[2025 EBA ESEP.pdf (europa.eu)]

EBA identifies key supervisory areas as part of the European Supervisory Examination Programme for 2025

Description: The European Banking Authority (EBA) published the European Supervisory Examination Programme (ESEP) for 2025, which identifies key topics for heightened supervisory attention across the European Union. The program aims to provide a selection of key topics for heightened supervisory attention to Competent Authorities (CAs), which are responsible for their implementation. The topics identified as key for 2025 include testing and adjusting to increasing economic and financial uncertainties, digital challenges, especially ICT risk management, and transitioning towards Basel III and the EU banking package implementation. Banks are expected to be prepared to withstand any emerging risks and financial shocks by setting aside necessary funds to cover potential losses.

Overview of the Publication

The European Banking Authority (EBA) published the European Supervisory Examination Programme (ESEP) for 2025, which identifies key topics for heightened supervisory attention across the European Union. The main purpose of EBA's ESE Programme is to provide a selection of key topics for heightened supervisory attention to Competent Authorities (CAs), which are responsible to reflect and implement these topics, but also assess and manage the relevant risk across Europe.

Competent authorities are expected to consider the key priorities set by the 2025 ESEP, but also to organize their supervisory activities based on the structure and specific vulnerabilities of the banking system and the idiosyncratic dimensions of the institutions under their supervisory remit.

Key topics

The key topics of the ESEP toolkit rely on the EBA's risk analysis work on the EU banking sector.

1. Testing and adjusting to increasing economic and financial uncertainties

The European Banking Authority (EBA) risk assessment report (2023) highlights heightened global uncertainties due to ongoing conflicts such as the war in Ukraine, the Middle East crisis, tensions in the Caucasus and issues between China and Taiwan. Moreover, trade tensions between the US, Europe and China contribute to the uncertainty. These geopolitical events not only have severe humanitarian impacts but also disrupt energy and supply chains, causing significant inflationary pressures in Europe. Financial restrictions and increased uncertainty from escalating tensions could raise banks' debt risks and funding costs. Furthermore, this situation may also lead to an increase in interest rates on government bonds, reducing the value of banks' assets. Geopolitical tensions can affect banks through disruptions in supply chains and commodity markets, impacting domestic growth and inflation, which may exacerbate banks' market and credit losses, thus reducing their profitability and capital reserves.

While there are currently no significant concerns, the quality of banks' assets could deteriorate if geopolitical risks escalate or if high inflation and tighten financing conditions challenge the debt servicing capacity of households and non – financial corporations. Based on the above, banks are expected to be prepared to withstand these emerging risks and financial shocks by setting aside necessary funds to cover potential losses.

<u>Supervisors' responsibilities</u>

1. Assess Institutions' Stress testing and adjustment capabilities
2. Support Stress testing capabilities
3. Evaluate contingency and recovery plans
4. Monitor vulnerable portfolios

5. Enhance supervisory scrutiny of ECL models

2. **Digital challenges, specifically ICT risk management and building resilience towards the digital transformation**

The EBA's June 2024 risk assessment report highlights that cyber risks and data security are ones of the most important operational risks, followed by conduct and legal risks and fraud. The notable increase in cyber – attacks warns that extreme losses are rising, potentially causing funding problems and threatening the solvency of banks.

Starting January 17,2025 the Digital Operational Resilience Act (DORA) will set harmonized requirements across the EU financial sector, by creating a Single Rulebook and a supervisory system to cover digital operational resilience. DORA empowers authorities to supervise ICR risk management in the financial sector, ensuring the integrity and efficiency of the internal market.

Four Key Pillars of DORA

- ICT risk management: Institutions must have robust processes to manage ICT risks effectively
- ICT – related incident reporting: Mandatory reporting of ICT – related incidents to appropriate authorities
- Digital Operational resilience testing: Regular testing to ensure resilience against operational disruptions
- ICT third – party risk management: Managing risk associated with third – party ICT service providers

Moreover, Digital transformation remains a priority for EBA and competent authorities, as highlighted in the 2023 ESEP. Institutions need to improve board members' competencies regarding digital topics and enhance monitoring of digital transformation success, such as Artificial Intelligence. Digital transformation necessitates changes in IT systems and new investments, impacting business models and requiring better risk analysis and management related to ICT.

To sum up, the EBA emphasizes the growing importance of managing digital challenges, especially in cybersecurity and digital operational resilience. With the implementation of DORA, EU financial institutions will need to meet stringent requirements to enhance their ICT risk management, resilience testing and third – party risk management.

Supervisors' responsibilities

1. Evaluate ICT risk management
2. Classify and report ICT incidents
3. Review resilience testing
4. Monitor ICT – third party risk
5. Assess Management's Digital Strategy

3. **Transition to Basel III and the EU Banking implementation**

Basel III framework in the EU includes a full revision of the CRR and CRD regarding the prudential metrics and encompasses various innovations in the prudential framework for credit institutions. The new framework enhances the risk sensitivity of the Standardized Approach and puts in place adequate safeguards for internal modelling to reduce undue variability of model outcomes and encompasses several innovations in credit risk, market risk, operational risk, reporting and disclosure, governance and ESG

The CRR introduces a new Standardized Approach for operational risk and eliminates the possibility of using an advanced measurement approach. It includes elements necessary for the calculation of capital requirements, the establishment of the operational risk loss database and the requirements related to the risk management framework for operational risk.

Supervisors' responsibilities

1. Assess institution’s ability to understand, calculate and comply with the regulatory requirements
2. Review institution’s capital planning abilities
3. Assess institutions’ ability to design, build and maintain data architecture and IT infrastructure
4. Assess Management’s ability to ensure the quality and resulting requirements of target data

Further considerations

- Climate-related and broader ESG risks

The increase in climate – related risk drivers underscore the need for CAs to monitor institutions’ efforts to reflect ESG risks in their business strategies, governance and risk management processes. It is also important to track climate change – related risks through its methodologies, data and scenarios and improve its stress test approach.

- EU/EEA banks’ liquidity

The higher interest rates and the gradual removal of excess liquidity by Central Banks underscores the need to continue monitoring the evolution of EU banks’ liquidity indicators.
Emphasis is placed on the importance of keeping a diverse funding mix in order to manage funding cautiously, by using windows of opportunity for debt issuances.

- The institution-specific nature of the SREP should guide supervisors in the bank-specific supervisory review, where all material idiosyncratic risks should be assessed

Conclusion

To sum up, the EBA’s 2025 ESEP outlines critical supervisory aeras for addressing economic uncertainties, digital transformation, Bael III implementation and additional considerations like ESG risks and liquidity. Competent Authorities must focus on these areas to ensure stability and resilience of the banking sector.