



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

ECB Annual Report on supervisory activities

2021

BANKENTOEZICHT

March 2022

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Foreword by Christine Lagarde, President of the ECB



In 2021 we continued to contend with the effects of the coronavirus (COVID-19) pandemic on our economies and lives. The strong and coordinated policy responses to the pandemic crisis, coupled with progress in the roll-out of vaccinations, underpinned the rapid pace of the recovery during the year. Economic output in the euro area reached its pre-pandemic level by the end of 2021.

Unlike in previous crises, the banking sector was in a strong financial position to support the economy and help strengthen our policy responses. Measures taken by ECB banking supervision ensured that banks could smoothly transmit our monetary policy actions, aimed at preserving favourable financing conditions for all sectors of the economy. Taken together, the responses of monetary policy and banking supervision are estimated to have saved more than one million jobs.

At the same time, the pandemic has led to more fundamental changes in the landscape in which banks operate. Digitalisation has accelerated and the urgency to tackle climate change has increased. Long-standing issues related to weak profitability and overcapacity could limit the ability of some banks to adapt and stay competitive in facing the digital and green transitions. The necessary response has two parts.

One is for banks to improve their cost efficiency and refocus their business models towards resilience and longer-term value creation. This includes making further progress in embedding climate-related and environmental risks into their existing strategies and risk management processes. Banks are still a long way off meeting our supervisory expectations in this field.

The second part is completing the banking union. A more robust, integrated and diversified financial sector would help unlock the large pool of private investment in Europe that is needed to accelerate the digital and green transitions.

I am confident that this is possible. Just as the banking sector has contributed to a successful solution to this crisis, it can also help get our economy ready for a greener and more digital future.

Introductory interview with Andrea Enria, Chair of the Supervisory Board



What was 2021 like for ECB Banking Supervision?

The pandemic continued to pose challenges for everyone in 2021, supervisors included. I am impressed with the operational resilience that the ECB as an institution has shown during the pandemic. Although we were still unable to conduct as many on-site inspections as we would have liked, our supervision remained effective. The frequency of our interactions with banks was relatively unabated too, even though most took place in remote working mode. We had good discussions within the Supervisory Board and were able to easily reach a consensus on most matters. Despite the difficulties raised by the pandemic, we managed to increase collaboration and team work across business areas within the ECB, within European banking supervision and between the ECB and the national competent authorities (NCAs). But I am keen to meet colleagues in person again and to restart visits to NCAs, face-to-face meetings with bankers and on-site inspections.

We are now two years into the pandemic. How do you think banks have fared during this period?

Since the outbreak of the pandemic European banks have shown strong resilience overall. I see this as the result of the post-financial crisis reforms, our long-standing efforts to strengthen banks' capital, asset quality and liquidity buffers, and the prompt deployment of extraordinary public support measures. Banks' capital ratios have remained resilient throughout this period, and they have been able to continue extending credit to households, small businesses and corporates. As yet, there has been no clear evidence of a deterioration in asset quality.

Although the macroeconomic projections for the euro area are generally positive, there is still uncertainty about how the pandemic will evolve. In particular, in some sectors more vulnerable to the pandemic, signs of latent credit risk have been observed. In addition, supply chain disruptions are weighing on trade and overall economic activity. Leverage in the financial system has also been on the rise and since some of our banks are exposed to it, we need to remain vigilant. Interest rate and credit spread adjustments along the path to recovery could increase credit risk for many banks and also harm those lenders that are particularly exposed to highly leveraged non-bank financial institutions. This deserves close attention.

But all in all, I would say that European banks have proven to be resilient in the face of a very serious crisis, and are in a much better position than they were after the 2008 crisis.

What do you think are the main challenges ahead for European banks? Is the COVID-19 crisis mostly behind them?

Thankfully, the macroeconomic outlook improved in 2021, and we are no longer expecting the wave of non-performing loans that we feared at the onset of the pandemic. That being said, banks should not lower their guard. The positive developments of 2021 prompted banks to reduce their provisioning significantly from the peak levels seen in 2020. But assessing the level of risk remains challenging, and the outlook still points to signs of latent credit risk. The share of underperforming loans did not recede in 2021. In accommodation and food services, as well as the air transport and travel-related sectors, underperforming loans continued to increase substantially during the year. So we will continue encouraging banks to tackle credit risks proactively and to keep a close eye on their loan books for any potentially material deterioration in asset quality.

In addition, some banks have increased their exposures to highly leveraged corporate counterparties, beyond our previously communicated supervisory expectations, and some are indirectly exposed to leverage through hedge funds and other non-bank financial institutions. These banks are particularly exposed to sudden interest rate and spread adjustments, which may materialise if the exit from the low interest rate environment turns out to be bumpy. If that is the case, we may witness significant corrections in asset prices and spreads, costly deleveraging and unexpected channels of direct and indirect contagion.

Moreover, too many European banks are still struggling with low profitability and heavy cost structures – the aggregate dynamics of the cost-to-income ratio since 2015 point to an enduring inefficiency problem in the European banking sector.

On the upside, several banks have recently embarked on comprehensive and tech-driven cost optimisation programmes, although these efforts will take time to translate into improved profitability and cost efficiency indicators. We have urged banks to refocus their business models towards long-term value creation, as robust and steady revenue generation capacity is the first line of defence in challenging business environments. The sustainability of banks' business models continues to be

one of our supervisory priorities. In 2021 we launched a series of inspections on business models and profitability, and these will continue throughout 2022.

Moving on to digitalisation in the banking and non-banking sector – how are banks dealing with the heightened competition it brings on the one hand, and the increase in customer demand for digital products on the other?

Digital transformation has accelerated during the pandemic and is changing the competitive landscape for good. There will be winners and losers, also in the banking sector. Effective strategic management, the volume and quality of IT investments and decisive actions to improve cost efficiency have proven to be key ingredients for success. More specifically, banks that have been successful in their digital journey have invested in modernising their IT infrastructures and optimising processes, and simplified and digitalised a number of internal procedures.

At the same time, the use of new technologies poses new challenges, not only to banks, but also to supervisors and regulators. Banks are increasingly exposed to IT and cyber risks. For the ECB to have a clear picture of these risks, we need our supervisors to be fully trained in this area as well. And in the same spirit, supervision should also embrace digital transformation: in 2021 we continued to roll out an array of suptech tools to make the work of supervisors across the banking union more effective and efficient.

Climate and environmental (C&E) risks gained prominence in 2021. Do you think European banks are prepared to tackle the expected increase in these risks?

In 2021 the ECB made notable progress in encouraging banks to become more proactive in their management of climate risks. We asked them to conduct self-assessments of their preparedness to deal with these risks, and we benchmarked their replies. We discussed our findings with the banks as part of our ongoing supervision, and published a report which describes some of the best practices we identified during this exercise. The bad news is that, according to the banks' estimates, 90% of their practices were either partially or not at all compliant with our supervisory expectations.

But banks have started to reflect C&E risks in their current structures, and roughly half of them are adapting their governance arrangements accordingly. In 2022 we will continue our work on C&E risks by conducting a dedicated thematic review within the SREP and a supervisory climate stress test. These will serve as learning exercises both for us as the supervisor and for the banks, and will lay the groundwork for including C&E risks in our SREP methodology in a more structural manner.

You mentioned that the ECB has been taking further strides to increase its transparency. What progress did you make in 2021?

ECB Banking Supervision has always been committed to this goal and in 2021 we made our supervisory methods and outcomes more transparent in a number of ways.

In the context of the 2021 stress tests, we took two big steps towards greater transparency. For the first time, we published the high-level individual stress test results of banks that were not in the sample for the EBA's EU-wide stress test, as well as the outcome in terms of banks' Pillar 2 guidance by bucket. We hope that the additional details we provided on the new methodology for Pillar 2 guidance foster a better understanding of the use of stress test results within the SREP.

Moreover, we provided more detailed information on how we set our supervisory priorities for the next three years. We have clearly laid out our risk map for the future, linking each identified vulnerability to a concrete supervisory priority. This also guides how ECB Banking Supervision as a whole allocates its resources for this period.

Moreover, we have sought to improve the transparency of our work on C&E risks by publishing the results of the benchmarking exercise on banks' preparedness, which I mentioned before, and sharing good practices within the industry. This is particularly important for a risk category that is in its infancy and for which substantial progress is needed very soon.

We also revised our Guide to fit and proper assessments. Besides introducing the concept of individual accountability, we focused on board members' expertise in C&E risks and highlighted the importance of diversity – including gender diversity – in the composition of bank boards.

Finally, we revamped the ECB's banking supervision website to make it easier and more intuitive to navigate for the public and for banks, with a simplified portal for banks and a streamlined whistleblowing platform.

Overall, I am very pleased with the progress achieved in 2021, especially when we consider that we were dealing with a unique crisis while working remotely most of the time.

1 Banking supervision in 2021

1.1 Supervised banks in 2021: performance and main risks

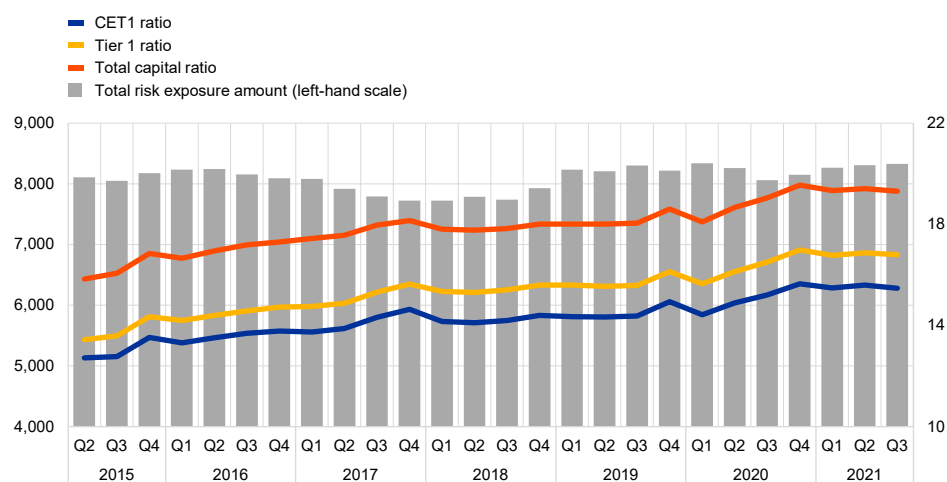
1.1.1 Overall resilience of the banking sector

Significant institutions entered the COVID-19 crisis with strong capital positions, which they maintained in 2021

Significant institutions (SIs) under European banking supervision entered the coronavirus (COVID-19) crisis with strong capital positions. After a slight dip in the first quarter of 2020, the aggregate Common Equity Tier 1 (CET1) ratio reached 15.6% in the fourth quarter of 2020 and stabilised at this level in 2021 (**Chart 1**). Banks' resilience during the crisis can be attributed to several factors, notably the public support measures implemented to protect customer solvency and facilitate access to credit, the strongly accommodative monetary policy response, and the timely supervisory and regulatory measures taken in response to the crisis. In addition, in March 2020 ECB Banking Supervision recommended that banks not distribute dividends or buy back shares and, in December 2020, that they limit such distributions. This allowed banks to strengthen their capital base amid relative uncertainty about the magnitude of potential credit losses. In June 2021, with macroeconomic forecasts pointing to an economic rebound and reduced uncertainty, the ECB decided not to extend its recommendation beyond September 2021. Instead, supervisors went back to the pre-pandemic practice of assessing the capital and distribution plans of each bank as part of the regular supervisory dialogue. Banks are expected to remain prudent when deciding on dividends and share buy-backs and to carefully consider their medium-term capital projections and the sustainability of their business models.

