EUROPEAN BANKING NEWSLETTER

NOVEMBER 2021

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EU-US Financial Regulatory Forum – European Commission publishes joint statement following September 2021 meeting – *4 October 2021* – The European Commission has published a joint statement by members of the EU-US Financial Regulatory Forum following a meeting held on 29 and 30 September 2021. Participants included representatives from the Commission, the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Central Bank (ECB), the US Department of the Treasury, the Commodity Futures Trading Commission (CFTC), the Federal Deposit Insurance Corporation (FDIC) and the Securities and Exchange Commission (SEC).

Discussions at the meeting focused on:

- **Market developments and the current assessment of financial stability risks:** In light of the uncertain economic outlook, participants agreed that co-operative international engagement to mitigate financial stability risks remains essential;
- **Sustainable finance:** Participants recognised the importance of addressing climate-related challenges for the financial sector and discussed priorities relating to sustainable finance, along with addressing climate-related financial risks;
- **Multilateral and bilateral engagement in banking and insurance:** Among other things, participants discussed implementation of the Basel III reforms, the treatment of foreign bank branches by both jurisdictions, the review of the Solvency II Directive (2009/138/EC) and the implementation of the EU-US covered agreement;
- **Regulatory and supervisory co-operation in capital markets:** Participants discussed progress in their respective legislative and supervisory efforts to ensure a smooth transition away from LIBOR, exchanged views on the upcoming EU reviews of the Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD) and the Markets in Financial Instruments Regulation (600/2014/EU) (MiFIR), and also took stock of ongoing discussions regarding data transfers and the registration of EU funds in the US;
- **Financial innovation:** Participants shared views on developments in financial innovation and recent efforts by the EU and the US to improve operational resilience in the financial sector. They also exchanged views on recent developments, including regulatory

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proposals involving new forms of digital payments, cryptoassets and stablecoins. Participants acknowledged the importance of ongoing international work in this area and recognised the benefits of greater international supervisory co-operation with a view to promoting responsible innovation globally; and

- **Anti-money laundering (AML) and counter-terrorist financing (CTF):** Participants discussed progress made in strengthening their domestic AML and CFT frameworks. They also exchanged views on the opportunities and challenges arising from financial innovation in this area and explored potential areas for enhanced co-operation to combat money laundering and terrorist financing bilaterally and within the framework of the Financial Action Task Force.

Participants intend to continue engaging on these topics ahead of the next Forum meeting, which is expected to take place in early 2022.

Joint statement: EU-US Financial Regulatory Forum

Bank supervision priorities – ECB publishes speech on the incorporation of climate risks in banks' risk governance frameworks – *5 October 2021* – The ECB has published a speech, given by ECB Supervisory Board Member, Edouard Fernandez-Bollo, on post-pandemic banking supervision priorities. Among other things, Mr Fernandez-Bollo talks about the need for banks to effectively incorporate climate risks into risk governance frameworks. He refers to this as an issue requiring urgent attention.

The ECB has carried out an extensive survey of banks' self-assessments against its supervisory expectations on climate-related and environmental risks. Although banks are now aware of the importance of this subject, and some banks have started adapting their practices, almost all of them still have a long way to go to be fully aligned with supervisory expectations. Generally, banks do not have a clear strategic and operational framework to deal with these risks in their day-to-day operations. The underlying issue is mainly the availability of adequate data.

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Mr Fernandez-Bollo notes that banks have started requesting greater data from their customers and using proxies when data is unavailable. Progress has been made by a variety of banks from different countries, with different business models and different asset volumes, which confirms that what the ECB is asking banks to do can be done.

In 2022, the ECB intends to carry out a full supervisory review of banks' practices for incorporating climate risks into their risk frameworks, as it gradually rolls out a dedicated supervisory review and evaluation process (SREP) methodology that will eventually influence banks' Pillar 2 capital requirements. It will also carry out a supervisory stress test focusing on climate-related risks, the methodology for which will be shared with banks shortly.

The outcome of these supervisory exercises next year will be reflected in qualitative measures. A possible quantitative impact, if any, will be indirect, via the SREP scores on Pillar 2 requirements and no bank-specific results will be published. Mr Fernandez-Bollo explains that this is only the beginning of the journey and requirements may change in the years to come, given the prominence of climate risks and evidence of the need to accelerate the transition to a greener economy.

Speech by Edouard Fernandez-Bollo: ECB Banking Supervision's post-pandemic priorities – the way forward

Banking supervision – ESG-related requirements - ECB publishes speech - *20 October 2021* - The ECB has published a speech, given by ECB Executive Board Member and Supervisory Board Vice-Chair, Frank Elderson, which covers three main areas:

- **Banks' progress in meeting ECB supervisory expectations:** The ECB has been taking steps to increase understanding of the impact of the climate crisis from a financial risk perspective and ensure that banks have a comprehensive, strategic and forward-looking approach to disclosing and managing all climate-related and environmental (C&E) risks. The ECB's review of banks' self-assessment as to their progress in meeting the ECB's supervisory expectations shows that, while banks have started reflecting C&E risks in their current structures and some have taken steps such as measuring and disclosing

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the carbon emissions linked to their loan books, the banks themselves deem 90% of their practices to be only partially or not at all compliant with the ECB's supervisory expectations. The ECB's review of banks' C&E disclosure and risk management practices suggests that, as things stand, European banks may be largely misaligned with the economic transition path towards carbon neutrality by 2050.

