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Deloitte Banking Alert

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Navigating 2024: EBA's Roadmap for EU Prudential Supervision

The European Banking Authority (EBA) plays a crucial role in promoting harmonized supervisory practices across the European Union (EU). One of its key tools for achieving this is the European Supervisory Examination Programme (ESEP), which outlines the focus areas for supervisory attention each year. This document outlines the **significant topics for 2024**, responding to current **challenges** and providing clear **priorities for EU supervisors**.

The 2024 ESEP serves as a guide for **Competent Authorities** (CAs) in setting their supervisory priorities and aligning their day-to-day activities with the identified key topics. It is important to note that the **ESEP does not replace the need for CAs to develop their own examination programs**, which should consider their specific banking system, individual banks or banking groups, and any cross-border considerations.

About the ESEP

The European Banking Authority (EBA) employs the European Supervisory Examination Programme (ESEP) as **a critical tool to achieve supervisory** convergence across the EU. ESEP's key topics for 2024 are chosen based on risk analysis, policy work, and input from Competent Authorities (CAs). In 2023, the ESEP focused on macroeconomic and geopolitical risks, operational resilience, transition risks and money laundering and terrorist financing (ML/TF) risks. **For 2024, ESEP targets asset and liability management, with emphasis on liquidity and funding risk, interest rate risk, and recovery operationalization.** The EBA remains adaptable to evolving market conditions and employs various tools for assessment, ensuring consistency in supervisory reviews across the EU.

Key Topics for Supervisory Attention in 2024

Several factors are underpinning the selection of these themes, specifically:

- The conclusion of TLTRO-3, resulting in **reduced liquidity** in the system, impacting bank funding strategies and necessitating a proactive approach to managing the transition.

- **The rising interest rate environment**, which affects both the liquidity and funding sources of banks, as well as influencing depositor behavior. This is compounded by the implementation of the IRRBB package in the EU.
- **Recent bank failures in the US and the case of Credit Suisse** , which have underscored the critical importance of effective asset-liability management and crisis preparedness.
- **The volatility in energy and food markets**, which is sustaining inflationary pressures and exerting pressure on economic growth and lending activities.

1. **Liquidity and Funding Risk**:

   EU/EEA banks face liquidity challenges due to market volatility, rising interest rates, and the phasing out of targeted longer-term refinancing operations (TLTRO) funding. Effective liquidity and funding management, including diverse funding sources and rapid communication strategies, are essential to mitigate these risks. Competent authorities need to assess liquidity risk, funding profiles, deposit management, and social media impact on bank runs.

2. **Interest Rate Risk and Hedging**:

   Banks must navigate the shift from ultra-low interest rates to a rising rate environment with inflation. Supervisors need to ensure banks have efficient interest rate risk management, including robust hedging strategies, modeling, and sensitivity analysis.

3. **Recovery Operationalization**:

   Recent market events underscore the **need for crisis preparedness and effective recovery plans**. Recovery plans must be updated, include credible options to restore financial soundness, and address emerging risks. Supervisors should assess the adequacy of recovery plan scenarios, the calibration of indicators, liquidity recovery capacity, testing of recovery plans, and communication arrangements to ensure institutions are prepared for crisis situations.

Further Considerations

- **Ongoing vigilance** is required for risks associated with higher interest rates, persisting inflation, and potential deterioration in asset quality, especially in commercial real estate portfolios.
- **Cyber risk and data security**, as well as **ICT risks**, remain critical operational concerns. These risks are evolving with digitalization, necessitating ongoing supervisory attention, aligned with the upcoming **Digital Operational Resilience Act** (DORA) regulation. Data security is also vital for emerging services like crypto assets and **ESG metrics**.
- **Sustainable finance**, although not a key item for 2024, will continue to be a focal point for the EBA. Progress has been made in integrating **ESG risk supervision into examination programs**.

- Banks must accelerate efforts in **risk data aggregation and digitalization strategies** to adapt to changing business models and risk profiles.
- **The institution-specific nature of supervisory review** ensures the assessment of all material idiosyncratic risks within individual banks.

Conclusion

In navigating the financial landscape of 2024, the **EBA has identified key supervisory areas vital for maintaining the stability and resilience of the banking system**. These encompass **liquidity and funding risk**, **interest rate risk and hedging and recovery operationalization**. However, challenges persist, including evolving risks in asset quality, the ever-present threat of cyber risk and the ongoing digital transformation. Sustainable finance and the need for accelerated digitalization efforts are also on the horizon. The institution-specific nature of supervisory review remains paramount. The EBA's vigilance and commitment to supervisory excellence ensure the EU's financial system continues **to adapt and thrive in a dynamic and ever-changing environment.**

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

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