Chart 1
Capital ratios of SIs (transitional definition)

(left-hand scale: EUR billions; right-hand scale: percentages)

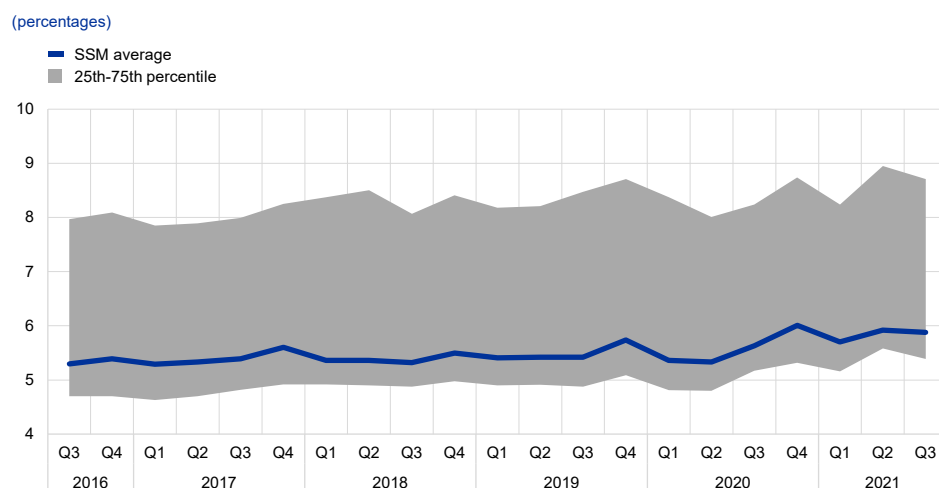


Source: ECB.

Note: The sample includes all significant institutions at the highest level of consolidation within the Single Supervisory Mechanism (varying sample).

The aggregate leverage ratio followed a similar trend during the pandemic, stabilising at 5.9% in the third quarter of 2021 after increasing from 5.3% in the second quarter of 2020. Banks adequately prepared for the application of the leverage ratio requirement in June 2021. In addition, in 2022 the newly developed methodology for assessing the risk of excessive leverage – which aims to capture the contingent leverage originating from the extensive use of derivatives, securities financing transactions, off-balance sheet items or regulatory arbitrage – will be applied in order to identify banks for which qualitative measures or Pillar 2 requirements for the leverage ratio may be necessary. This will further restrict the build-up of excessive leverage and thus contribute to the resilience of the euro area banking system. However, risks to capital adequacy remain and banks should not underestimate the risk that additional losses may still have an impact on their capital trajectory as support measures expire.

Chart 2
Leverage ratio of SIs



Source: ECB.
Note: The sample includes all significant institutions at the highest level of consolidation within the Single Supervisory Mechanism (varying sample).

The COVID-19 related extraordinary support measures have helped prevent a surge in NPLs, but the full impact of the pandemic may only materialise in the medium term

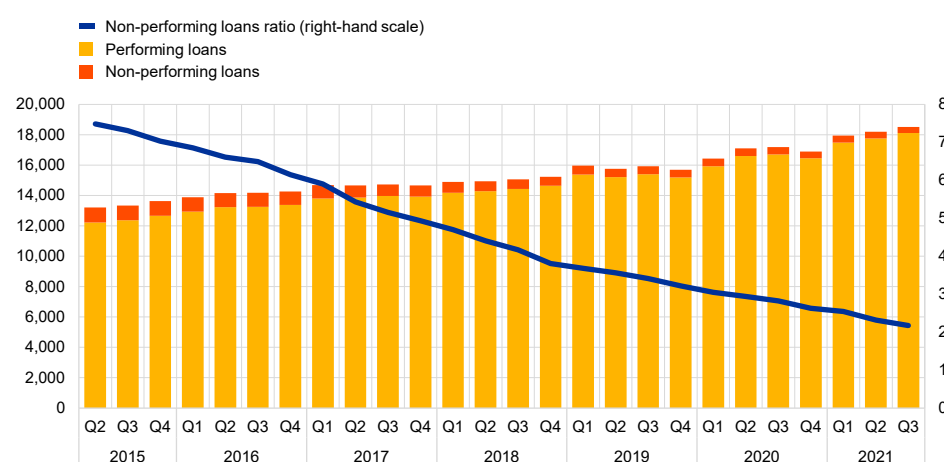
The ECB continued to foster banks’ resilience by challenging their overall recovery capacity, i.e. the extent to which banks can recover from severe stress by implementing the recovery options set out in their recovery plans.¹

Banks supported lending to customers throughout the crisis and so far there has not been a significant impact on asset quality. The overall positive trend in asset quality (**Chart 3**) has been driven by several factors, including the continued reduction of legacy non-performing loans (NPLs) by high-NPL banks and an increase in lending supported by state guarantees and other borrower support measures. In this regard, the range of COVID-19-related extraordinary support measures put in place to ease financing conditions and support households, small businesses, and corporates in 2020 and 2021 have helped prevent a surge in bankruptcies and NPLs. However,

¹ For more details on the assessment of banks’ overall recovery capacity, see “Challenging banks’ capacity to recover from severe crises”, *Supervision Newsletter*, ECB Banking Supervision, August 2021.

ECB Banking Supervision is still concerned about the quality of banks' assets in the medium term, as the full impact of the pandemic may only materialise once the majority of the emergency public support measures have been withdrawn. Classifications of loans as underperforming (stage 2) remain higher than before the pandemic and loans that have benefited from COVID-19 support measures appear to have a slightly higher risk profile. In addition, the substantial increase in debt levels in various segments of the economy might translate into higher solvency risks, particularly in economic sectors or countries that have been more severely affected by the pandemic. In this context, as part of its supervisory work on credit risk in 2021, the ECB highlighted the need for a strong focus on robust credit risk management practices.²

Chart 3
Evolution of SIs' NPLs (total loans)



Source: ECB.
Note: The sample includes all significant institutions at the highest level of consolidation within the Single Supervisory Mechanism (varying sample).

Despite business continuity challenges, the impact of the pandemic on operational risk has so far been limited

Despite the exceptional operational and business continuity challenges faced by banks since the outbreak of the pandemic, the amount of pandemic-related operational risk losses reported to have materialised in 2021 was significantly lower than in 2020. This is in line with the expectation that operational risk losses related to COVID-19 would mainly occur in the early stages of the pandemic, as these losses include major elements of a one-off nature.³

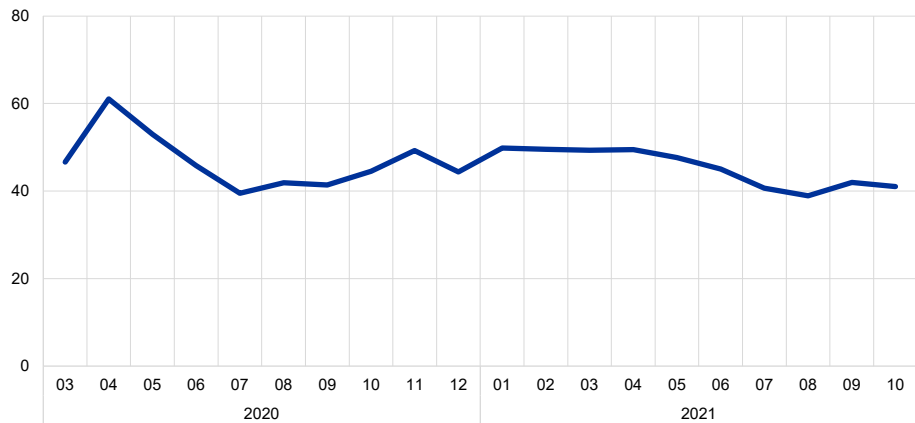
After the initial activation of business continuity plans in response to the pandemic, remote working models stabilised from summer 2020, with between 40% and 50% of the workforce of SIs working from home in 2021 (Chart 4).

² See Section 1.2.2. See also "COVID-19: gaps in credit risk management identified", *Supervision Newsletter*, ECB Banking Supervision, May 2021; McCaul, E. "Who pays the piper calls the tune: The need for and benefit of strong credit risk management", *The Supervision Blog*, 4 December 2020; and McCaul, E., "Credit risk: Acting now paves the way for sound resilience later", *The Supervision Blog*, 19 July 2021.

³ For the criteria used to identify one-off operational risk costs, see Section 3.3.5. of the *EBA report on the implementation of selected COVID-19 policies*.

There was a moderate increase of 9.8% in significant cyber incidents reported to the ECB in the first half of 2021, but the impact on the availability of IT systems and the amount of losses caused by these attacks were very limited.⁴

Chart 4
Remote working at SIs



Source: ECB.
Note: Data comprise a consistent sample of SIs which reported all data points during the period considered.

Nevertheless, operational and IT risks remain high, owing to the continued challenges facing banks and their service providers worldwide. As a result of the pandemic, cyber security threats, change management challenges and dependencies on IT infrastructures and IT service providers have all increased. It is crucial that banks properly manage the associated risks to ensure the uninterrupted provision of financial services.

At the same time, the ECB has continued to emphasise the need for supervised banks to improve their governance frameworks. The COVID-19 crisis has shown the importance of having strong governance arrangements, internal control functions and data aggregation capabilities. Although some improvements have been observed, several structural weaknesses persist.

Banks have made some progress on the composition of their management bodies, such as by progressively enhancing the skillset of board members and appointing more formally independent board members. Nevertheless, some weaknesses remain, namely (i) the low level of involvement of the management body in its supervisory function and its limited ability to challenge strategic decisions in the areas most affected by the COVID-19 crisis; (ii) insufficient expertise in banking and risk management of non-executive directors in a few banks; (iii) the lack of a diversity policy and insufficient promotion of diversity in some banks, which hampers the board's collective suitability; (iv) the low proportion of independent board members in some banks, which further hinders the ability of the management body in its supervisory function to constructively challenge executive directors.

⁴ See Section 1.2.3. for more details on IT and cyber risk.

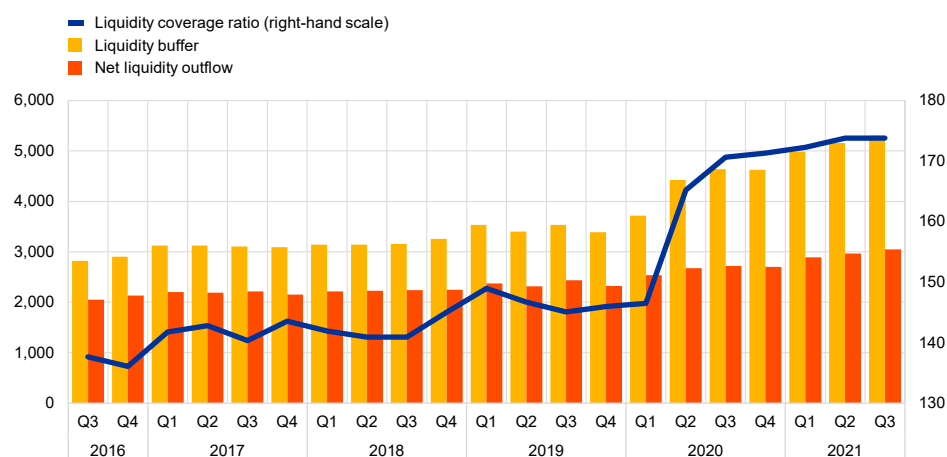
Despite some improvements, several structural weaknesses related to banks' management bodies and internal control functions remain

Monetary and prudential policies strongly supported the increase in SIs' available liquidity and funding throughout 2021

The COVID-19 crisis also exacerbated pre-existing weaknesses in several areas of governance and risk management. First, there are still shortcomings in data aggregation and reporting owing to fragmented and non-harmonised IT landscapes, a lack of automation, widespread use of manual controls, and deficiencies in data governance (e.g. insufficient independent validation of data quality). This hinders banks' decision-making processes. Second, several banks still need to further improve their internal control functions, especially to address low staffing, the insufficient stature of the function and deficiencies in processes (such as compliance monitoring programmes and the definition of the bank's risk appetite).

