2013/36/EU that also performs critical functions, and that is assessed either as important for the group/parent institution or considered to be important for the financial stability of the host Member State should be deemed ‘significant-plus’.
38. The guidelines include principles for the cooperation and coordination between authorities aimed at intensifying the supervision of these ‘significant-plus’ branches.

Figure 4: ‘Significant-plus’ branches assessment process



39. The EBA observed the use of the Guidelines on the supervision of significant branches in the context of the so-called ‘branchification’ in the European Union, where banking groups transform subsidiaries into branches. They are used by competent authorities to support the process of reaching joint decisions on ‘significant-plus’ branches in their jurisdictions and to establish a framework for effective and efficient cooperation between authorities to intensify the supervision of these largest and systemically important branches.

40. In the practical application of the EBA guidelines, competent authorities identified the need to seek bilateral agreement on a few interpretative issues, including, for example, the consolidation of entities for the purposes of the intensification test. That is, in some host jurisdictions, banks operate other local entities of the group, which could be important for the branch as far as they provide services to the branch or are otherwise relevant for its functioning. Competent authorities identified the need to seek bilateral agreement on whether or not such other important local entities can be included in the intensification test, to reflect the local footprint of the branch. As regards the qualitative assessment of critical functions of the branch and its importance for the group, authorities identified some room for further harmonisation, including the use of quantitative thresholds, to ensure a consistent assessment approach.
41. Among the best practices observed in this area, competent authorities have set up processes, which closely follow the EBA guidelines, in order to be able to perform the intensification test in a harmonised and consistent manner and to reach joint/common decisions regarding the identification of 'significant-plus' branches in their jurisdictions and ensure their annual review.

## 2.4 Passport notifications

42. One of the goals of Directive 2013/36/EU (the Capital Requirements Directive — CRD) is to ensure due observance of the right of establishment and the freedom to provide services for credit institutions within the EU. In this regard, the EBA was mandated by the CRD to develop draft regulatory technical standards (RTS) to specify the information to be notified and implementing technical standards (ITS) to establish forms, templates and procedures for such notifications in accordance with Articles 35, 36 and 39 of the CRD.
43. In 2018, a peer review was carried out by the EBA and the competent authorities to assess how the competent authorities comply with these technical standards. The scope of the peer review focused mainly on the RTS. However, for the purpose of the assessment of Article 36 of the CRD, in particular the requirements on how host competent authorities prepare the supervision of the institution/branch before the commencement of activities of a branch, it was necessary to look at the application of some specific articles of the ITS.
44. This peer review focused on all the notifications included in Articles 35 to 39 of the CRD and provided by credit institutions from 01 July 2016 to 30 June 2017. It reviewed competent authorities' practices for managing the passporting process. It specifically assessed how competent authorities deal with mandatory information from credit institutions. The peer review also focused on the data quality process, paying particular attention to the timeliness in handling credit institutions' information as well as to the completeness and granularity of this information. The peer review also sought to assess the cooperation arrangements between home and host competent authorities.

45. The peer review revealed that competent authorities have globally developed consistent and robust passporting processes to comply with the RTS requirements, even if the level of sophistication and the automation of these processes vary among competent authorities. In this regard, the peer review identified best practices related, for instance, to the timeframe to assess the completeness and the accuracy of notifications received from credit institutions.
46. However, the peer review also showed inconsistencies in practices related to the cooperation between competent authorities when dealing with branch or services passport notifications. The exchange of information, its timing and the granularity of the transmitted information were not always consistent among competent authorities. In the context of Brexit and for the sake of convergence of practices in the Single Market, it may be worth establishing better cooperation channels as well as developing more meaningful interactions between competent authorities.
47. The peer review identified some possible best practices in this regard. For instance, the sharing, between home and host competent authorities, of the qualitative assessment of the notification sent by the credit institutions was seen as a potential improvement of the framework. This kind of practice appears particularly relevant in complex cases, such as the establishment of significant branches, the transformation of the existing O-SII subsidiary in a branch or material changes in the activity of the branch.
48. The peer review gave the opportunity to the competent authorities to raise concerns in relation to the RTS and the ITS.
49. Regarding the practical application of proportionality, competent authorities viewed the framework as unable to offer the ability to develop internal procedures to factor in proportionality with regard to passporting, given that the RTS/ITS on passport notifications impose full harmonisation. However, considering that this principle must not prevent competent authorities paying more attention to more complex notifications, they were encouraged to give proper regard to the nature, size and riskiness of the business envisaged, in particular when dealing with this kind of notification.
50. Regarding the information to be requested from credit institutions, despite the high level of consensus around the suitability of the current RTS and ITS requirements expressed by competent authorities, they provided ideas on how to enhance the granularity of information contained in both the RTS and the ITS. For instance, some competent authorities considered that further clarifications should be introduced to better reflect the interlinkages between the RTS and the ITS with other pieces of legislation dealing with passporting (e.g. the Markets in Financial Instruments Directive (MiFID), the Payments Services Directive and the Mortgage Credit Directive). Besides, some proposals were made with a view to ensuring timely sharing of information between home and host competent authorities and smoothening the passport notifications procedures.

## 2.5 Benchmarking exercises for internal models

51. 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, among others, that (i) competent authorities conduct an annual assessment of the quality of internal models and (ii) EBA produces reports to assist competent authorities in this assessment.
52. 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 (i.e. more than 130 institutions at the highest level of consolidation). The EBA calculates benchmark values on selected portfolios, which allows a comparison of individual institutions' risk parameters. It helps competent authorities to identify internal models that show significant deviation of risk parameters and RWAs, from those of their peers, and potential significant underestimations. The benchmarking portfolios, templates, definitions, IT solutions and reporting instructions are communicated by the EBA through an ITS updated every year<sup>11</sup> (Regulation (EU) No 2016/2070).
53. EBA publishes two horizontal reports on the outcomes of the yearly benchmarking exercises. One with respect to credit risk and one for market risk. The reports published in 2018 present the outcomes of the analyses on benchmarks for both low default portfolios (LDPs) and high default portfolios (HDPs), as well as for market risk.

### **Market risk benchmarking report 2018.**

54. With respect to market risk, the 2018 analysis shows a reduction in the dispersion in the initial market valuation and risk measures, compared with the 2017 exercise. This improvement was expected and is mainly due to the simplification in the market risk benchmark portfolios.
55. The major part of the significant dispersions has been examined and justified by the banks and the competent authorities. A minor part of the outlier observations remains unexplained and is expected to be part of the ongoing supervision activities of supervisors, who are expected to monitor and investigate the situation.
56. The quantitative analysis was complemented by a questionnaire to competent authorities, used to collect competent authorities' assessment of the over- and underestimation of RWAs. In most cases, competent authorities 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 RWAs, the effectiveness of these actions can be evaluated only with further analysis.

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<sup>11</sup> On June 2018, the EBA published an updated ITS for the 2019 data collection.



## Credit risk Benchmarking Report 2018

57. With respect to credit risk, the report is using a mix of qualitative and quantitative analysis to measure the variability.
58. On the quantitative side, three analyses confirm the previous findings that RWA variability can be explained, to a large extent, by looking at some measurable features of institutions' exposures:
  - An overall 'top-down analysis' highlights that differences in (i) the share of the defaulted exposures and (ii) the portfolio mix effect explain around 50% of the variability observed in the outcome of internal models. The remaining 50% may be due to differences in institution-specific factors, such as risk strategy and management practices, portfolio composition, collateralisation and client structure.
  - For common (low default) counterparties, the RW deviations resulting from benchmark substitutions are below 10%. These interquartile differences are greater under the advanced internal ratings-based approach than under the foundation internal ratings-based approach for large corporates and sovereigns.
  - For HDPs, backtesting results show that the great majority of institutions have conservative estimates, in particular when compared with the observed values for the past year.
59. On the qualitative side, the assessment comprised three analyses:
  - A questionnaire, in which it can be noted that in comparison with previous exercises (the 2016 HDP exercise and the 2017 LDP exercise), institutions' internal validations as well as the competent authorities' monitoring activities (ongoing or on-site) are increasingly picking up on issues identified by the EBA's supervisory benchmarking (SVB) exercise. This is reassuring and indicates that the increased regulatory and supervisory attention paid to internal models is contributing to the consistency of the RWAs of internal models.
  - Interviews with the 11 institutions for which the highest number of outlier observations were spotted. In general, the interviews were useful because they allowed a number of points to be clarified and a thorough understanding of the observed deviation from the benchmarks.
  - A survey to gain an overview of how guarantees and derivatives are currently taken into account for the purpose of RWA calculation and, in particular, whether or not SVB parameters are biased as a result of the incorporation of guarantees and/or derivatives into the RW calculation.