- **Mandatory requirement for transition plans** Given these findings, the legislative initiatives currently under way and the industry's own acknowledgement of the importance of moving to transition-robust business models, Mr Elderson proposes that there should be a mandatory requirement on banks to develop transition plans compatible with EU policies implementing the Paris Agreement. The transition plans should include concrete intermediate milestones from now until 2050 and the associated key performance indicators. Banks should also be required to disclose progress towards these goals on an annual basis so that banks' management and national competent authorities (NCAs) can understand the risks arising from a possible misalignment with the transition path. If banks fail to meet these milestones, NCAs will be expected to take appropriate measures to ensure that this failure does not result in financial risks.

- **ECB's climate strategy – next steps** : The ECB will continue to roll out other elements of its climate strategy, including:
  - conducting a supervisory stress test with a focus on C&E risks;
  - carrying out a full supervisory review of banks' practices in relation to the incorporation of C&E risks into their risk frameworks; and
  - gradually rolling out a dedicated Supervisory Review and Evaluation Process (SREP) methodology that will eventually influence banks' minimum capital requirements.

Speech by Frank Elderson: Overcoming the tragedy of the horizon: requiring banks to translate 2050 targets into milestones

Please see the News from the Single Supervisory Mechanism section for an item on ECB's 2022 climate risk stress test.

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Economy-wide climate stress test – ECB publishes letter to CEOs of significant institutions – *18 October 2021* – The European Central Bank (ECB) has published a letter sent to chief executive officers (CEOs) of significant institutions setting out information on participation in the ECB's 2022 climate risk stress test (2022 CST). The 2022 CST is for banks in the Single Supervisory Mechanism that the ECB supervises and aims to identify vulnerabilities, industry best practices and the challenges faced by banks.

The 2022 CST will comprise several phases, including data collection, quality assurance and the computation of results. It will include three modules:

- module 1: an overarching questionnaire to assess how banks are building their climate stress test capabilities for use as a risk management tool;
- module 2: a peer benchmark analysis to compare banks across a common set of climate risk metrics; and
- module 3: a bottom-up stress test targeting transition and physical risks.

The stress test will take place between March – July 2022 and scenarios used in it will be based on the ECB's 2021 CST, which was the first climate risk stress test to be carried out and the results of which were published in September 2021.

The output of the 2022 CST will be integrated into the Supervisory Review and Evaluation Process (SREP) using a qualitative approach. The ECB will conduct the 2022 CST alongside other ECB supervisory initiatives and environmental risk in 2022, including a thematic review of bank's climate-related and environmental risk management practices, the results of which will be included in the SREP.

The letter also contains a link to the methodology for the 2022 CST which explains how institutions should conduct the exercise.

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Letter to banks: Information on participation in the 2022 ECB Climate Risk Stress Test

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Bank resolution - SRB holds its sixth annual conference – *14 October 2021* - The Single Resolution Board (SRB) has held its sixth annual conference on 14 October 2021, bringing together industry, public authorities and key stakeholders to discuss how bank resolution delivers for financial stability. Key topics discussed included the evolution of the resolution framework; the achievement of a home-host balance; and the impact of COVID-19 on the banking sector.

Among others, Elke König, Chair of the SRB, noted that: "Recent years have proved that our framework has made banks more resilient and the SRB is committed to delivering on financial stability. However, we are not yet bringing the full benefits of the Banking Union to European citizens or to the banking sector while it is not complete."

Press Release

BRRD – SRB publishes updated guidance on notifications of impracticability of bail-in recognition clauses – 25 October 2021 – The SRB has published an update to its document setting out how banks can notify their resolution authority when bail-in recognition clauses cannot be added to contracts under third-country law. The requirement for bail-in recognition clauses stems from Article 55 of the Bank Recovery and Resolution Directive 2014/59/EU (BRRD).

The SRB published its initial guidance in June 2021 and the update concerns, among other things, adequate references to new delegated and implementing regulations supplementing the BRRD that recently came into force.

Revised guidance: Notification of impracticability to include bail-in recognition clauses in contracts: SRB approach and expectations

Press release

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Separability for transfer tools – SRB publishes operational guidance for banks – *26 October 2021* – The SRB has published operational guidance for banks on separability. It notes that separability — which refers to a bank's ability to implement a transfer of legal entities, business lines or portfolios of assets and liabilities at short notice to a third party — is relevant to all resolution strategies, and is particularly relevant for banks for which the resolution strategy envisages the use of a transfer tool.

The guidance follows the SRB's Expectations for Banks document, published in April 2020, under which banks are required to deliver separability analyses by the end of 2023. The guidance helps banks by providing more detail on how to achieve this expectation, namely through a so-called "separability analysis report", and an operational document called a "transfer playbook". The SRB observes that this information should enable full use of available resolution tools to be made should a bank get into difficulty.

Guidance: Operational guidance for banks on separability for transfer tools

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