Liquidity and funding conditions for SIs continued to improve, largely supported by monetary policy measures. Banks were allowed to operate below the general minimum liquidity coverage ratio (LCR) level of 100% until the end of 2021.⁵ This notwithstanding, liquidity positions continued their upward trend, with the LCR reaching 173.8% in the third quarter of 2021, the highest level recorded since the start of European banking supervision (**Chart 5**). This can primarily be explained by the large take-up of targeted longer-term refinancing operations (TLTROs) by banks, as it enabled them to obtain funding and build cash reserves without encumbering their high-quality liquid assets. The total TLTRO uptake as at September 2021 reached €2.2 trillion, accounting for around half of the current excess liquidity in the Eurosystem.

(left-hand scale: EUR billions; right-hand scale: percentages)



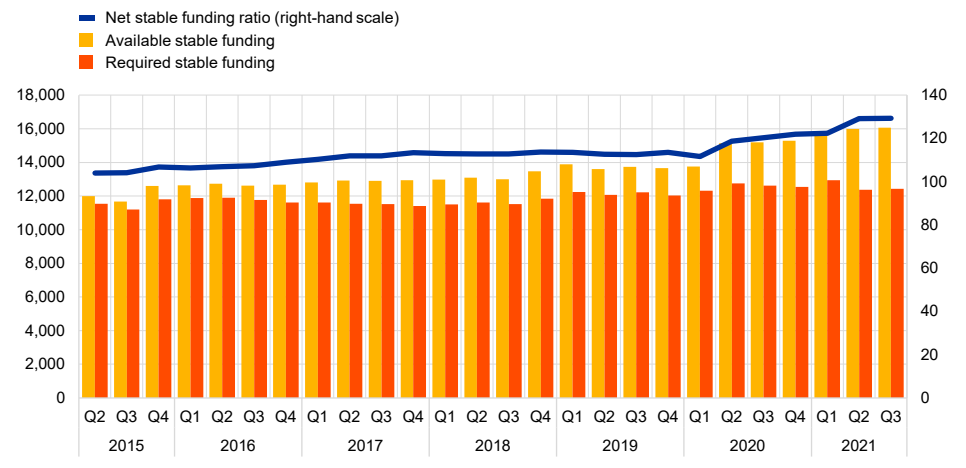
Source: ECB.
 Note: The sample includes all significant institutions at the highest level of consolidation within the Single Supervisory Mechanism (varying sample).

Like the LCR, the net stable funding ratio (NSFR) also increased steadily from the second half of 2020, reaching its peak of 129.3% in September 2021 (**Chart 6**). The NSFR requirement of 100% on an ongoing basis became applicable as a binding minimum requirement on 28 June 2021. While banks generally need to comply with the NSFR at both the consolidated and individual levels, in 2021 the ECB granted

⁵ For details about the end of the liquidity relief measure, see “[ECB will not extend liquidity relief beyond December 2021](#)”, *press release*, ECB Banking Supervision, 17 December 2021.

waivers from compliance at individual level to some banks when the conditions set out by the regulation were met and, in particular, when there was sound liquidity risk management in place.

(left-hand scale: EUR billions; right-hand scale: percentages)



Source: ECB.

Note: The sample includes all significant institutions at the highest level of consolidation within the Single Supervisory Mechanism (varying sample).

General market conditions for euro area banks have continued to ease since the second half of 2020 following the exceptional intervention by governments and central banks, which resulted in lower volatility, tighter credit spreads and buoyant equity markets. As a result, broad market risk indicators, such as value at risk and risk-weighted assets (RWAs), have declined. Against this backdrop, potential market risks – linked mainly to counterparty credit risk and shocks to interest rates and credit spreads – have been identified as supervisory priorities for 2022-24.

1.1.2 General performance of banks under European banking supervision

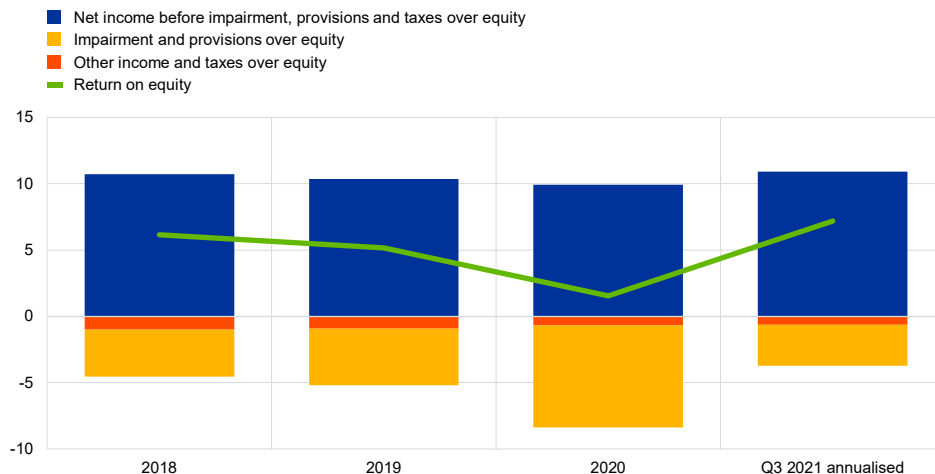
The rebound in banks' profitability in 2021 was mainly driven by lower impairments as the economy recovered from the pandemic

After hitting a low in 2020 during the peak of the pandemic, the profitability of SIs under European banking supervision rebounded in 2021. Banks' aggregate annualised return on equity rose to 7.2% (**Chart 7**) – the highest level seen in several years, but still below banks' average cost of equity. This increase was mainly driven by a cyclical reduction in impairment flows, which more than halved compared with the previous year. Banks had to book significant precautionary provisions in 2020 owing to the unprecedented uncertainty about the impact of the pandemic. In 2021 this practice was halted or, in some cases, even reversed on account of the economic rebound observed during the year.

Chart 7

SIs' aggregate return on equity broken down by income/expense source

(percentage of equity)

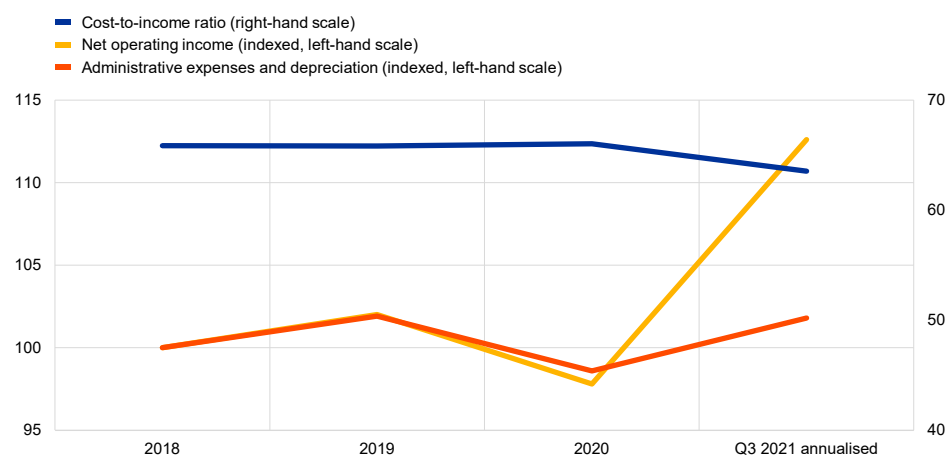


Source: ECB supervisory statistics.

Note: The sample includes all significant institutions at the highest level of consolidation within the Single Supervisory Mechanism (varying sample).

The economic rebound also benefited income before impairment, provisions and taxes, which recovered to pre-pandemic levels. This was mostly due to the boost to banks' income from trading and investment activities and to their net fee and commission income, with asset management-related fees playing a key role. By contrast, net interest income remained subdued and below pre-pandemic levels owing to persistent pressure on banks' lending margins. Overall, banks managed to increase their net operating income by 15% (Chart 8). This increase in income was central to the improvement in banks' cost efficiency, with the cost-to-income ratio decreasing by more than 2 percentage points in 2021 to stand at 63.5%.

(percentages)



Source: ECB supervisory statistics.

Note: The sample includes all significant institutions at the highest level of consolidation within the Single Supervisory Mechanism (varying sample).

Trading income contributed positively to the profitability of banks under European banking supervision and peaked in the first half of 2021, especially for global systemically important banks (G-SIBs) (**Chart 9**). Banks also managed to substantially increase their net fee and commission income, with asset management-related fees benefiting from high asset prices.

Chart 9

Trading and investment income flows⁶ by selected business models

(quarterly flows in EUR billions)



Source: ECB.

Notes: The sample for "SSM average" includes all significant institutions at the highest level of consolidation within the Single Supervisory Mechanism (varying sample); the "G-SIB", "Universal and investment bank" and "Other" charts represent the sub-sample with the respective business models.

On the cost side, administrative expenses and depreciations increased by 3.3%, primarily owing to increased staff expenses and IT-related costs. However, banks maintained their broader strategic objectives of reducing expenses and investing in IT and digital initiatives. Such strategies entail significant costs that need to be borne upfront, but banks expect to reap the benefits of this transformation in the medium

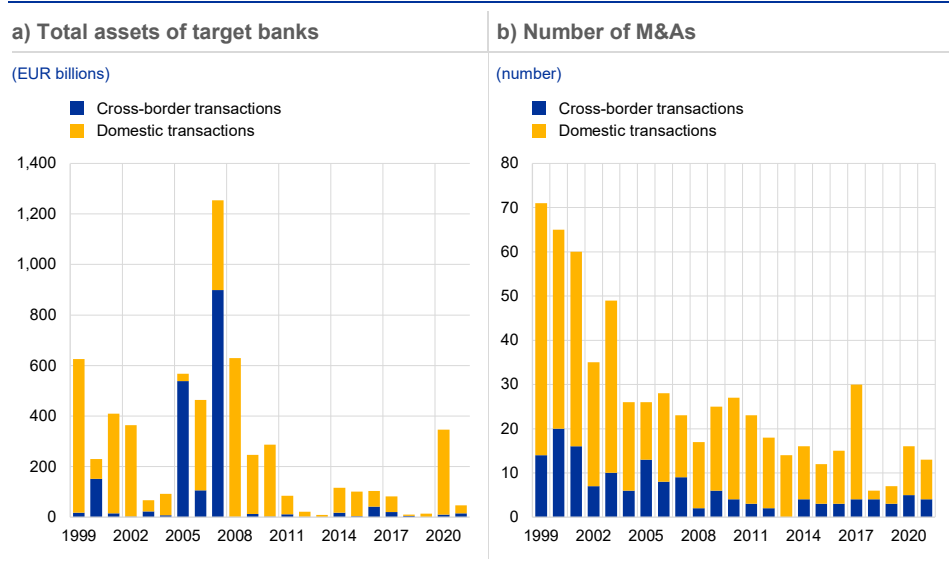
⁶ Standard definitions of trading income are applied, in line with [supervisory banking statistics](#).

term. Additionally, in the light of customers' increased usage of digital channels as a result of the pandemic, banks might be able to further reduce overcapacity and achieve leaner cost structures, thereby improving their cost efficiency even more.

Bank mergers and acquisitions (M&As), generally considered the boldest and most transformative type of consolidation, appear to act as a catalyst for the sector to improve efficiency and return to more sustainable levels of profitability.⁷ M&A activity appears to have gained some momentum over the past two years. In particular, banks have engaged more actively in targeted consolidations at the level of a business line. In the areas of asset management, securities business, custody services and payment technology, some institutions have been expanding or diversifying, while others have been downsizing in order to redirect resources.

Chart 10

Total assets of target banks and number of M&As in the euro area



Source: ECB calculations based on Dealogic and Orbis BankFocus.
Notes: The sample includes M&A transactions involving SIs and LSIs in the euro area, excluding some private transactions and transactions between small banks not reported in Dealogic. Transactions associated with the resolution of banks or distressed mergers were removed from the sample. Transactions are reported on the basis of the year in which they were announced.