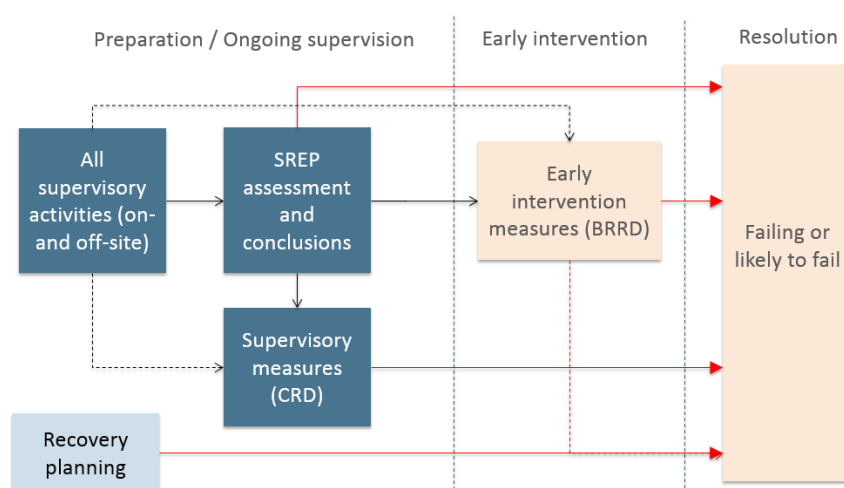
## 2.6 Benchmarking of remuneration

60. As part of the SREP assessment of internal governance and institution-wide controls, competent authorities also assess the adequacy of institutions' remuneration practices and their compliance with the requirements of Articles 92-95 of the CRD and the relevant RTS and EBA guidelines.
61. The EBA annually publishes aggregated data of staff earning a total remuneration of EUR 1 million or more in the previous financial year (high earners), and biennially publishes a benchmarking report on the remuneration of 'identified staff', based on data provided by the competent authorities from over 100 banking groups and institutions. These publications aim to ensure a high level of transparency regarding the remuneration practices within the EU, which should help the harmonisation of remuneration frameworks.
62. In April 2018, the EBA published its report on benchmarking of remuneration practices in EU banks for the financial years 2015 and 2016 and high-earners data for 2016. The report shows that the number of high earners who were awarded EUR 1 million or more in annual remuneration decreased from 5 142 in 2015 to 4 597 in 2016 (-10.6%). This variation is mainly driven by changes in the exchange rate between EUR and GBP, which led to a reduction in the value of staff income paid in GBP when expressed in EUR.
63. The number of individuals whose professional activities have a material impact on an institution's risk profile ('identified staff') and who are identified as such in accordance with the criteria set out in the EBA's RTS on identified staff, decreased significantly from 67 802 in 2015 to 53 382 in 2016 (-21.3%). In 2016, only 2.00% of staff in institutions were 'identified staff', which is a significant decrease compared to 2.42% in 2015.
64. Overall, it appears that following the introduction of a limit on the ratio between the variable and the fixed remuneration of 100% (200% with shareholders' approval, where implemented by the Member State), the average effective ratio between the variable and fixed component for all 'identified staff' continued to decrease to 57.1% in 2016 (2015: 62.2% and 2014: 65.5%).
65. As in the previous years, the report shows that remuneration practices within institutions were not sufficiently harmonised. In particular, the application of deferral and pay-out in instruments differed significantly across Member States and institutions. This is mainly due to differences in the national implementation that in many cases allows for waivers of these provisions when certain criteria are met.
66. The EBA will continue to publish annually data on high earners and biennially a report on benchmarking of remuneration practices in the EU to closely monitor and evaluate developments in this area. In addition, the EBA will review the application of the RTS on 'identified staff' and will particularly look into the identification process.

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

Establishing a continuum between ongoing supervision, recovery and resolution is a quite new consideration given the relative novelty of the BRRD. In principle, the continuum between ongoing supervision, recovery and resolution should be ensured by a continuum in the supervisory actions all along the different stages. A fundamental element of this continuum is the SREP, as SREP outcomes should reflect the financial situation of an institution and ultimately should play a key role in deciding when to move from one step to another.

Figure 5: Continuum between ongoing supervision, recovery and resolution



The 2018 bilateral convergence visits allowed the EBA to build up a more comprehensive view on how the BRRD framework is applied from the ongoing supervision side and in particular to LSIs. During these bilateral convergence visits, the EBA observed in particular that authorities have developed internal procedures specifying approaches to be followed, for instance, when determining if an institution is FoLTF or when granting waivers or simplified obligations. Regarding the formalisation of the organisational provisions for the exchange of information between competent authorities and resolution authorities, some of them have also set up internal procedures or are in the process of doing so. The implementation of these sets of procedures, which take into account the Single Rulebook, contributes to ensuring the convergence of supervisory practices.

However, there are several aspects still requiring improvement. These are mainly aspects of the recovery plans. In particular, the efforts need to be pursued in order to ensure that all the institutions that do not benefit from a waiver have developed a recovery plan. Moreover, it

**appears that the recovery plans still present weaknesses regarding the selection and calibration of recovery indicators.**

### 3.1 Recovery planning for less significant institutions

#### Approach to simplified obligations

67. The BRRD, which is applicable to all credit institutions, has introduced an obligation to prepare and maintain recovery plans. However, the framework is based on the principle of proportionality and gives competent and resolution authorities the ability to grant simplified obligations and waivers for recovery planning to institutions under their jurisdiction, provided that the institutions fulfil specific eligibility criteria for simplified obligations or meet particular conditions for waiver.
  
68. The report published in December 2017 by the EBA shows that, by 30 April 2017, around half of the competent and resolution authorities had granted simplified obligations or waivers to institutions under their jurisdiction. In some cases, the authorities have chosen not to exercise their discretion and instead to ensure that all institutions, including LSIs, are subject to the full BRRD requirements concerning recovery planning. However, and as underlined by some of these authorities, the proportionality principle can be deemed, to some extent, as indirectly reflected in the plans of LSIs, as they usually have less complex governance structures and recovery options.
  
69. The BRRD allows competent authorities and resolution authorities to apply simplified obligations for recovery and resolution planning provided that an institution meets the eligibility criteria specified in Article 4(1) of the BRRD. In addition, Article 4(8)-(10) of the BRRD introduced the possibility of the authorities granting waivers from recovery and resolution planning obligations to specific types of institutions.
  
70. As reported in the EBA report published in December 2017, for the period between 1 May 2016 and 30 April 2017, waivers from recovery planning were granted in six Member States (Austria, Belgium, Spain, Hungary, Luxembourg and Portugal). The utilisation of waivers was either marginal (1-4% in Belgium, Spain and Luxembourg), or applied to a majority of credit institutions operating in a given Member State (53-67% in Austria, Hungary and Portugal). The highest level of eligibility for waivers was identified in Germany, where 89% of credit institutions fulfilled the conditions for being waived from recovery planning obligations (even though formal waivers had not been granted there before the end of the analysis period).

Figure 6: Application of waivers for recovery planning for credit institutions for the period between 1 May 2016 and 30 April 2017

Member States	Total number of credit institutions	Number of credit institution to which waivers apply	% of all credit institutions in the Member State
AT	528	351	66%
BE	30	1	3%
DE*	1 600	1 419	89%
ES	134	5	4%
FI	245	3	1%
HU	88	58	66%
LU	142	1	1%
PT	123	82	67%

\*In DE, at that time, no waivers for recovery plans had been formally granted because relevant legislation has not been finalised yet

71. Regarding the eligibility assessments for simplified obligations carried out by competent authorities, the analysis also shows a significant variation in practices across the EU.
72. As reported in the report published in December 2017, for the period between 1 May 2016 and 30 April 2017, 18 competent authorities submitted data about credit institutions in their jurisdictions eligible for simplified recovery plans. The differences in the extent to which institutions could benefit from reduced requirements remained significant, ranging from 0.4% of credit institutions in Finland to 93% in Italy.

Figure 7: Application of simplified obligations for recovery planning for credit institutions for the period between 1 May 2016 and 30 April 2017

Member States	Total number of credit institutions	Number of credit institutions to which simplified obligations apply	% of all credit institutions in the Member State
AT	528	163	31%
BE	30	13	43%
DE*	1 600	136	9%
DK	78	55	71%
EE	9	6	67%
ES	134	13	10%
FI	245	1	0.4%
FR	374	84	22%
HU	88	13	15%
HR	31	17	55%
IE	25	8	32%
IT	488	452	93%
LT	7	1	14%
LU	142	28	20%
LV	16	9	56%
NL	38	1	3%
PT	123	22	18%
SE	125	99	79%
SK	13	5	38%

\*In DE, at that time, no simplified recovery plans had been requested because relevant legislation had not been finalised.

