

## Deloitte Banking Alert

February 2021

### ECB: SREP Result 2020 & Priorities for 2021

On January 28, the ECB issued the SSM Supervisory Priorities for 2021 together with the results of the 2020 SREP exercise.

The supervisory priorities for 2021 follow the assessment of the key risks and vulnerabilities in the banking sector. Although the uncertainty regarding the impact of the COVID-19 pandemic remains high in the short to medium term, the ECB plans to proceed with its supervisory work plan for 2021.

The four priority areas for 2021 are:

- Credit risk management;
- Capital strength;
- Business model suitability;
- Governance.

Additionally to the priorities listed above, the ECB announces that supervisors will also focus on the banks' alignment with the expectations regarding to climate-related and environmental risks, risks from money laundering, cyber and digitalization risks and banks' preparedness for implementation of Basel III.

#### Highlights from the Supervisory Priorities for 2021

##### 1. Credit risk management

- It is expected that the COVID-19 pandemic and the deteriorating macroeconomic environment will have a significant impact on banks' asset quality (translated into downgrades, increase in distressed borrowers and impaired collaterals);
- The actions taken by the public authorities (be it monetary, fiscal, regulatory and supervisory) have ensured that the liquidity issues did not turn into solvency issues;
- For 2021, the ECB plans to further strengthen the initiatives already launched in 2020 so that banks still have **adequate risk management practices** in place to identify, measure and mitigate

the impact of credit risk, as well as the operational capacity to manage the expected increase in distressed borrowers;

- The ECB Banking Supervision announced that they will focus its efforts **on the adequacy of banks' credit risk management, operations, monitoring and reporting**;
- Emphasis will be placed on the banks' capacity to continue taking the necessary actions that ensure an **appropriate management of loan arrears and NPLs**.

## 2. Capital strength

- The ECB states as important the adequacy of banks' capital positions and the identification of specific vulnerabilities at an early stage in order to implement remedial actions;
- Banks should follow **sound capital planning processes** on capital projections in order to be able to adapt to a rapidly changing environment, particularly in a crisis situation;
- The **EU-wide stress test** coordinated by the EBA is scheduled to be conducted during 2021.

## 3. Business model suitability

- Taken into account the pressures of the current economic environment, the banks' profitability and business model suitability have been deeply impacted;
- The ECB plans to challenge the banks' **strategic plans** and the measures taken in order to overcome the existing shortcomings that they may face;
- **Digital transformation** has also become a key topic for ECB, in the light of the acceleration of this area due to COVID-19; thus, supervisors will be assessing banks' progress in response to the developments.

## 4. Governance

- Supervisors will continue to focus on the adequacy of banks' **crisis risk management frameworks**, as well as their ability to adapt and implement them in the context of the current crisis;
- Another key topic to be assessed is the **Management Body's** challenge and awareness of the entire risk management framework within the banks;
- The ECB will also focus on **risk data aggregation, risk information reported to management**;
- **IT and cyber risk** management practices and governance;
- Risks resulting from the **outsourcing** of services to third-party providers;
- The ECB will continue its assessment of the prudential impact of **money laundering and terrorism financing risks**, paying a particular attention to banks' internal control frameworks.

## Highlights from the ECB's qualitative SREP results for 2020

The ECB has issued a series of qualitative recommendations during the 2020 SREP exercise. Please see below some of them:

- The majority of the recommendations sent to banks referred to the adequacy of their processes under crisis conditions;
- Compared to the previous SREP cycle:
  - **Significantly increase of findings related to credit risk (by 79%).** The recommendations issued were more severe than in previous years, which can attest the increased supervisory scrutiny into credit risk management practices;
  - There has been a **significant increase also in the business model related findings (by 105%);**
  - **A stable trend has been identified with regards to findings related to capital and internal governance,** although internal governance recommendations still represent the highest portion of all SREP recommendations;
  - On the bright side, findings related to **liquidity risk have decreased significantly (by 20%).**

For further questions regarding the aspects mentioned in this alert, please don't hesitate to contact us.



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#### Sources:

[https://www.bankingsupervision.europa.eu/banking/priorities/html/ssm.supervisory\\_priorities2021~9b7076bb8b.en.html#toc1](https://www.bankingsupervision.europa.eu/banking/priorities/html/ssm.supervisory_priorities2021~9b7076bb8b.en.html#toc1)