Fully fledged bank M&As are still predominantly domestic, but some of the more targeted transactions feature a cross-border dimension and thus also contribute to financial integration within the EU. Another avenue to pursue cross-border integration would be for banks to review their cross-border organisational structures. In particular, relying more extensively on branches and the free provision of services, instead of on subsidiaries, could be a promising approach to developing cross-border business within the banking union and the Single Market.

Efforts to increase profitability in a sustainable way could also trigger further consolidation initiatives, which could lead to more diversified income sources and greater efficiency if accompanied by a clear operational direction and a sound business strategy. However, these strategic actions have to be designed and managed by the banks themselves, with their boards ensuring that there are robust

⁷ “Financial Stability Review”, ECB, November 2021.

governance procedures in place that can appropriately identify, manage and mitigate all material risks to the execution of these consolidation activities. To facilitate banks' planning in this regard, in January 2021 the ECB published a guide on the supervisory treatment of mergers and acquisitions⁸ to provide transparency on how the ECB assesses merger transactions, so that banks know what to expect from their supervisor.

LSIs' profitability also improved in 2021, driven primarily by lower impairments

Following a similar trend to that of SIs, the profitability of less significant institutions (LSIs) under European banking supervision also showed signs of recovery in 2021. As at the end of September 2021, the average return on equity was 3.3%, up from 1.7% at the end of 2020. This increase was mainly driven by lower impairments compared with 2020, when LSIs had to book a significant amount of provisions to prevent a sharp deterioration of their loan books. Similarly to SIs, in 2021 some LSIs released some of their previously booked provisions, which helped to restore their profitability to pre-pandemic levels.

LSIs have been able to offset the pressure on their lending margins by enhancing fee and commission-based activities. Overall, LSIs' net operating income increased by 9.7% year on year. This boost to LSIs' sources of income supported the improvement in their average cost-to-income ratio, which decreased from 70.3% at the end of 2020 to 66.7% at the end of September 2021. On the cost side, LSIs were unable to effectively reduce their administrative expenses.

Box 1

Stress testing in 2021

As in previous years, the ECB was involved in the preparation and execution of the 2021 EU-wide stress test, which was coordinated by the European Banking Authority (EBA). As part of the preparatory work, the ECB took part in designing the stress test methodology as well as the baseline and adverse scenarios. The adverse scenario was developed together with the European Systemic Risk Board (ESRB) and the EBA, and in close cooperation with the national central banks and national competent authorities. The ECB also produced the official credit risk benchmarks for the EU-wide stress test. These benchmarks provide banks with projection paths for the behaviour of credit risk parameters (such as probabilities of default, transition rates and loss given default), with banks expected to apply them to portfolios where no appropriate credit risk models are available.

Following the launch of the stress test exercise on 29 January 2021, ECB Banking Supervision carried out the quality assurance process for the banks under its direct supervision with the aim of ensuring that the banks correctly applied the EBA's methodology. Of the 50 banks covered by the EU-wide stress test, 38 are directly supervised by ECB Banking Supervision and account for around 70% of euro area banking sector assets. The EBA published the individual results for all 50 participant banks, along with detailed balance sheet and exposure data as at year-end 2020, on 30 July 2021.

⁸ "Guide on the supervisory approach to consolidation in the banking sector", ECB Banking Supervision, January 2021.

In addition to the EU-wide exercise, the ECB conducted its own stress test on 51 medium-sized banks that are under its direct supervision, but were not included in the EBA exercise. For the first time, the ECB also published high-level [individual results](#) for these banks.

The 38 euro area banks covered by the EU-wide stress test and the 51 medium-sized euro area banks supervised by the ECB together represent slightly more than 75% of the total banking assets in the euro area.

Scenarios

The [adverse scenario](#) for the 2021 stress test assumed a prolonged impact from the COVID-19 shock in a lower-for-longer interest rate environment. In this scenario, the uncertainty around pandemic-related developments results in a prolonged economic contraction, characterised by a sustained drop in GDP and a strong increase in unemployment. Corporate bankruptcies and business downsizing force considerable adjustments in asset valuations, credit spreads and borrowing costs. Finally, residential and, in particular, commercial real estate prices fall significantly.

Results⁹

Under the adverse scenario, the final CET1 ratio for the 89 banks directly supervised by the ECB was 9.9% on average, 5.2 percentage points lower than the starting point of 15.1%. For the 38 banks tested by the EBA, the average CET1 capital ratio fell by 5 percentage points from 14.7% to 9.7%. The 51 medium-sized banks tested solely by the ECB showed an average capital depletion of 6.8 percentage points to 11.3%, from a starting point of 18.1%. Medium-sized banks experienced a larger capital depletion under the adverse scenario because they were more affected by lower net interest income, lower net fee and commission income and lower trading income over the three-year horizon.

Overall, banks were in better shape at the start of the 2021 exercise than at the start of the previous EU-wide stress test in 2018.¹⁰ This was due to significant reductions in operational costs and material declines in NPL stocks in many countries. However, the capital depletion at the system level was higher in 2021. This is because the adverse scenario in the 2021 stress test was more severe than the one used in the 2018 exercise.

The first key driver of capital depletion was credit risk, as the large macroeconomic shock in the adverse scenario led to significant loan losses. In addition, and despite the overall resilience of the banking system even under adverse conditions, the stress scenario resulted in significant market losses for the largest banks in the euro area in particular, as they are more exposed to equity and credit spread shocks. The third main driver of capital depletion was banks' limited ability to generate income under adverse economic conditions, as banks faced a significant decrease in their net interest income, trading income and net fee and commission income.

Integration of the stress test into regular supervisory work

The qualitative results (i.e. the accuracy and timeliness of banks' submissions) and the quantitative results (i.e. capital depletion and banks' resilience to adverse market conditions) of the stress test both served as input to the annual Supervisory Review and Evaluation Process (SREP). The

⁹ See "[SSM-wide stress test 2021 – final results](#)", ECB Banking Supervision, July 2021.

¹⁰ See "[SSM-wide stress test 2018 – final results](#)", ECB Banking Supervision, February 2019.

quantitative impact resulting from the adverse scenario was also a key input for supervisors to determine the level of Pillar 2 guidance (P2G), through a new two-step bucketing approach. The details provided on the [new P2G methodology](#) should foster a better understanding of the use of the stress test results within the SREP.

1.2 Supervisory priorities and projects in 2021

1.2.1 Supervisory priorities for 2021

In 2021 the ECB's supervisory priorities focused on areas materially affected by the pandemic

In 2021 ECB Banking Supervision primarily focused its supervisory efforts on four priority areas materially affected by the COVID-19 pandemic: credit risk management, capital strength, business model sustainability and governance. The supervisory activities and projects carried out over the year were aimed at strengthening the resilience and practices of supervised banks, with a particular focus on those vulnerabilities deemed critical in the context of the pandemic.

Credit risk

A unique feature of the COVID-19 crisis is that, amid an enormous drop in economic output, NPLs have continued to fall, also thanks to the exceptional policy measures taken to support the real economy. These unprecedented measures have blurred borrowers' creditworthiness and therefore challenged banks' ability to manage credit risk. Against this background, the work undertaken by ECB Banking Supervision in 2020 to assess the adequacy of banks' credit risk management frameworks continued through 2021. The objective was to strengthen banks' operational preparedness to address distressed debtors in a timely manner as well as their ability to adequately identify, assess and mitigate potential deteriorations in borrowers' asset quality, especially in sectors particularly vulnerable to the impact of the pandemic. Initiatives undertaken in 2021 to achieve this objective include deep dives into banks' exposures to the accommodation and food services sector, dedicated on-site activities, and follow-ups by Joint Supervisory Teams (JSTs) with banks that were flagged as deviating considerably from the supervisory expectations.

Capital strength

The concerns about heightened credit risk made it essential for supervisors to assess the strength of SIs' capital positions and identify bank-specific vulnerabilities at an early stage, so that timely remedial actions could be taken where needed. In 2021 ECB Banking Supervision reviewed banks' capital planning practices to assess their capacity to produce realistic capital forecasts that take into account the

economic uncertainties stemming from the pandemic. The 2021 EU-wide stress test exercise allowed for an in-depth assessment of banks' capital positions and showed that the euro area banking sector would remain resilient even under an adverse scenario.

In July the ECB decided not to extend beyond September 2021 its recommendation that all banks limit dividends. The capital and distribution plans of every bank would instead be assessed as part of the regular supervisory process. Banks are expected to remain prudent when deciding on dividends and share buy-backs and to carefully consider the sustainability of their business model and the risk of additional losses affecting their capital trajectory once public support measures expire. At this stage, the ECB does not expect to extend its prudential relief measures related to banks' use of capital buffers beyond the end of 2022.

Business model sustainability

Banks' profitability and business model sustainability remained under pressure in 2021 against an economic background of low interest rates, excess capacity and low cost efficiency in the European banking sector and increasing competition from non-banks. ECB Banking Supervision has continued to strengthen its supervisory toolkit to assess banks' business strategies to meet these challenges as well as their ability to effectively implement them, with a specific focus on digitalisation strategies. In this context, JSTs have engaged in a structured dialogue with banks' management bodies on the oversight of their business strategies. Finally, bank-specific deep dives and on-site inspections were conducted to investigate profitability drivers and weaknesses.

Governance

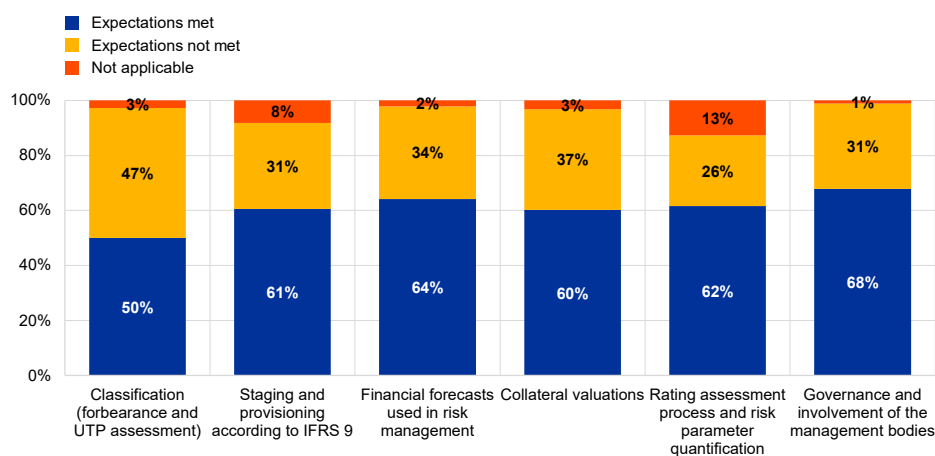
Sound governance practices and robust internal controls are crucial for mitigating the risks that banks face during normal times, and even more so in times of crisis. In 2021 ECB Banking Supervision pursued several supervisory activities in the area of governance. First, it scrutinised banks' procedures for responding to a crisis, which included assessing banks' capacity to produce effective recovery plans and credibly demonstrate their overall recovery capacity. Second, it followed up on the thematic review on risk data aggregation and reporting and launched targeted reviews for specific banks, in an effort to promote banks' management having access to and challenging the accuracy of risk information. Finally, prudential work continued on money laundering and terrorism financing risks, which included updating the supervisory methodologies for the SREP and on-site investigations to reflect these risks.