73. These divergences have been addressed in the final draft of the EBA RTS on simplified obligations. According to the draft RTS, the authorities should have regard to the criteria by following a two-stage approach. Firstly, they should select the institutions that could potentially benefit from simplified obligations, based on a number of quantitative criteria that are fully aligned with the methodology used for identifying O-SIIs, and then they should verify whether or not institutions selected as being potentially eligible for simplified obligations also meet the qualitative criteria.
74. Apart from deciding which institutions can benefit from simplified obligations, authorities should also decide on the scope of simplifications to be applied to those institutions in comparison with the full requirements defined by BRRD. On this point, the BRRD allows the competent authorities flexibility in defining the scope of these simplifications. Based on the information reported to the EBA, there are divergences in the authorities specifications related to the reduced scope of requirements for institutions under their jurisdiction.
75. Among the good practices, the EBA observed the development of comprehensive internal procedures on simplified obligations. These procedures, which take into account the EBA current products (in particular, the EBA Guidelines on the application of simplified obligations and EBA Guidelines on the criteria for the assessment of O-SIIs), allow a classification of the institutions depending on the possibility to apply simplified obligations or not and specify the corresponding requirements.
76. On this last point, it appears that some competent authorities have not imposed uniform requirements on institutions under the simplified obligations regime, because of the diversity of the LSI population in their jurisdiction. Their approach is to apply tailored expectations in terms of the content of the recovery plans.

#### **Assessment of the LSIs' recovery plans**

77. Regarding the assessment of the LSIs' recovery plans, the competent authorities rely on the BRRD and relevant EBA products, including the Supervisory Handbook module on the assessment of recovery plans and its template for the assessment of recovery plans (Template 2). In most cases, no other templates have been developed locally. The tools used allowed authorities to identify significant and sometimes material deficiencies, in particular in the first years after the implementation/transposition of the BRRD.
78. One of the main points of attention remains the recovery indicators, as explained in Section 3.2. With regards to recovery plan scenarios, the EBA Guidelines on the range of scenarios fully supported the competent authorities' practice and their dialogue with institutions. In particular, the explanation around the 'near-default' scenario helped institutions to better understand how to develop plausible scenarios.
79. The outcomes of the recovery plan assessment are generally communicated to the institutions in a feedback letter sent by the competent authorities. In general, recovery plans are deemed by competent authorities to be a very good source of information for LSIs. In particular, the

recovery plan assessment would provide essential information to the SREP assessment and vice-versa, so the two exercises complement and inform each other.

80. Overall, the content and the quality of the recovery plans has increased, as evaluated by competent authorities. However, effort is needed to ensure that all institutions that do not benefit from a waiver have developed a recovery plan.

## 3.2 Selection and calibration of recovery indicators, coverage of entities in group recovery plans

### Selection and calibration of recovery indicators

81. As a recovery plan is essentially a special case of contingency planning, it is of utmost importance to ensure that it can be activated in a timely manner. Therefore, institutions should feature an appropriate set of quantitative and qualitative indicators that adequately reflect the size and complexity of the bank and allow a proper and regular monitoring of potential risks. The recovery indicators are to be established by each institution, with the aim of identifying the points at which the escalation process should be activated to assess which appropriate actions referred to in the recovery plan may be taken. So, the fundamental objective of the recovery plan indicators framework is to help the institution to monitor and respond to the emergence and evolution of a stress.
82. Such indicators must be examined by the competent authorities when assessing recovery plans. A common and convergent approach of the supervisory authorities has been to first focus on the enhancement of the indicators and their calibration. It appears that, in this area, progress has been made in the last years as a result of the supervisory dialogue with the institutions.
83. However, efforts are needed to improve the set of recovery indicators included in recovery plans under the mandatory categories of indicators set out in the EBA Guidelines on recovery plan indicators (i.e. indicators related to capital, liquidity, profitability and asset quality)<sup>12</sup>. Obviously, institutions should not limit their set of indicators to the mandatory minimum list set out in the EBA guidelines. Competent authorities commonly pay attention to the need to tailor indicators in this regard.
84. Moreover, regarding the calibration of the recovery indicators, which is also a focal point for competent authorities, the EBA has detected that the thresholds applied are sometimes too low, meaning that the institutions' management would not have sufficient time to implement corrective actions. The timeframe for the implementation of recovery options and for receiving the expected/corresponding benefits should be considered in the calibration of all indicators. In particular, the thresholds of indicators should be calibrated in such a way that they would be reached before the competent authority is likely to take supervisory actions. Recovery plans

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<sup>12</sup> Some competent authorities highlighted that these recovery indicators should be tailored to institutions' risk profiles.



are owned by the institution and should enable them to overcome a crisis using their own efforts.

85. The EBA has also identified weaknesses regarding the regular monitoring of the indicators, with there being a lack of appropriate integration within the risk management framework. On this point, a best practice approach is to encapsulate recovery plan indicators into the whole continuum of the life cycle, from 'business as usual' to recovery stages, in order to be sure that the recovery plan indicator framework is effective.

#### **Coverage of entities in group recovery plans (GRPs)**

86. The assessment of GRPs in the past few years has highlighted that many recovery plans were often drafted from the perspective of the parent undertaking. Thus, the local entities were, in general, poorly or not covered in the GRPs at the beginning. This approach, which affects the credibility and the effectiveness of the GRP, undermines compliance with the BRRD requirements pursuant to which the GRP must identify measures that may be required to be implemented at the level of the parent entity and each individual subsidiary.
87. The EBA observed that the coverage of entities in GRPs is improving as a result of the EBA Recommendation on the coverage of entities in a GRP, published in November 2017, and also as a result of college discussions. As mentioned in the EBA Recommendation, inadequate coverage of entities in the GRPs should not be addressed by resorting to requests for individual plans but should be addressed in the context of the GRPs.
88. Besides, some competent authorities have, in the past, requested individual plans from the legal entities established in their respective jurisdictions. Following the BRRD implementation and as mentioned above, there is now a need to ensure that data and information required for the elaboration of an effective and efficient GRP are fully shared between all competent authorities concerned and smoothly transferred into the GRP. The overall integration of the individual plans relied on a transitional approach, by first including them in an annex to the GRP and then fully integrating them into the GRP.

### **3.3 Application of early intervention measures**

89. Early intervention constitutes a key component of supervisory action. Following the entry into force of the BRRD, competent authorities have developed their approaches for early intervention in order to strengthen their capability to intervene when the financial situation of an institution is deteriorating. In principle, a framework of early intervention should be complementary to ongoing supervision, resulting in the application of supervisory measures based on the outcomes of ongoing supervision.
90. Competent authorities have, in general, identified triggers for the decision on whether or not to apply early intervention measures. These triggers are mostly based on (i) the scores supporting the outcomes of the assessment of various SREP elements and the overall SREP assessment or (ii) material deterioration in the key financial and non-financial indicators

monitored by the competent authorities or (iii) significant events, in line with the EBA Guidelines on triggers for use of early intervention measures (EBA/GL/2015/03).

91. Competent authorities have, in general, set internal threshold levels for the indicators identified. Good practices show that IT systems support competent authorities with automated warnings when there is a deterioration of the key indicators and a breach of the early intervention triggers.
92. When triggers are breached, an escalation process is applied and competent authorities undertake further investigations to decide whether early intervention measures need to be applied or not. Some competent authorities have applied supervisory measures instead (e.g. specific P2R) that have proved to be more effective in particular cases, because applying more intrusive measures have not been deemed desirable for the institutions under consideration. Besides, regarding notification, it appears that resolution authorities have always been notified about the application of early intervention measures<sup>13</sup>.
93. Depending in particular on the size and structure of their national banking systems, such internal procedures and formal escalation processes have not always been developed, as more judgemental approaches are regarded as proportionate in the case of a few LSIs in particular.

### 3.4 Approach for the determination of failing or likely to fail

94. Resolution marks the end of a sequence of supervisory actions and may follow, where possible and appropriate, the adoption of early intervention measures. Resolution constitutes an alternative to normal insolvency proceedings. Indeed, resolution actions can be taken by the resolution authorities only when an institution is considered as FoLTF, where private sector solutions and supervisory actions are not likely to prevent the failure of an institution within a reasonable timeframe, and where normal insolvency proceedings would not meet the resolution objectives to the same extent.
95. The determination that an institution is FoLTF is necessary to start any resolution process. This determination can be made either by the competent authority after consulting with the resolution authority or, when the national legislation allows it<sup>14</sup>, by the resolution authority, after consulting with the competent authority, provided that the resolution authority has the necessary tools and, in particular, adequate access to the information required. Both situations exist within the EU but, in practice, it is almost always the competent authority who is the better placed to conclude on this determination, after consulting the resolution authority.

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<sup>13</sup> However, regarding notification before the application of early intervention measures, it appears that there are, in practice, different implementations of Article 27-2 of the BRRD, which provides that 'the competent authorities shall notify the resolution authorities without delay upon determining that the conditions laid down in paragraph 1' [of the same article] have been met.

<sup>14</sup> According to the Single Resolution Mechanism Regulation, the Single Resolution Board can declare an institution FoLTF after consulting with the European Central Bank and if the European Central Bank does not declare this institution FoLTF in three days.

96. For the purpose of making this determination, as a result of their different roles and interactions with the institutions, the competent authorities and the resolution authorities might follow different practices, within their respective roles, when determining that an institution is FoLTF. However, these practices should be consistent and coordinated, and supported by an appropriate exchange of information (see Section 3.5).
97. In any case, the competent authorities and the resolution authorities should consult each other and appropriately discuss the results of their FoLTF assessments that must be based on objective elements and, in particular, on the overall SREP assessment (the latter carried out by the competent authority). In practice, some competent authorities and resolution authorities have experienced such cases and had the opportunity to cooperate.
98. Among the best practices observed by the EBA in this area is the development/implementation of comprehensive internal procedures. These procedures, which take into account the EBA FoLTF Guidelines, include, for instance, specifications regarding the detailed circumstances of when an institution is FoLTF as well as operational aspects of the process to follow when determining that an institution is FoLTF. This includes timeframes for the various steps of the process, clear and straightforward escalation procedures as well as allocation of responsibilities between the competent authorities and the resolution authorities.

### 3.5 Cooperation and exchange of information between competent authorities and resolution authorities

99. As provided by the BRRD, Member States are free to choose which authorities should be responsible for applying the resolution tools and exercising the powers laid down in this Directive. Where a Member State designates the competent authority as a resolution authority, adequate structural arrangements must be in place to separate the supervisory and resolution functions.
100. However, that separation must not affect the exchange of information and cooperation obligations between these authorities and must not prevent the resolution function from having access to any information available to the supervisory function. Consequently, the competent authorities must provide relevant information to the resolution authorities and must cooperate closely on the preparation, planning and application of resolution decisions.
101. In particular, the competent authorities must notify the resolution authorities without delay upon determining that the conditions for early intervention have been met in relation to an institution, so that the resolution authorities can update the resolution plan and prepare for the possible resolution of the institution. In addition and as mentioned above (Section 3.4), the determination that an institution is FoLTF can be made either by the competent authorities or by the resolution authorities. Whatever the case, these authorities must consult each other. Regarding the recovery plans, the BRRD requires competent authorities to provide these plans to the resolution authorities, to allow them to identify any recovery actions that would adversely impact the resolvability and to make recommendations to address any issues.

102. The EBA observed that, in general, a close cooperation and exchange of information is ensured between the competent authorities and the resolution authorities. The exchange of information is done on an ad hoc basis, for instance when the conditions for early intervention have been met or in the context of important decisions to be taken, such as decisions regarding early intervention measures or FoLTF determination.
103. There is also an ongoing exchange of information, with information shared on a regular basis regarding, in particular, SREP outcomes and supervisory reporting. Similar exchange of information concerns also some data directly collected from institutions by resolution authorities, as part of their resolution functions.
104. Regarding the consultation of resolution authorities with regard to recovery plans, the EBA observed that the resolution authorities were always provided with the recovery plan of each institution and had the opportunity to examine it in order to identify the recovery actions that may adversely impact the resolvability of the institutions. Some resolution authorities have developed internal procedures to facilitate this assessment. Further elements of the recovery plans examined by the resolution authorities are, for instance, the identification of critical functions. The outcomes of the resolution authorities' examinations are communicated to the institutions in a feedback letter on the assessment of the recovery plans sent by the competent authorities.
105. On their side, the resolution authorities must consult the competent authorities with regard to the resolution plan development, the resolvability assessment, substantive impediments to the resolvability and MREL determination. Although this particular aspect was not assessed in detail as part of the current report, no concerns were raised as regards the cooperation between the resolution authorities and competent authorities in this respect. This aspect will be covered in more detail in the 2018 EBA activities on resolution and related reports.
106. Regarding the formalisation of the organisational provisions for the exchange of information, the EBA observed that some authorities have set up internal procedures or are in the process of doing so. These procedures specify operational details of the various circumstances in which information has to be exchanged between competent authorities and resolution authorities.

## 4. Convergence in colleges of supervisors

Colleges of supervisors play an important role in the efficient, effective and consistent supervision of financial institutions operating across borders. Colleges of supervisors are the forums for planning and coordinating supervisory activities, for conducting the supervisory risk/liquidity risk assessment, for reaching joint decisions on institution-specific requirements and for sharing important information about the supervised institutions.

The EBA, who is a member of colleges set up for the supervision of cross-border institutions, has a leading role in monitoring the proper functioning of the colleges of supervisors and in fostering the convergence and the consistency of the application of the Single Rulebook among these colleges.

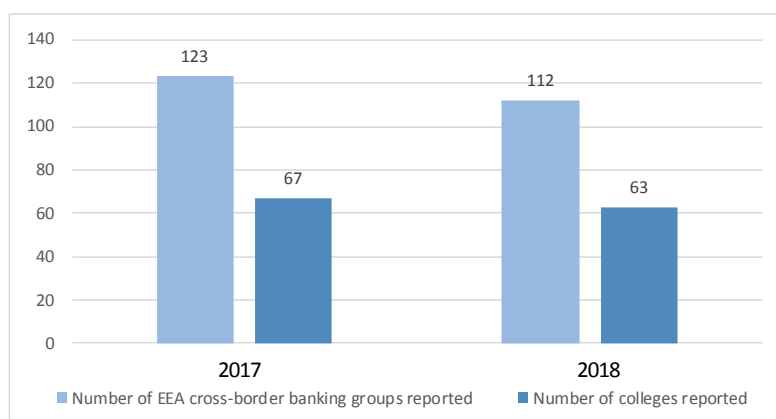
The EBA findings related to this monitoring are summarised in a report on colleges of supervisors that is published on an annual basis.

### 4.1 Monitoring of supervisory colleges in 2018

107. The list of colleges monitored and the approach taken for college monitoring is reviewed on a yearly basis. The EBA therefore uses the results of an annual mapping exercise that allows the identification of the EEA cross-border banking groups and the supervisory colleges that are active for the supervision of these groups.

108. Based on the information obtained from EEA consolidating supervisors during the 2018 mapping exercise, 112 EEA-headquartered cross-border banking groups were identified (compared with 123 in 2017), for which 63 active colleges have been reported (compared with 67 in 2017).

Figure 8: EEA cross-border banking groups and active colleges in 2017 and 2018



109. In addition, five active colleges were reported to have been set up for third-country banking groups at the EEA sub-consolidated level in 2018 (compared with 7 in 2017).

110. Overall, the number of colleges reported in 2018 (68) has slightly decreased compared with 2017 (74), as the restructuring of banking groups was not counter-balanced by newly established ones.

111. Within its mandate of facilitating supervisory cooperation and convergence between the competent authorities, the EBA monitors the functioning of supervisory colleges and participates in their activities.

112. The monitoring and assessment of the colleges covers the following main elements:

- organisational aspects;
- colleges' interactions;
- colleges' legal deliverables:
  - o group risk/liquidity risk assessments;
  - o joint decisions on capital and liquidity;
  - o joint decisions on the assessment of GRPs;
- key topics for supervisory attention.

113. According to its means, in 2018, the EBA's participation in meetings and conference calls focused on the main colleges.

114. The report relating to the 2018 cycle of colleges will include an overview of the supervisory colleges in the EEA and the role and approach of the EBA to the monitoring of colleges. The core of the report will be dedicated to the key observations from the 2018 monitoring of colleges. The observations will cover: (i) organisational aspects of colleges work and colleges' interactions (ii) the colleges' legal deliverables and (ii) the key topics for supervisory attention in 2018 (see Section 4.2). Throughout the sections best practices will be highlighted. The report will also provide an overview of the activities and tools provided by the EBA to support supervisory colleges. Finally, the report will set out the colleges' action plan for 2019.