1.2.2 Credit risk management

ECB Banking Supervision assessed banks' compliance with the supervisory expectations on credit risk management and JSTs have been following-up with the banks on addressing identified gaps

In times of uncertainty, such as during the COVID-19 pandemic, credit risk management – and in particular identifying, classifying and measuring credit risk in an adequate and timely way – is key to ensuring that banks are able to provide viable, prompt solutions to distressed debtors. On 4 December 2020 the ECB sent a letter to the CEOs of all SIs setting out its supervisory expectations in this regard. During 2021 ECB Banking Supervision assessed banks' risk management practices against these expectations and concluded that 40% of SIs have significant gaps. The main gaps relate to early warning systems, classification (including forbearance and unlikely-to-pay (UTP) assessments), provisioning practices and, for some banks, practices for collateral valuation and financial forecasts (**Chart 11**). The issues identified are structural and relevant both in the context of the COVID-19 crisis and in a business-as-usual situation. Notably, shortcomings were identified and will also need to be addressed in banks that have not seen a significant build-up of credit risk in previous years. JSTs have been following up with the banks on their implementation of remedial actions.

Chart 11
Gaps in SIs' credit risk management



Source: ECB. The sample includes 108 significant institutions at the highest level of consolidation within the Single Supervisory Mechanism.
Note: The chart presents the JST view on the materiality of the gaps in SIs' credit risk management in relation to the supervisory expectations set out in the "Dear CEO" letter of 4 December 2020.

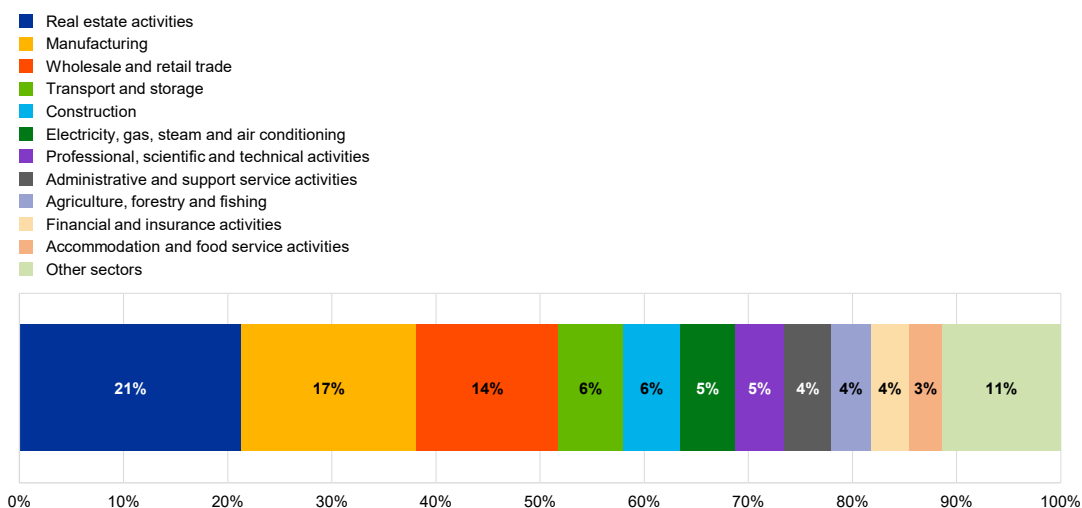
Box 2 Vulnerable sector analysis

The COVID-19 pandemic has increased corporate vulnerabilities in certain sectors. The immediate impact of the pandemic shock was largely mitigated by the substantial schemes that were set up to support smaller companies, while larger companies were able to tap into capital markets to withstand the initial fallout from the shock. However, as the extraordinary support measures start to be withdrawn, some companies may find themselves in financial distress as debt accumulated during the COVID-19 crisis falls due. For some industries, persistent supply chain problems are

increasing costs and putting a drag on liquidity, thereby further heightening credit risk. Significant institutions' exposure to all business sectors is outlined in **Chart A**.

Chart A

SIs' exposure to non-financial corporates by economic sector of activity



Source: FINREP reporting.

Notes: Economic sectors are based on the NACE level 1 classification. "Other sectors" includes Other services; Information and communication; Human health services and social work; Mining and quarrying; Water supply; Arts, entertainment and recreation; Education; and Public administration and defence, compulsory social security.

In the light of the increased vulnerabilities in certain sectors, in early 2021 ECB Banking Supervision launched a targeted review of the accommodation and food services sector, based on an analysis of exposures of a sample of SIs to this sector. The objective of this review was to understand and assess how banks were managing credit risk in one of the sectors most affected by the COVID-19 pandemic. ECB Banking Supervision identified several areas of concern across the different stages of the credit risk cycle, with small and medium-sized enterprise borrowers being a source of particularly serious concern.

In September 2021 ECB Banking Supervision continued its work on vulnerable sectors by launching a targeted review of the commercial real estate sector, with a particular focus on the office and retail market. This targeted review has continued into 2022. Although exposure varies across member countries, commercial real estate¹¹ is the largest sectoral exposure for SIs in the euro area, accounting for around 22% of the total exposure of banks to non-financial corporations.

1.2.3 IT and cyber risk

IT and cyber risk continued to be a key risk driver for the banking sector in 2021

IT and cyber risk continued to be a key risk driver for the banking sector in 2021 amid the trend towards digitalisation, which has been accelerated by the pandemic.

¹¹ Commercial real estate as defined in Recommendation ESRB/2016/14 as amended by Recommendation ESRB/2019/3 and reported in FINREP template F.18.2. This definition encompasses exposures to borrowers across different NACE sectors and includes, among others, borrowers with codes 41-Construction of buildings and 68-Real estate activities.

This trend has forced banks to adopt widespread remote working arrangements and increased their exposure to cyberattacks and their reliance on third-party providers. In the first half of 2021 the number of significant cyber incidents reported to the ECB increased slightly, by 9.8%, compared with the same period in 2020, but the impact of the incidents remained relatively contained. Although some of the reported incidents have increased in complexity, many still reflect failures in basic cyber security measures, suggesting that banks are yet to implement comprehensive cyber security practices.

In July 2021 ECB Banking Supervision published its [Annual report on the outcome of the 2020 SREP IT Risk Questionnaire](#), which presents the ECB's main observations about SIs' responses to the questionnaire. The report notes that (i) SIs are becoming increasingly reliant on third-party service providers, including cloud services; (ii) there is room for improving the way banks implement basic measures to maintain the health and security of their systems; (iii) the number of end-of-life systems is increasing; and (iv) data quality management remains the least mature risk control area. While many banks embarked on large-scale programmes to improve their data management capabilities, progress has varied. This is due to difficulties in managing the programmes' complex interdependencies with strategic and regulatory IT and operational projects as well as the structural changes the programmes entail in the IT landscapes of institutions. The pandemic conditions have also slowed progress in this area.

To address IT and cyber risk, ECB Banking Supervision has continued to strengthen its use of supervisory instruments such as the annual SREP, the SSM cyber incident reporting process, on-site inspections and other targeted horizontal activities.

In 2021 ECB Banking Supervision also contributed to the activities of international working groups on this topic, including those led by the EBA, the Basel Committee on Banking Supervision, and the Financial Stability Board.

1.2.4 Follow-up on Brexit

The transition period – during which time European Union law continued to apply within and to the United Kingdom – ended on 31 December 2020, marking the end of banks' Brexit preparations.

In this context, and as part of its ongoing supervision, ECB Banking Supervision monitored the implementation of the post-Brexit target operating models of SIs affected by the United Kingdom's departure from the EU to ensure they progressed in line with the time frames previously agreed on. Horizontal monitoring exercises were complemented by bank-specific follow-ups, and supervisory actions were taken when shortcomings were identified. To meet the ECB's supervisory expectations, banks took action in the areas of internal governance, business origination, booking models and funding, repapering of EU clients and intragroup arrangements, and IT infrastructure and reporting.

ECB Banking Supervision will continue to monitor banks' alignment with its post-Brexit expectations and, if needed, further refine its stance towards the adequacy of banks' structures and governance

To ensure that, post-Brexit, banks are operationally self-standing and not overly reliant on group entities outside the EU, the ECB focused on preventing empty shell characteristics in the newly established EU subsidiaries of international banking groups. In this context, it launched a desk-mapping review – a harmonised assessment of SIs' booking models – to ensure that banks' arrangements sufficiently reflect the size, nature and complexity of their business and risks. In addition, the ECB launched a targeted review of the credit risk management and funding set-ups of these banks to ensure that they are able to independently manage all material risks that could potentially affect them at the local level (i.e. in the EU), and that they have control over their balance sheets and exposures.

ECB Banking Supervision also followed post-Brexit regulatory developments to anticipate any possible impact on the financial industry. In particular, it asked banks to pay special attention to the European Commission's communications on the risks stemming from over-reliance on UK central counterparties in the longer term.

Under the cooperation framework concluded in 2019, ECB Banking Supervision and the UK supervisory authorities continue to closely cooperate in supervising banks that are active in countries participating in European banking supervision and the United Kingdom. ECB Banking Supervision maintains close interactions with the UK authorities on topics of common interest, at senior level and operational level.

ECB Banking Supervision will continue to follow post-Brexit regulatory developments and monitor banks' alignment with its post-Brexit expectations and, if needed, will further refine its stance towards the adequacy of their structures and governance.

1.2.5 Fintech and digitalisation

As banks continue their digital transformation, ECB Banking Supervision is actively shaping the European supervisory and regulatory frameworks on technology and digitalisation

In 2021 ECB Banking Supervision continued its work on fintech and digitalisation-related topics. This included organising a workshop with the JSTs of the largest SIs on the strategic, governance and risk management aspects of digital transformation. It also launched the revision of the SREP methodology on business models with a view to better reflecting digital transformation aspects in upcoming supervisory cycles. Furthermore, ECB Banking Supervision continued to develop its tools to systematically assess banks' digital transformation frameworks. This assessment looks at key performance indicators and the use of new technologies by banks, focusing on the relevance of these aspects to their business models.

The COVID-19 pandemic has demonstrated the importance of digital transformation and technology in enabling banks to remain operationally resilient in a remote working context. Given the role technology can play in reducing costs and meeting the expectations of increasingly digitally oriented banking customers, it is crucial that banks continue to innovate and pursue digital transformation to remain competitive now and in the future.

ECB Banking Supervision also took further steps to actively shape digitalisation aspects of the future European regulatory framework by contributing to the ECB

opinions on the draft legislative proposals on markets in crypto assets¹², the pilot regime for market infrastructures based on distributed ledger technology¹³, and the digital operational resilience act¹⁴. In addition, it contributed to the ECB opinion on the legal framework on artificial intelligence. ECB Banking Supervision also took part in discussions with the European Supervisory Authorities on the regulation of fintech and big tech and the regulatory scope of consolidation.

1.3 Direct supervision of significant institutions

1.3.1 Off-site supervision

ECB Banking Supervision strives to supervise SIs in a proportionate and risk-based manner that is both demanding and consistent. To that end, it defines a set of core ongoing supervisory activities for each year. These activities draw on the existing regulatory requirements, the [SSM Supervisory Manual](#) and the [SSM supervisory priorities](#), and are included in the ongoing supervisory examination programme (SEP) for each SI.

In addition to those activities addressing system-wide risks, other supervisory activities that are tailored to banks' specificities can be included in the SEP, leaving room for JSTs to analyse and tackle idiosyncratic risks.

The off-site SEP activities include (i) risk-related activities (e.g. the SREP), (ii) other activities related to organisational, administrative or legal requirements (e.g. the annual assessment of significance), and (iii) additional activities planned by JSTs to further tailor the ongoing SEP to the specific characteristics of the supervised group or entity (e.g. analyses of the bank's business model or governance structure). While the first two sets of activities are defined centrally, the third is bank-specific and defined by the respective JST.

Being proportionate

The SEP follows the principle of proportionality, i.e. the intensity of the supervision depends on the size, systemic importance, risk and complexity of each institution.

As in previous years, the average number of planned supervisory activities per SI in 2021 reflects this principle of proportionality, ensuring that JSTs have sufficient leeway to address institution-specific risks ([Chart 12](#)).