## 4.2 Key topics for supervisory attention

115. The action plan for 2018, annexed to the 2017 report on supervisory colleges<sup>15</sup>, included the key tasks for supervisory colleges, the EBA's approach for college monitoring in 2018 as well as a list of important key topics for supervisory attention in 2018. These key topics were (i) NPL cleaning, (ii) business model and profitability, (iii) IT risk and operational resilience, (iv) internal governance, (v) Brexit, (vi) structural changes and (vii) IFRS 9. By communicating these key topics, the EBA ensures that the risks that are identified at macro level are cascaded through

<sup>15</sup> <https://eba.europa.eu/documents/10180/2159826/Report+on+colleges+functioning+2017.pdf/cde45674-1718-43dc-b22e-8fe7f7157186>

college structures to the micro level in a consistent manner across all colleges and that appropriate attention is dedicated to these areas of concern.

116. Competent authorities supervising cross-border banking groups were requested to pay particular attention to these topics in 2018 and to organise relevant discussions within the supervisory colleges' framework. Considering that all topics listed were not necessary equally relevant for all the credit institutions, the EBA expected that colleges would discuss their relevance early on and include the agreed priorities in the college supervisory examination programme, so that to embed the relevant ones in college work in 2018 (college discussion, joint activity, onsite activity, offsite activity, etc.).
117. The EBA staff followed up on how far these colleges incorporated the key topics into their yearly work. The EBA monitoring of the 2018 key topics shows that, in general, all of them have been taken into account in the college works in 2018. The full set of topics have not been necessarily discussed during the supervisory colleges meetings, but, in general, they have been subject to supervisory activities (mostly off-site activities but also on-site activities) and have been embedded in college works through, at least, the SREP assessment, as set out in the group risk assessment reports. The interest granted to each of these topics has not been uniform across the colleges. The main outcomes regarding these key topics will be detailed in the 2018 report on supervisory colleges.
118. For 2019, a convergence plan has been established to assess the degree of convergence in supervisory practices using key topics on which the EBA has recently developed guidelines. This convergence plan is presented in detail in Section 7 of this report.
119. The EBA will use the convergence tools at its disposal (see Section 1), in particular the monitoring of supervisory colleges, to review the approach applied by the competent authorities to monitor and assess these key topics. The '2019 EBA Colleges Action Plan', which will be included in the 2018 EBA report on supervisory colleges, will refer to the '2019 Convergence Plan'.



## 5. EBA policy work supporting supervisory convergence

**The EBA has expanded its regulatory framework to promote higher convergence of practices among the competent authorities.**

**This EBA policy work will provide a reference for future monitoring and assessment of convergence of supervisory practices. The policy development in the field of supervisory practices is mostly driven by the EBA addressing supervisory needs and areas where further convergence is needed.**

**In 2017-2018, the EBA completed policy work of the utmost importance and finalised guidelines in different areas, such as those developed to reinforce the EU SREP framework and those developed to improve and harmonise the institutions' sound governance arrangements.**

**The EBA guidelines, and all the other regulatory and policy products, are valuable tools to support convergence because they help establish consistent, efficient and effective supervisory practices within the EU. In the coming years, the EBA will pay great attention to the compliance with these EBA products and will carefully follow their effective implementation by competent authorities.**

### 5.1 Supervisory review and evaluation process

#### 5.1.1 Revision of the SREP Guidelines

120. Following the recent developments in the EU and international forums, as well as the EBA's assessments of the convergence of supervisory practices, specific changes were needed to reinforce the EU SREP framework, established by the former SREP Guidelines that were published in 2014 and have been in force since 2016. In accordance with its Pillar 2 Roadmap<sup>16</sup>, issued in April 2017, the EBA published in July 2018 its final revised Guidelines on the common procedures and methodologies for the SREP and supervisory stress testing.

121. These guidelines, which apply to competent authorities, are applicable from 01 January 2019 and aim to further enhance convergence in the SREP process. The changes introduced to the guidelines do not alter the overall SREP framework, established by the former SREP Guidelines in 2014. They mainly aim to enhance the requirements for supervisory stress testing and explain how stress testing outcomes will be used in setting P2G.

122. The changes include (i) a section on P2G, (ii) supervisory stress testing requirements, (iii) guidance on the supervisory assessment of institutions' stress testing, (iv) a clarification of the scoring framework, (v) an explanation of the interaction between the SREP elements and the

<sup>16</sup> See: <https://www.eba.europa.eu/documents/10180/1814098/EBA+Pillar+2+roadmap.pdf>

articulation of TSCR and OCR and the communication of supervisory capital expectations to the institutions, and (vi) consistency checks with relevant revised EBA standards and guidelines, in particular in the areas of internal governance and IRRBB.

### **5.1.2 Revision of the IRRBB Guidelines**

123. In accordance with the Pillar 2 Roadmap published by EBA in April 2017, the IRRBB Guidelines have been revised and published in July 2018. They will be applicable from 30 June 2019 with transitional arrangements for specific provisions until 31 December 2019.

124. IRRBB is an important financial risk for credit institutions that is considered under Pillar 2. The supervisory framework assumes that banks develop their own methodologies and processes for identification, measurement, monitoring and control of this risk. These methodologies and internal processes, including the assumptions used, are subject to the SREP carried out by supervisory authorities.

125. The aim of these guidelines is to set out supervisory expectations regarding the management of IRRBB. These guidelines build upon the EBA guidelines published in May 2015 and take account of existing supervisory expectations and practices including the standards on IRRBB published by the Basel Committee on Banking Supervision (BCBS Standards) in April 2016.

126. These BCBS Standards are being implemented in the EU framework in two phases: (i) through this update to the EBA guidelines, and (ii) through the ongoing revision of the CRD/CRR and the enactment of a number of technical standards that are expected to be mandated to the EBA in the revised CRD and CRR.

127. The EBA decided to implement this progressive approach and to update these EBA guidelines, in order to bridge the time gap between the implementation of the BCBS Standards and the technical standards to be introduced following the revision of the CRR/CRD framework, and also to improve the existing guidelines, in particular in those areas where the competent authorities feel the need for a more practical approach.

128. The main changes to the IRRBB Guidelines include (i) the inclusion of high-level guidance for the monitoring of credit spread risk in the banking book, (ii) requirements for model validation, (iii) a number of changes to the existing supervisory outlier test including the removal of the zero bound floor and the inclusion of NPEs as general interest rate sensitive instruments, and (iv) the introduction of an 'early warning signal' in addition to the existing supervisory outlier test.

### **5.1.3 Revision of the Guidelines on institutions' stress testing**

129. In accordance with the Pillar 2 Roadmap published by EBA in April 2017, the Guidelines on institutions' stress testing have been revised and published in July 2018. They are applicable from 01 January 2019.

130. These Guidelines on institutions' stress testing update the 2010 Committee of European Banking Supervisors (CEBS) guidelines on this topic. Since 2010, when the CEBS Guidelines on stress testing were issued, there have been a number of developments in stress testing with regard to its methodologies and usage. The financial crisis and several negative events in the financial sector since 2010 have highlighted significant lessons in relation to stress-testing practices. Supervisory expectations in relation to institutions' stress-testing practices have changed in light of this recent experience.
131. These revised guidelines aim to achieve convergence of the practices followed by institutions for stress testing across the EU. They provide detailed guidance on the way institutions should design and conduct a stress-testing programme/framework. They define common organisational requirements, methodologies and processes for the performance of stress testing by institutions as part of their risk management processes. They feature a common taxonomy on stress testing.
132. The revised guidelines reflect industry practices as well as the incorporation of recovery planning. They also address the deficiencies identified by the EBA as part of the peer review process of the implementation of 2010 CEBS Guidelines on stress testing.

#### 5.1.4 Supervisory risk taxonomy

133. It appeared, in recent years<sup>17</sup>, that it was necessary to develop a comprehensive supervisory risk taxonomy in order to ensure the common understanding of risks and their respective categorisation among competent authorities. This would provide a harmonised way for competent authorities to assess institutions' internal risk management and risk quantification. The aim of the shared supervisory risk taxonomy is to improve convergence in the SREP practices and to improve consistency in the application of supervisory measures, including Pillar 2 capital add-ons across the EU.
134. To this end, in 2017 the EBA has developed a supervisory risk taxonomy that has been subject to an 18-month testing period and which is in the process of being finalised. The testing period allowed sufficient time to test the taxonomy in practice, covering at least one SREP cycle.
135. In order to facilitate the integration of the supervisory risk taxonomy into existing supervisory practices and outcomes, the taxonomy builds, as much as possible, on definitions provided by the Level 1 and Level 2 regulations as well as the SREP Guidelines and other EBA policy products.
136. In practice, the supervisory risk taxonomy could be applied, in particular, to the following supervisory activities:
- the ICAAP assessment (reconciliation of the risks identified by institutions with risks provided by the CRR/CRD and SREP Guidelines or other relevant regulatory products);

<sup>17</sup> See in particular the 2017 report on convergence of supervisory practices and the outcomes of the EBA's analysis of aggregate P2R.