Planned supervisory activities in 2021 followed the principle of proportionality, tailoring the intensity of supervision to the systemic importance and risk profile of the supervised bank

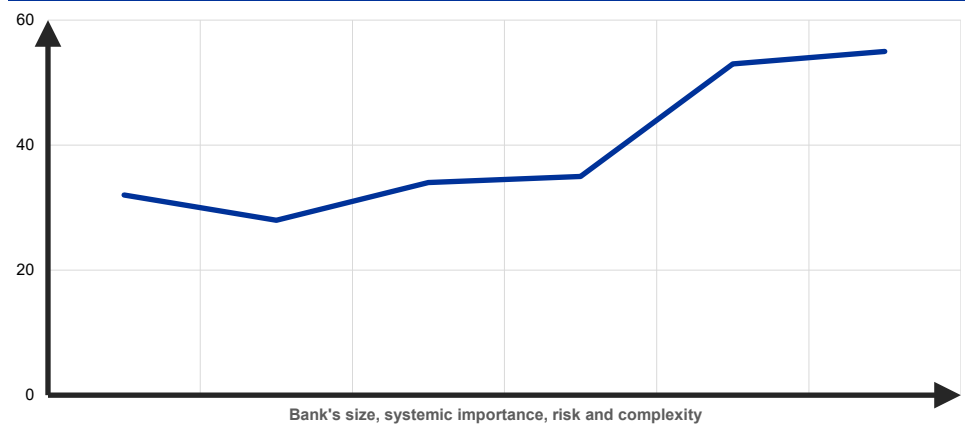
¹² Opinion of the European Central Bank of 19 February 2021 on a proposal for a regulation on Markets in Crypto-assets, and amending Directive (EU) 2019/1937 ([CON/2021/4](#)) (OJ C 152, 29.4.2021, p. 1).

¹³ Opinion of the European Central Bank of 28 April 2021 on a proposal for a regulation of the European Parliament and of the Council on a pilot regime for market infrastructures based on distributed ledger technology ([CON/2021/15](#)) (OJ C 244, 22.6.2021, p. 4).

¹⁴ Opinion of the European Central Bank of 4 June 2021 on a proposal for a regulation of the European Parliament and of the Council on digital operational resilience for the financial sector ([CON/2021/20](#)) (OJ C 343, 26.8.2021, p. 1).

Chart 12

Average number of planned tasks per SI in 2021



Source: ECB.
Note: Data extracted as at 29 December.

Taking a risk-based approach

The SEP follows a risk-based approach, focusing on the most relevant risk categories for each SI. For example, the percentage of tasks related to credit risk is greater for high-NPL banks than it is for the average bank. Similarly, the percentage of tasks relating to market risk is higher for banks with large exposures to market and trading activities than it is for the average bank (**Chart 13**).

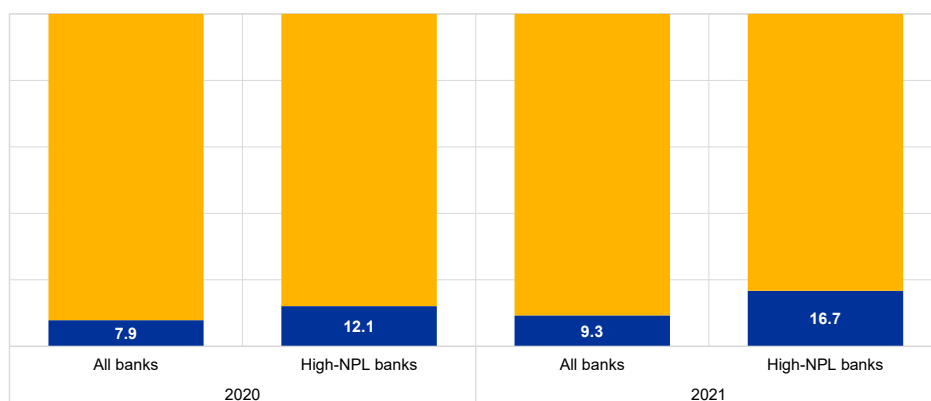
Chart 13

SEP activities in 2020 and 2021: credit and market risk activities as a share of all activities

Credit risk

(percentages)

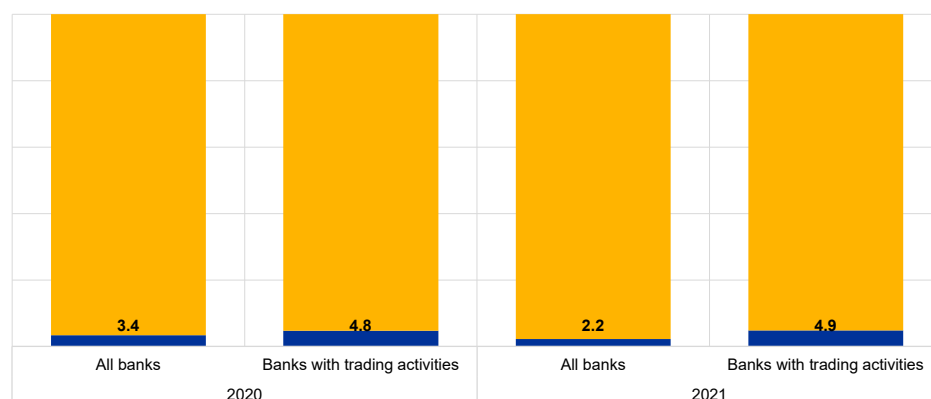
■ Credit risk
■ Other risk categories



Market risk

(percentages)

■ Market risk
■ Other risk categories



Source: ECB.

Notes: The sample includes all banking supervision activities carried out by JSTs (varying sample). Data extracted as at 29 December. Only planned activities related to risk categories were considered. Activities with multiple risk categories (e.g. the SREP and stress test exercises) are included under "Other risk categories".

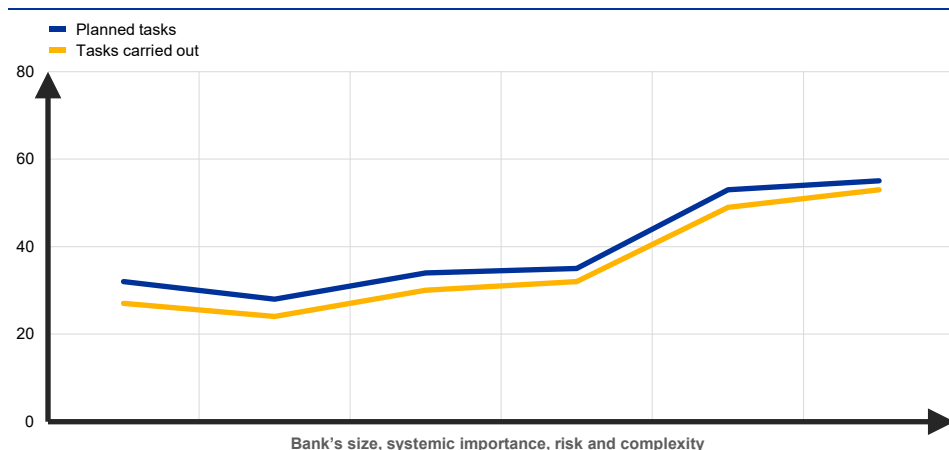
Highlights of off-site supervision in 2021

As a consequence of the reorganisation of ECB Banking Supervision, the COVID-19 pandemic and simplification efforts, ECB Banking Supervision reviewed and reprioritised supervisory processes and activities to enable the JSTs to adequately focus on monitoring the conditions of supervised banks. The planned set of off-site activities for 2021 was also reviewed and calibrated to the risk prioritisation. Examples of the centrally driven activities carried out in 2021 are the SREP assessment, the reviews of credit risk management practices and sectoral vulnerabilities, the SSM-wide stress test exercise, the NPL strategy assessment and the climate risk self-assessment.

The number of activities carried out in 2021 was marginally lower than what was originally planned at the beginning of the year (Chart 14). This is mostly due to a small number of administrative tasks being cancelled throughout the year, which is in line with previous years.

Chart 14

Average number of tasks per SI in 2021



Source: ECB.
Note: Data extracted as at 29 December.

SREP assessment

In 2020 ECB Banking Supervision adopted a pragmatic approach to the SREP in the light of the COVID-19 pandemic. In 2021 it returned to a full SREP assessment. The SREP results point to a broad stability in scores despite the challenges posed by the COVID-19 crisis, as banks had generally entered the pandemic with strong capital positions and were supported by relief measures, which remained in place in 2021. Consistent with previous SREP cycles and the 2021 supervisory priorities, the majority of measures addressed deficiencies in credit risk and internal governance.

Credit risk was the main area of focus of the SREP assessment. Banks' risk control frameworks were assessed against the supervisory expectations communicated to banks in the "Dear CEO" letter of 4 December 2020. The assessment led to an increased number of findings, which mostly reflected concerns about the quality of banks' processes. In a number of cases, the severity of the findings raised concerns about the adequacy of the underlying provisioning processes, including in banks that had not previously stood out from a credit risk perspective.

Despite the challenges brought about by the pandemic, capital adequacy proved resilient: supervisors closely reviewed banks' dividend plans and maintained a supervisory dialogue with banks whose plans were deemed not commensurate with their risk profile. Average Pillar 2 requirements (P2R) and Pillar 2 guidance (P2G) remained broadly stable and in line with previous years: a marginal increase in the average P2R was driven by add-ons to P2R which were imposed on banks whose provisioning of legacy non-performing exposures was not yet in line with previously

communicated coverage expectations. Average P2G has marginally increased owing to higher capital depletions in the 2021 EU-wide stress test. The methodology for determining P2G was revised for the 2021 SREP.

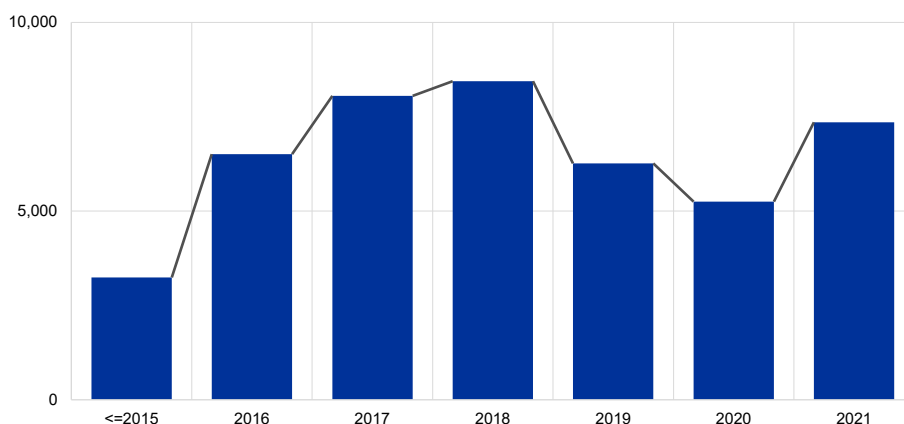
Supervisory findings

Supervisory findings are one of the main outcomes of the regular supervisory activities and reflect shortcomings that need to be remedied by banks. The JSTs are responsible for monitoring how banks follow up on these findings. As at 29 December 2021, the overall number of findings increased in comparison with 2020, reaching a level similar to that seen before the pandemic. This was mainly caused by the partial resumption of on-site inspections (OSIs) and internal model investigations (IMIs)¹⁵. The majority of the findings originated from IMIs, OSIs and activities related to authorisations. The largest number of findings were reported in the area of credit risk (**Chart 15**).

¹⁵ The ECB's decision-making process for IMIs was temporarily suspended from March to September 2020 owing to the COVID-19 situation. This meant that IMI decisions that would normally have been issued to banks in 2020 were issued in 2021 instead.

Chart 15
Supervisory findings

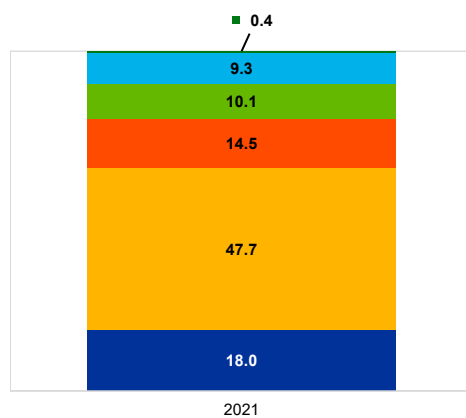
Number of findings year on year



2021 findings by type

(percentages)

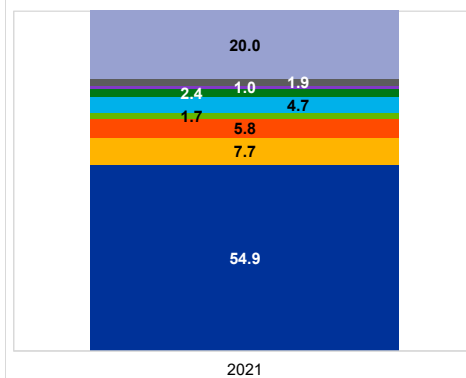
- OSI
- IMI
- Authorisation
- SREP
- Other ongoing tasks
- Thematic reviews



2021 findings by risk category

(percentages)

- Credit risk
- Governance risk
- Market risk
- Operational risk
- Capital risk
- Liquidity risk
- Interest rate risk in the banking book
- Profitability
- Miscellaneous



Source: ECB

Notes: The sample includes findings from all JSTs working in banking supervision (varying sample). 23 findings from old JSTs have been excluded. Data extracted as at 29 December.

1.3.2 On-site supervision

In 2021 most missions were performed remotely off-site

In 2021 the COVID-19 pandemic continued to significantly affect how OSIs and IMIs were carried out. Most missions¹⁶ were performed off-site, as in 2020. From October 2021 onwards, a hybrid approach was adopted for a number of inspections,

¹⁶ For ease of reference, in this section OSIs and IMIs are collectively referred to as “missions” or “inspections”.

combining the traditional on-site presence at the premises of the supervised entity with a greater reliance on remote working arrangements tested during the pandemic.

Following the slow-down experienced in 2020, 123 OSIs and 96 IMIs were launched in 2021, moving closer to the levels seen before the pandemic (**Chart 16**).¹⁷

With regard to OSIs, the campaign approach used in previous years continued to be applied¹⁸, complementing the bank-specific OSIs requested by JSTs. In line with the supervisory priorities for 2021, key campaigns launched by the ECB included: (i) the commercial real estate (CRE) campaign which assessed the quality of banks' exposures to the CRE sector by challenging collateral valuations; (ii) the large SME/corporate campaign, which focused on the management, monitoring and control of the relief measures granted in response to the crisis; (iii) the granular portfolios campaign, which reviewed banks' IFRS 9 provisioning frameworks; (iv) the market risk campaign on valuation risk; (v) the IT and cybersecurity campaign; (vi) the internal capital adequacy assessment process (ICAAP) campaign; and (vii) the business model and profitability campaign.

For IMIs, the main topics addressed in 2021 concerned the implementation of new EBA regulatory products, the temporary tolerance of models in the context of Brexit, and follow-ups to the targeted review of internal models (TRIM). In addition, a new off-site investigation approach was adopted for the first time in 2021 to deal with less material or less complex model change requests; these investigations have a very targeted scope and a resource-light assessment concept.

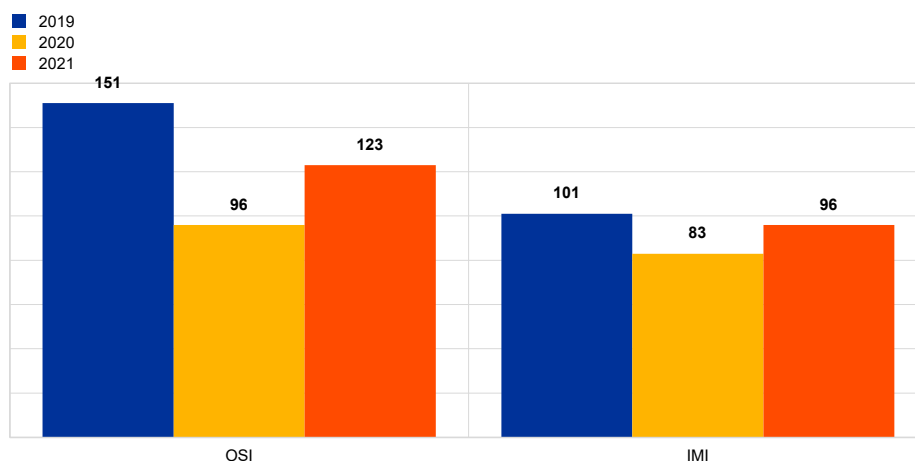
¹⁷ Owing to the continuation of the COVID-19 pandemic, the planning of OSIs and IMIs was only organised over three quarters in 2021. This means that while the overall number of missions was lower compared with before the pandemic, it is comparable in relative terms. The pandemic caused inspections to be cancelled or postponed in 2020. In 2021 the swift implementation of an organisational set-up for conducting inspections off-site was very successful, resulting in most inspections being conducted as initially planned and only limited cancellations.

¹⁸ A campaign clusters together several OSIs examining the same topic and thus provides a framework for inspection teams to coordinate and collaborate by aligning objectives and capitalising on synergies.

Chart 16

OSIs and IMIs launched in 2019, 2020 and 2021

(number of investigations)



Source: ECB Banking Supervision.

In 2021 ECB Banking Supervision began exploring new approaches to enrich the on-site investigations model

While preserving the primacy of the on-site approach to mission work, the gradual return to a normal work environment will incorporate the valuable lessons learned and good practices acquired during the pandemic as regards remote working modalities. To this end, ECB Banking Supervision began exploring ways to enrich the traditional on-site model by integrating hybrid working modalities that can improve the overall efficiency, agility and resilience of investigations while maintaining their thoroughness, intrusiveness and quality. These approaches also aim to reduce the environmental impact of investigations while further promoting cross-border¹⁹ and mixed team²⁰ cooperation, fostering integration across European banking supervision, and supporting diversity and inclusion.

1.3.2.1 Key findings from OSIs

The following analysis provides an overview of the most critical findings identified in OSIs.²¹

Credit risk

In the context of the COVID-19 pandemic, credit risk OSIs were mainly conducted off-site and had a qualitative focus. Their purpose was to assess the robustness of credit risk management and control as well as the implementation of relief measures. In the sample considered for this analysis, only a limited number of investigations

¹⁹ In a cross-border inspection team, the head of mission and at least one team member do not come from the related home/host NCA.

²⁰ In a mixed inspection team, the head of mission comes from the related home/host NCA and at least two team members do not come from the related home/host NCA (one team member for smaller NCAs).

²¹ The analysis was conducted on a sample of 89 OSIs for which final reports were released between October 2020 and September 2021.

were based on a more quantitative approach focusing on credit file reviews; these led to additional reclassifications of exposures amounting to €855 million and additional provisions of €1 billion.

In 2021 credit risk inspections highlighted the following important weaknesses in how banks carry out and monitor key credit risk processes in the pandemic environment.

- **Underestimation of expected credit losses (ECL):** overvaluation of collateral and inappropriate ECL calculations owing to shortcomings in the estimation of key parameters.
- **Credit underwriting and loan origination:** poor eligibility controls related to the granting of COVID-19 relief measures.
- **Inappropriate classification of debtors:** shortcomings in the assessment of financial difficulties leading to UTP and forbearance classifications and to identification as stage 2 under IFRS 9.
- **Weak monitoring processes:** inadequate oversight of credit risk by the supervised banks' management bodies and shortcomings in the adaptation of early warning systems and rating models to COVID-19 developments and government support measures.

Internal governance

The most critical findings²² revealed deficiencies in the following governance areas.

- **Internal control functions (including compliance, risk management and internal audit):** severe shortcomings in the status, resources and scope of activity of all internal control functions.
- **Risk data aggregation and risk reporting:** insufficiently comprehensive risk management reporting and weaknesses in data architecture and IT infrastructure.
- **Outsourcing:** inadequate risk assessments for decision-making on outsourcing and flaws in the delivery and monitoring of outsourced services, especially in relation to IT services.
- **Corporate structure and organisation:** weak institution-wide risk culture, deficiencies in internal control frameworks and inadequate human and technical resources.

²² Some of the most critical findings relating to internal governance were identified in OSIs focusing primarily on specific risk areas (e.g. credit risk, market risk and IT risk).

Market risk

The market risk campaign on valuation risk was concluded in 2021. This three-year initiative was launched with the aim of promoting a level playing field for banks based on a common methodology and providing consistent follow-up to findings from on-site missions. The main weaknesses identified in 2021 were related to **fair value measurement and additional value adjustments** (insufficient independent price verification coverage, inadequate methodologies for the fair value hierarchy and additional value adjustments, inappropriate day one profit recognition practices). Shortcomings were also identified in the management of market data to ensure reliable valuation inputs.

IT risk

In 2021 the main focus of IT risk OSIs was **cybersecurity**. Most of the high-severity findings were related to deficiencies in:

- banks' **cybersecurity management** to identify potential cyber threats and risks and maintain an accurate inventory of all IT assets;
- how banks **safeguard** their IT assets and provide sufficient cybersecurity awareness training for their staff;
- banks' **restoration capabilities** after disruptions from cyber incidents.

Regulatory capital and ICAAP

The main findings on **regulatory capital (Pillar 1)** were related to: (i) the underestimation of risk-weighted assets (RWAs) as a result of incorrectly allocating exposure classes; (ii) the use of ineligible collateral for credit risk mitigation techniques; and (iii) low data quality (e.g. for the recognition of guarantees). In addition, several weaknesses in the control framework were identified, such as the limited capacity to identify the incorrect use of risk weights for Pillar 1 risks.

The most severe issues identified in **ICAAP** inspections concerned: (i) internal quantification methodologies (e.g. for credit risk, market risk or pension risk); (ii) the definition of internal capital; (iii) the incorrect design and level of severity of the adverse scenarios; and (iv) the incompleteness of the capital planning process.

Interest rate risk in the banking book (IRRBB)

The majority of critical findings were related to weaknesses in the **perimeter and risk identification of IRRBB** and deficiencies in the **audit plan for IRRBB management functions** and the **measurement and monitoring of IRRBB**. Behavioural modelling assumptions, model validation functions and limit systems were found to be particularly insufficient or inadequate.

Operational risk

The most severe findings were related to the **management of operational risks**, with deficiencies in operational risk monitoring processes and inadequate quality assessments of operational risk data, risk prevention and remediation actions when dealing with operational risk events.

Liquidity risk

The majority of high-severity findings were related to weaknesses identified in the **stress testing** framework (stress test scenarios with insufficient coverage of all material liquidity risk sources, limited use of reverse stress-testing approaches and insufficiently conservative mitigating actions) and in **risk measurement** and **monitoring** (deficiencies in the set-up of internal limits).

Business model and profitability

The most critical findings were related to deficiencies in **income**, **cost** and **capital allocation** (contributing to a distorted view of the profitability of different business lines) and to the **sensitivity analyses of financial projections** (e.g. limited capacity to anticipate changes in key risk drivers such as the cost of credit).

1.3.2.2 Main topics of IMIs

In April 2021 the ECB published the results of TRIM²³, which aimed to assess whether the Pillar 1 internal models used by SIs are appropriate in the light of regulatory requirements and whether their results are reliable and comparable.

Under TRIM, 200 on-site IMIs across 65 SIs were performed between 2017 and 2019. Overall, the outcomes of the TRIM investigations confirmed that the internal models of SIs can continue to be used for the calculation of own funds requirements. However, for a certain number of models, limitations were needed to ensure an appropriate level of own funds to cover the underlying risk. In total, over 5,800 findings were identified across all risk types, of which around 30% had a high severity, requiring a significant effort by the institutions to remediate the deficiency by pre-defined deadlines.

While banks have started to address TRIM findings and the assessment of these remediation activities has been included in the scope of some IMIs, in 2021 a significant number of internal model-related requests were driven by the need for banks to change their models to comply with new EBA products.