- supervisory benchmarks development (construction of relevant supervisory benchmarks to assist supervisory authorities in their assessment of the institutions ICAAP);
- the SREP process (beyond the ICAAP assessment, which is embedded in the SREP process, the taxonomy should support competent authorities in designing their SREP processes and should facilitate benchmarking against peers).

## 5.2 Internal governance

### 5.2.1 Revision of the Guidelines on internal governance

137. Weaknesses in corporate governance have contributed to excessive and imprudent risk-taking in the financial sector. In recent years, internal governance issues have received increased attention from various international bodies. Directive 2013/36/EU reinforces the governance requirements for institutions and in particular stresses the responsibility of the management body for sound governance arrangements. In this context, a mandate has been given to the EBA to develop guidelines to further harmonise institutions' internal governance arrangements, processes and mechanisms within the EU.

138. Accordingly, the EBA published in September 2017 its revised Guidelines on internal governance. They entered into force on 30 June 2018 and are applicable to competent authorities across the EU, as well as to institutions on an individual and consolidated basis. Their main aim has been to correct institutions' weak or superficial internal governance practices, as identified during the financial crisis, and to enable competent authorities to supervise and monitor the adequacy of institutions' internal governance arrangements, increase supervisory convergence and contribute to efficient and effective cooperation among competent authorities.

139. The guidelines, which take into account the proportionality principle, put more emphasis on the duties and responsibilities of the management body in its supervisory function in risk oversight, including the role of their committees.

140. They aim to improve the status of the risk management function, enhancing the information flow between the risk management function and the management body and ensuring effective monitoring of risk governance by supervisors. The 'know your structure' and complex structures sections, especially following the 'Panama events', have been strengthened to ensure that the management body is aware of the risks that can be triggered by complex and opaque structures and to improve transparency. In addition, the framework for business conduct has been further developed and more emphasis is given to the establishment of a risk culture, a code of conduct and the management of conflicts of interest.

141. Competent authorities should ensure that institutions comply with these guidelines on an individual, sub-consolidated and consolidated basis. In addition, the guidelines set out how competent authorities should establish effective and reliable mechanisms to enable

institutions' staff to report to competent authorities any relevant potential or actual breaches of regulatory requirements, including, but not limited to, those of Regulation (EU) No 575/2013 and national provisions transposing Directive 2013/36/EU.

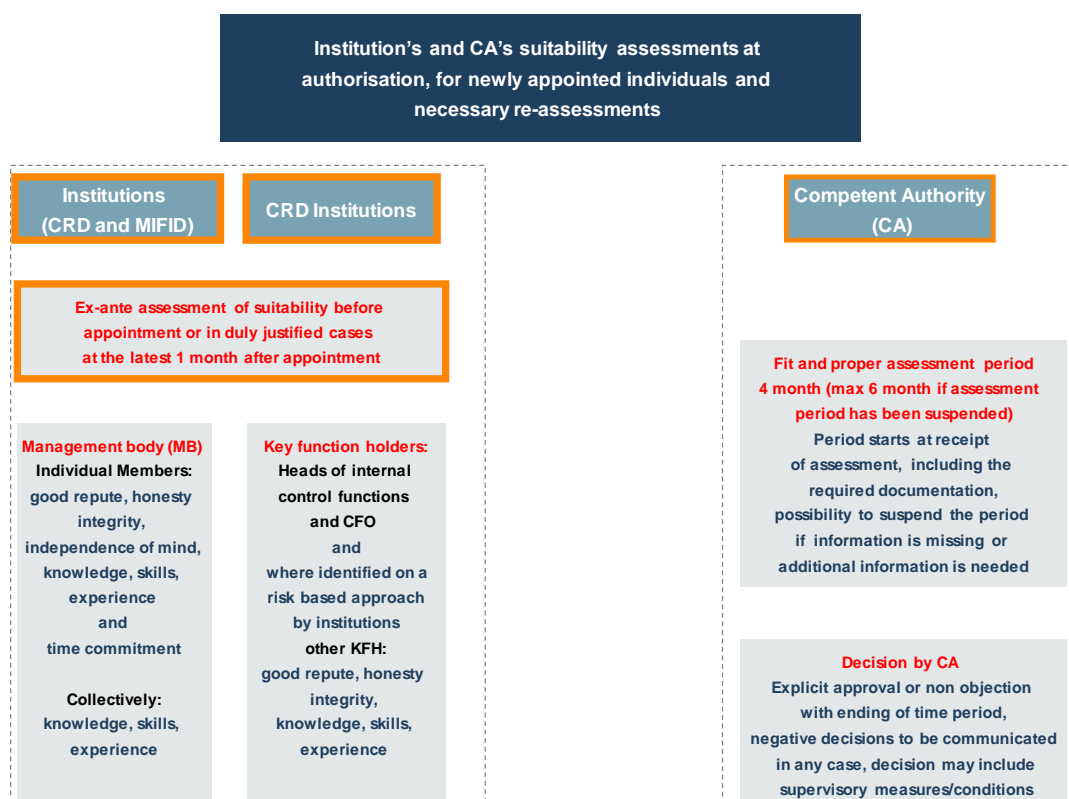
## 5.2.2 Revision of the Guidelines on 'fit and proper'

142. In order to address weaknesses in corporate governance, it has become obvious that the role and responsibilities of management bodies in both their supervisory and management functions need to be strengthened in order to ensure sound and prudent management of credit institutions. To further improve and harmonise the assessment of the suitability of members of the management body and key function holders within the EU banking and securities sector, in line with the requirements introduced by the CRD and MIFID II, a mandate has been given to the EBA, jointly with ESMA, to issue guidelines on the notion of suitability.
143. Accordingly, the EBA and ESMA published in September 2017 their joint Guidelines on the assessment of the suitability of members of the management body and key function holders ('fit and proper'). The joint guidelines entered into force on 30 June 2018 and are applicable to competent authorities across the EU, as well as to institutions on an individual and consolidated basis. They aim to harmonise and improve suitability assessments, including the assessment processes performed by competent authorities, within EU financial sectors and to ensure sound governance arrangements in financial institutions. A higher level of harmonisation would be desirable within the banking union but could not be achieved in the current circumstances because of, amongst other things, the existing fragmented national frameworks<sup>18</sup>.
144. Competent authorities are required to assess all members of the management body. For significant CRD-institutions, competent authorities should assess the heads of internal control functions and the chief financial officer (CFO), where they are not members of the management body. This should be done at the highest level of consolidation for significant CRD-institutions that are part of a group but not subject to prudential consolidation by a significant consolidating CRD-institution, and at the individual level if the significant CRD-institution is not part of a group. Competent authorities should ensure that a description of these assessment procedures is publicly available.

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<sup>18</sup> With regard to the national implementation of the EBA Guidelines on the assessment of the suitability of members of the management body and key function holders, please refer to the compliance table available under: <https://eba.europa.eu/regulation-and-policy/internal-governance/joint-esma-and-eba-guidelines-on-the-assessment-of-the-suitability-of-members-of-the-management-body>

Figure 9: Institutions' and competent authorities' suitability assessments



145. The guidelines specify that competent authorities should take a decision based on the assessment of individual and collective suitability of members of the management body and the assessment of heads of internal control functions and the CFO, where they are not members of the management body, within a maximum period of, in the general case, 4 months.

146. Competent authorities should also provide each other, in accordance with the applicable data protection legislation, any information they hold about a member of the management body or key function holder for the performance of a suitability assessment and may take into consideration the results of the assessment of suitability conducted by other competent authorities about members of the management body or key function holders and request the necessary information from other competent authorities in order to do so.

### 5.2.3 Revision of the Guidelines on outsourcing

147. Over recent years, there has been an increasing interest of financial institutions to outsource business activities in order to reduce costs and improve their flexibility and efficiency.

148. In a context of digitalisation and increasing importance of new financial innovation and financial technology (FinTech) providers, financial institutions are adapting their business models to embrace such technologies. Some have increased the use of FinTech solutions and have launched respective projects to improve their cost efficiency as the intermediation

margins from the traditional banking business model are put under pressure by the low interest-rate environment. Outsourcing is a way to get relatively easy access to new technologies and to achieve economies of scale.

149. Notwithstanding its benefits, outsourcing of IT services and data poses security issues and challenges to institutions' governance framework, in particular to internal controls as well as to data management and data protection.
150. As mentioned above, in line with the governance requirements introduced by the CRD, a mandate has been given to the EBA to develop guidelines to further harmonise institutions' internal governance arrangements. Outsourcing is one of the specific aspects of institutions' governance arrangements. The EBA launched in June 2018 a public consultation on its draft Guidelines on outsourcing.
151. These draft guidelines, which review the existing CEBS Guidelines on outsourcing published in 2006, aim to establish a more harmonised framework for outsourcing arrangements of all financial institutions in the scope of the EBA's action, namely credit institutions and investment firms but also payment institutions and electronic money institutions. They include the Recommendation on outsourcing to cloud service providers published in December 2017.
152. These draft guidelines are applicable to competent authorities across the EU, as well as to financial institutions. They set out specific provisions for these financial institutions' governance framework with regard to their outsourcing arrangements.
153. According to these guidelines, competent authorities should assess, in particular, whether or not institutions monitor and manage appropriately any outsourcing arrangement and in particular those that are critical or important, whether or not institutions have sufficient resources in place to monitor and manage outsourcing arrangements and whether or not institutions identify and manage all relevant risks.
154. Competent authorities should be satisfied that they can effectively supervise institutions including those outside the EU/EEA, and that institutions have ensured within the outsourcing arrangement that service providers are obliged to grant the competent authority and the institution audit and access rights.
155. A register of all outsourcing arrangements should be made available to competent authorities upon request (e.g. as part of the SREP). This requirement aims to facilitate supervision on a macro and a micro level. Institutions should adequately inform competent authorities in a timely manner or engage in a supervisory dialogue with regard to planned critical or important outsourcing arrangements. The final guidelines are in the process of being finalised.

## 6. Training provided to competent and resolution authorities

### Promoting supervisory convergence through EBA training programmes

**As one of the main tools for the EBA in promoting supervisory convergence and contributing to a common supervisory culture, EBA training programmes aim to deliver interactive courses whereby speakers from all over the EU are also able to present a diversity of EU perspectives.**

#### Overview of training provided in 2017

156. In 2017, the EBA organised 16 training events. Overall attendees expressed very positive views on the training offered.

157. Following the increase in demand in 2017 for EBA's online courses and in line with its 2016 business plan to further extend its training activities, the EBA purchased a learning management system (LMS) to implement its online training in-house. The new online platform for training was instrumental in rerunning updates of the existing core curriculum courses on 'Bank Recovery Planning' and 'SREP'. With its new LMS, the EBA aimed to deliver modules on key risk topics to an estimated 500 active users per month and further reach out to the wider supervisory, regulatory and resolution networks.

158. The training offered in 2017 is shown in Table 1.

**Table 1: Overview of the training events that the EBA provided for EU competent and resolution authorities in 2017**

	Title	Date	Host	Number of attendees
1	EBA workshop on EBA Guidelines on DGS stress tests	21 February 2017	EBA, London	64
2	Risk-based AML/CFT supervision	3 March 2017	EBA, London	76
3	The role of mediation in colleges	22 March 2017	EBA, London	12
4	Joint EBA/BCBS — Basel III and the EU Capital Requirements Regulation and Directive (CRD/CRR) — latest developments	4-5 April 2017	EBA, London	45
5	Online module — SREP process and methodology for assessment of risks	12-19 May 2017	Online	110
6	Supervisory colleges and joint decisions	6-7 June 2017	EBA, London	28
7	Online module — recovery planning	6-16 June 2017	Online	36
8	Supervisory reporting	13-14 June 2017	EBA, London	73
9	Cross-sector: working with ESAs (organised by ESMA)	23 June 2017	Paris, France	34
10	Resolution plans and resolvability assessment: current practices and challenges	29-30 June 2017	EBA, London	100



11	IRB Approach I — RTS on assessment methodology of the IRB approach	18-19 October 2017	EBA, London	68
12	IRB Approach II — assessment of PD models	21-22 November 2017	EBA, London	81
13	Operational risk — a regulatory and supervisory update	23 November 2017	Vilnius, Lithuania	41
14	Practical application of and methodological aspects of BMA	4-5 December 2017	EBA, London	64
15	IRB Approach III — assessment of LGD models and models for defaulted exposures	6-7 December 2017	EBA, London	77
16	IT risk on supervision and cloud outsourcing	18-19 December 2017	EBA, London	76
<b>Total</b>				<b>985</b>

### Overview of training provided in 2018

159. In 2018, the EBA offered in total 27 training events to competent and resolution authorities: 26 sectoral training events and one cross-sector training event on ‘Impact Assessment’, given jointly with EIOPA.
160. EBA’s 10 online training events, in the form of online modules and informational webinars, contributed considerably to the expansion of the number of training events and attracted over 400 registrants. In an effort to accommodate all registered candidates, in the case of 5 out of 27 training events, registrants were waitlisted and prioritised for future reruns.

### Residential training

161. Among the most visited training events were the EBA’s workshops on supervisory convergence, a series of workshops on Supervisory Convergence in Payment Services. The workshops focused on the EBA’s development of technical standards and guidelines aimed at protecting consumers across the 28 EU Member States, primarily in support of the Mortgage Credit Directive, the Payment Accounts Directive, the Payment Services Directives and the Electronic Money Directive. With the said requirements in force across EU Member States, the EBA delivered supervisory convergence workshops with the national representatives who had developed the requirements and their supervisory colleagues who would now supervise them.
162. EBA’s first training event on ‘Money remitters’, part of the series of workshops on anti-money laundering, was held on 8 February 2018 in the form of an interactive panel discussion. Industry representatives and supervisors exchanged best practices and useful approaches to potential problem areas in the supervision of money remitters. Additionally, the second training event in the anti-money laundering series, ‘The risk-based approach to anti-money laundering and counter-terrorist financing’ held on 20-21 March 2018, welcomed 80 participants, of whom 50 expressed a high level of satisfaction in the feedback forms, in particular with regard to the case studies conducted at the workshop.
163. On 15-16 March 2018, the EBA held its first joint training event with the Academy of European Law (ERA) on ‘FinTech: Challenges for regulators and legal professionals’ at its premises in London. The training focused on EBA’s Roadmap on FinTech, which was published on

15 March 2018. The 83 participants who attended were mainly representatives of national competent authorities and also members of the ERA. The immediate feedback received on the format of the training, which was a combination of presentations and discussions, was expressly positive. The EBA welcomed speakers from the Bank of Italy and KPMG Law who together with EBA policy experts on anti-money laundering and consumer protection, presented topics relating to the potential risks and opportunities for credit and payment institutions.

### Online training

164. Since going live in February 2018, the EBA's LMS has enrolled 482 participants and accredited 286 participants with certificates of completion. The EBA's core curriculum training on 'Bank recovery planning' held on 12-22 February 2018 and 'SREP' on 19-23 March 2018 were developed in and delivered from the EBA's new online platform, using its own resources. Updates of both training events, including the online training on MREL, were run again later in the year with recordings of the sessions made available on the LMS for absent participants. Further online sessions have included the online webinars 'NPLs — Introduction to and discussion of the EBA templates' and 'Q&A Implementation Review', which were interactive informational discussions also made available to those unable to join the live sessions. Some training events were oversubscribed, with 44 registrants waitlisted for the online training on MREL held between 24 September 2018 and 03 October 2018 and 8 registrants waitlisted for the training on SREP held on 12-16 November 2018, all of whom will be prioritised for reruns in 2019.

165. The training offered in 2018 is shown in Table 2.

Table 2: Overview of the training events that the EBA provided for EU competent and resolution authorities in 2018

	Title	Date	Host	Number of attendees
1	Supervisory convergence in payment services II (for SCPS members only)	10 January 2018	EBA London	57
2	EBA/EUI <sup>19</sup> online module — Supervisory review and evaluation process	5-9 February 2018	online	79
3	Money remitters	8 February 2018	EBA, London	56
4	Online module — Bank recovery planning	12-22 February 2018	online	32
5	EBA technical standards under Payments Account Directive (PAD) implementation workshop	14 February 2018	EBA, London	23
6	FinTech: Challenges for regulators and legal professionals (only for ERA and EBA staff)	15-16 March 2018	EBA, London	83

<sup>19</sup> European University Institute

7	Online module — Supervisory review and evaluation process	19-23 March 2018	online	52
8	The risk-based approach to anti-money laundering and counter-terrorist financing	20-21 March 2018	EBA, London	80
9	EBA NPL template	11 April 2018	webinar	77
10	Supervisory convergence in payment services III (for SCPS members only) — RTS on strong customer authentication	18-19 April 2018	EBA, London	47
11	Regional seminar on Basel III and the EU Capital Requirements Regulation and Directive (CRR/CRD) — finalising post-crisis reforms	15-17 May 2018	EBA, London	51
12	Q&A Implementation Review	3 August 2018	webinar	77
13	Supervisory review and evaluation process (only for supervisors of the Bank of Moldova)	20 August-14 September 2018	online	18
14	Supervisory convergence in payment services IV — Focus on application programming interfaces (for SCPS members only)	11 September 2018	EBA, London	59
15	The role of mediation in colleges	19 September 2018	EBA, London	30
16	Supervisory convergence in consumer protection — product oversight and governance and remuneration of sales staff (for SCPS members only)	20-21 September 2018	EBA, London	31
17	Loss absorption capacity: MREL and total loss absorption capacity	24 September-3 October 2018	online	57
18	Electronic money and AML/CTF	27 September 2018	EBA, London	80
19	Cross-sector seminar on impact assessment	27 September 2018	EBA, London	35
20	FinTech knowledge: The impact of FinTech on incumbent credit institutions' business models	11 October 2018	online	220
21	EBA workshop on supervisory convergence in payment services V	16-17 October 2018	EBA, London	66
22	Data analytics and the data point model	7-8 November 2018	EBA, London	78
23	Online module - Supervisory review and evaluation process	12-16 November 2018	online	80
24	IFRS 9	26-27 November 2018	EBA, London	52
25	Online module on MREL	3-14 December 2018	online	66
26	Workshop on stress test	5 December 2018	EBA, London	42
27	Liquidity risk regulation and supervision	5-6 December 2018	EBA, London	59
<b>Total</b>				<b>1687</b>

## 7. 2019 Convergence plan

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166. The general idea guiding the EBA when defining the convergence plan is to assess the degree of convergence in supervisory practices through key topics, having regard in particular to key risks (as identified in the EBA Risk Assessment Report and Risk Dashboard or other risk analysis tools) as well as the recent developments of the Single Rulebook that amended the supervisory requirements for competent authorities or that require attention for a common implementation of their supervision when it comes to requirements addressed to banks.
167. In 2019, the EBA will review the approach applied by the competent authorities to monitor and assess key topics. For some topics, it would be possible to include objective metrics in this review. In order to facilitate comparability, the metrics chosen will be usual ones, widely shared among competent authorities.
168. The EBA will use the convergence tools at its disposal (see Section 1) to conduct this review, in particular the monitoring of colleges. Depending on its means in 2019, other complementary tools could be used for the same purpose, for instance the bilateral convergence visits.

### Key topics identified for the 2019 convergence plan

#### (a) Internal governance

169. Weaknesses in corporate governance have contributed to excessive and imprudent risk-taking in the financial sector, as identified during the financial crisis. Consequently, internal governance has been a major point of attention of the regulators in the recent years. The CRD reinforces the governance requirements for institutions and in particular stresses the responsibility of the management body for sound governance arrangements.
170. In 2017-2018, the EBA completed various guidelines to improve and harmonise the institutions' sound governance arrangements.
171. The revised Guidelines on internal governance (EBA/GL/2017/11), published in September 2017, put more emphasis on the duties and responsibilities of the management body in its supervisory function in risk oversight.
172. Guidelines addressing specific aspects of internal governance have also been published in September 2017. These guidelines, jointly developed by the EBA and ESMA (EBA/GL/2017/12), aim to harmonise and improve the assessment of the suitability of members of the management body and key function holders ('fit and proper') within EU financial sectors and to ensure sound governance arrangements in financial institutions.
173. Regarding another specific aspect of internal governance, the EBA started in Q4 2018 a formal peer review regarding the RTS on criteria to identify categories of staff whose professional

activities have a material impact on an institution's risk profile (RTS on identified staff). The report should be published in 2019.

174. In 2019, the EBA will review the approach followed by the competent authorities to monitor and assess the adequacy and the robustness of internal governance arrangements of institutions.

175. In particular, the EBA will examine the compliance of this approach with the revised EBA Guidelines on internal governance (EBA/GL/2017/11) and the EBA-ESMA joint Guidelines on the assessment of the suitability of members of management bodies and key function holders (EBA/GL/2017/12), both of which entered into force on 30 June 2018.

**(b) ICT risk and operational resilience**

176. Information and communication technology (ICT) plays an important role in the functioning of institutions, and the risks associated with ICT may pose a significant prudential impact and even threaten the viability of an institution.

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

- the emergence of (new) cyber risks together with the increased potential for cybercrime and the appearance of cyber terrorism;
- the increasing reliance on outsourced ICT services and third-party products, often in the form of diverse packaged solutions resulting in manifold dependencies and potential constraints and new concentration risks.

178. The growing importance and increasing complexity of ICT risk within the banking industry and in individual institutions, as well as the increasing potential adverse prudential impact from this risk on an institution and on the sector as a whole, have prompted the EBA to develop its own-initiative guidelines to assist competent authorities in their assessment of ICT risk as part of the SREP and to promote common procedures and methodologies in this area. These Guidelines on ICT risk assessment under the SREP were published on May 2017 and entered into force on 01 January 2018.

179. In 2019, the EBA will review the approach followed by the competent authorities to monitor and assess the IT risk and operational resilience as well as to integrate the outcomes of this assessment into the overall SREP. In particular, the EBA will examine the compliance of this approach with the Guidelines on ICT risk assessment under the SREP.

**(c) Non-performing exposures**

180. The financial crisis negatively affected the European banking sector and contributed to a build-up of NPEs on many banks' balance sheets. The joint efforts of banks, supervisors, regulators and macroprudential authorities have led to a slow improvement in recent years. The ratio of

NPLs to total loans continued the downward trend and achieved a level of 3.6% in Q2 2018 (compared with 4.5% in Q2 2017 and 5.4% in Q2 2016).

181. However, this level remains too high compared with international standards and is broadly dispersed across the EU (ratios between 0.66% and 44.6%), meaning that NPL/asset quality remains an issue to deal with. Similarly, the average coverage ratio has decreased (46% in Q2 2018 compared with 45% in Q2 2017 and 43.9% in Q2 2016) but also masks important differences from one jurisdiction to another.
182. In accordance with the European Council Action Plan set up in July 2017 to tackle NPL in Europe, the EBA developed Guidelines on management of non-performing and forborne exposures. These guidelines aim to ensure that credit institutions have adequate prudential tools and frameworks in place to manage effectively their NPEs and to achieve a sustainable reduction on their balance sheets. To this end, the guidelines require institutions to establish NPE reduction strategies and introduce governance and operational requirements to support them.
183. The Guidelines on management of non-performing and forborne exposures, which are addressed to credit institutions and competent authorities, were published on October 2018 and will be applicable from 30 June 2019.
184. In 2019, the EBA will review the approach followed by the competent authorities to monitor and assess the reduction of NPLs in institutions' balance sheets as well as their coverage. In particular, the EBA will examine the level of compliance of this approach/the degree of preparation of the competent authorities to comply with the Guidelines on management of non-performing and forborne exposures.

**(d) Use of benchmarking exercise for internal models**

185. 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, among others, that (i) competent authorities conduct an annual assessment of the quality of internal models and (ii) EBA produces reports to assist competent authorities in this assessment.
186. The EBA's report is based on data submitted by institutions in accordance with Regulation (EU) No 2016/2070, which specifies the benchmarking portfolios, templates and definitions to be used.
187. These benchmarking exercises have been developed in order to assist competent authorities in the authorisation and review of internal models and to support their on-site and off-site supervisory works. These benchmarking exercises help to identify internal models that show significant deviation of risk parameters and RWAs from peers and potential significant underestimations in the calculation of the regulatory capital. These deviations and

underestimations need to be fully analysed, duly justified, and, if necessary, be subject to supervisory actions/bank-specific implementation plans.

188. More generally, the EBA published in 2016 an Opinion on the implementation of the regulatory review of the internal ratings-based (IRB) approach. This Opinion specifies the general principles and timelines for the implementation of the regulatory review of the IRB approach. This Opinion and the underlying report are part of the EBA's work to identify the main regulatory actions necessary to address the key drivers of variability in the implementation of IRB models. Following the conclusion of its regulatory repair roadmap on these matters and based on the duties required by Article 78 of the CRD, the EBA will focus more on how the repaired outcomes give rise to supervisory actions.

189. In 2019, the EBA assessment will review the approach followed by the competent authorities regarding:

- The review of the IRB approach, in order to evaluate the progresses made since the publication in 2016 of the EBA Opinion on the implementation of the regulatory review of the IRB approach.
- The use of the outcomes of the 2018 benchmarking exercises, in particular for credit risk internal models, in order to assess the quality of the institutions' internal approaches used for the calculation of own-funds requirements.



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