²³ See “[Targeted Review of Internal Models – project report](#)”, ECB, April 2021.

For credit risk, a significant number of model change applications related to the EBA's guidelines on the application and definition of default²⁴ and its internal ratings based (IRB) repair programme²⁵, for which institutions have to ensure compliance by 1 January 2021 and 1 January 2022 respectively. Furthermore, a high number of applications related to reverting to less sophisticated approaches, especially in the context of the initiatives launched by banks to simplify their model landscapes. For market risk, in addition to the follow-up on TRIM findings, several investigations were performed to assess model changes related to the inclusion of valuation adjustments in the internal models for market risk as well as other specific model change requests. Finally, initial approvals of internal models previously under temporary tolerance (for example owing to new SIs linked to Brexit or institutions subject to consolidation) were within the scope of ECB Banking Supervision's assessments.

In total, 214 supervisory decisions on IMIs²⁶ (including for TRIM) were issued in 2021.

1.4 Indirect supervision of LSIs

In 2021 the "market share" of the LSI sector remained unchanged

The number of LSIs fell in 2021 but the LSI sector managed to maintain its "market share", representing 18.4% of total SSM banking assets. However, the weight of the LSI sector in the countries where they operate varies widely across countries participating in European banking supervision (**Chart 17**). While LSIs represent around 40% of total banking assets in Luxembourg and Germany, their importance is substantially lower in other countries, notably in Greece and Spain (3.4% and 5.7% respectively), whose banking systems are dominated by SIs. Relative to the size of their domestic economy, the biggest LSI sector can be found in Luxembourg, where LSIs primarily focus on private banking and custodian banking and accumulate assets representing 210.8% of GDP. The next two largest LSI sectors with respect to GDP are located in Austria (94.4%) and Germany (88.0%).

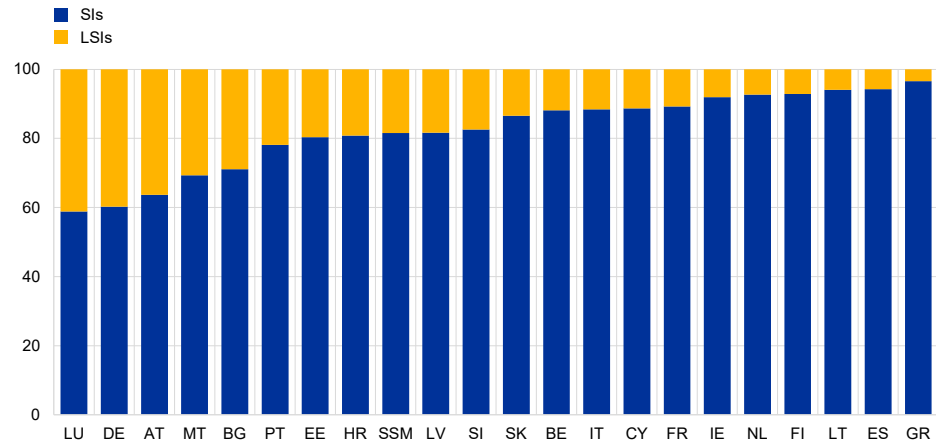
²⁴ EBA Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013 ([EBA/GL/2016/07](#)).

²⁵ This refers to the EBA Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures ([EBA/GL/2017/16](#)), EBA Guidelines for the estimation of LGD appropriate for an economic downturn ('Downturn LGD estimation') ([EBA/GL/2019/03](#)), [Commission Delegated Regulation \(EU\) 2021/930](#) of 1 March 2021 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the nature, severity and duration of an economic downturn referred to in Article 181(1), point (b), and Article 182(1), point (b), of that Regulation (OJ L 204, 10.6.2021, p. 1), and the Final Draft Regulatory Technical Standards on the specification of the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use the IRB Approach in accordance with Articles 144(2), 173(3) and 180(3)(b) of Regulation (EU) No 575/2013 ([EBA/RTS/2016/03](#)), which is pending European Commission endorsement.

²⁶ Excluding follow-up decisions on ancillary provisions.

Chart 17**Market share of SIs and LSIs by country**

(as a percentage of total assets)



Source: ECB.

Notes: Data as at 30 June 2021. Data reflect the highest level of consolidation, with the exception of Bulgaria, Croatia and Slovakia. For these three countries, the data include local subsidiaries of cross-border institutions in order to avoid a material misrepresentation of the market shares of SIs and LSIs.

The overall number of LSIs decreased in 2021²⁷, despite 27 new LSIs being added to the ECB's list of LSIs following the establishment of close cooperation between the ECB and Българска народна банка (Bulgarian National Bank) and Hrvatska narodna banka. According to the ECB's list of LSIs, there were 2,187 LSIs as at the end of December 2021, a 4.2% decline on the previous year. As at the end of December 2021, 81.5% of all LSIs were domiciled in Germany, Austria and Italy, reflecting the presence of large decentralised systems of savings and/or cooperative banks in those countries. In terms of the share of total LSI banking assets, Germany accounted for 53.6%, while Austria and Italy each accounted for 6.5%.

In line with ongoing trends in the European banking industry, consolidation in the LSI sector continued to advance in 2021, albeit at a slower pace. A total of 61 LSIs were acquired or merged in 2021, compared with 69 in 2020. Given the larger number of German LSIs, most of the mergers in the last two years affected its LSI sector (with 32 in 2020 and 49 in 2021). In Italy, the consolidation of the cooperative banking sector into two major groups was concluded in 2019, while in Austria 26 LSIs merged in 2020. In 2021 there were no major developments in the LSI sectors of those two countries.

²⁷ The number of LSIs in 2021 also decreased owing to Brexit; since 1 January 2021 UK branches have been considered to be third-country branches, meaning they are no longer part of the SSM LSI sector.

Table 1
Number of LSIs per country

	Q4 2020	Q4 2021
Belgium	17	16
Bulgaria	13	13
Germany	1,335	1,273
Estonia	8	9
Ireland	13	12
Greece	11	11
Spain	61	57
France	90	82
Croatia	14	14
Italy	135	122
Cyprus	5	5
Latvia	10	9
Lithuania	11	12
Luxembourg	54	52
Malta	16	16
Netherlands	29	26
Austria	390	387
Portugal	25	24
Slovenia	5	5
Slovakia	9	9
Finland	33	33
SSM	2,284	2,187

Source: ECB.

Note: Data reflect the highest level of consolidation, except for Bulgaria, Croatia and Slovakia.

Selected LSI oversight activities

The aggregate NPL ratio of LSIs continued to decrease despite the pandemic, standing at 2.1% in June 2021, down from 2.3% in June 2020. In a similar vein, the number of high-NPL LSIs²⁸ also fell further, to 217.

While LSIs' NPL ratios continued to decrease in 2021 despite the pandemic, the fact that many national support measures expired mid-year warrants further scrutiny in the future

In its LSI oversight capacity, the ECB focused on assessing, with the support of the national competent authorities (NCAs), the impact of the pandemic and of the wind-down of relevant national support measures on LSIs' credit risk profiles, as well as LSIs' readiness to deal with a potential increase in defaulting exposures. While the LSI sector appears to be broadly resilient to the negative effects of the crisis, the fact that the bulk of national support measures expired in the middle of 2021 warrants further scrutiny in the future. Therefore, credit risk activities in 2022 will continue to focus on assessing the effect of the pandemic on LSIs' asset quality and on ensuring a consistent supervisory response across countries participating in the SSM.

²⁸ High-NPL banks are those with an NPL ratio above 5%. See the [EBA Guidelines on management of non-performing and forborne exposures](#).

LSIs' use of deposit platforms to attract deposits has been increasing

In 2021 the ECB started a dialogue with NCAs on the fastest-growing LSIs in their countries. The NCAs provided their assessments of each of the fast-growing banks and outlined the supervisory actions being taken to ensure that they are not taking excessive risks. It was agreed to make this an annual exercise for supervised LSIs.

LSIs' use of online deposit platforms to attract deposits has been increasing. The ECB has worked closely with the NCAs to better understand how banks are using these platforms and to find out more about NCAs' supervisory approaches in this area. The purpose of the work on online deposit platforms is to gain greater visibility on the issue and a better understanding of the associated risks.

Governance has long been an area of supervisory focus. In 2021 the ECB, in cooperation with the NCAs, launched a thematic review on LSIs' internal governance.

A thematic review on LSIs' internal governance was launched by the ECB in cooperation with the NCAs

The focus of this thematic review is twofold and covers:

- the governance arrangements of LSIs in terms of the composition and functioning of the management body in its supervisory function (size, expertise, formal independence, committee structure, reporting lines, etc.) as well as their internal control functions;
- NCAs' supervisory practices for governance in LSIs, with a particular focus on standard-setting and off-site and on-site supervisory activities.

The ECB and the Austrian Financial Market Authority (*Finanzmarktaufsicht*) approved the Raiffeisen institutional protection scheme (IPS) in 2021. The reorganised IPS has been recognised for prudential purposes since 28 May 2021. The ECB also conducted further monitoring activities for hybrid IPSs, some of which are undergoing significant changes. In this context, the ECB and the relevant NCA are following-up on the remediation actions taken by one IPS to address concerns raised by the ECB's Supervisory Board.

The identification of financial holding companies has a direct bearing on the scope and conduct of consolidated supervision and has gained further relevance in the light of the introduction of a dedicated approval regime in the revised Capital Requirements Directive (CRD V)²⁹. In 2021 the ECB worked closely with NCAs to ensure consistent and thorough practices in this area for LSIs across European banking supervision, with case-specific and horizontal follow-up activities continuing into 2022.

LSI sectors in the countries welcoming incoming LSIs do not appear to have been be majorly affected by Brexit

In 2021 the ECB and NCAs analysed the impact of Brexit on the LSI sector. The results suggest that the LSI sectors in the five countries welcoming approximately 20 incoming LSIs have not been significantly affected by Brexit. The RWAs related to exposures to UK credit institutions have increased owing to the lack of equivalence

²⁹ Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (OJ L 150, 7.6.2019, p. 253).

for the UK under the Capital Requirements Regulation (CRR)³⁰, but this has not resulted in a major capital impact, owing to the limited amount of exposures affected and to the amount of capital available to absorb the increase in RWAs. Moreover, the analysis confirmed that for most of the national LSI sectors, the share of over-the-counter derivatives traded at UK central counterparties is not material.

Oversight methodologies

European banking supervision continued its efforts to enhance the common SREP methodology for LSIs in 2021, developing new elements in areas including credit risk controls, business model assessment and Pillar 2 guidance. These are due to be applied as of 2022.

ECB and NCAs jointly developed approaches to gauge the effectiveness of LSI supervision and oversight in 2021

In line with the broader objective of continuously improving the consistency of supervisory outcomes across countries participating in the SSM, the ECB and NCAs jointly developed approaches to gauge the effectiveness of LSI supervision and oversight in 2021. These approaches are being applied on a trial basis in 2022, which will inform discussions on how they can be refined and applied going forward.

High-risk and high-impact LSIs are subject to more frequent and in-depth supervisory activities

As of 2022 LSIs are to be separately classified based on impact and risk criteria. LSIs that meet one of the impact criteria, which include size, importance for the local economy, complexity and business model, are classified as high-impact. LSIs are classified as high-risk on the basis of a risk assessment by the NCA and their compliance with capital and leverage requirements. LSIs classified as high-impact are subject to more frequent and in-depth supervisory activities, such as the SREP and on-site inspections, by NCAs. High-impact LSIs and high-risk LSIs are also subject to greater oversight by the ECB, as the NCAs are required to notify the ECB of procedures and decisions they intend to take in respect of these institutions. The list of high-impact LSIs for 2022 can be found in Chapter 2 of this report. The list of high-risk LSIs will not be made public.

CRR II allows for targeted simplifications of requirements for small and non-complex institutions

The revised Capital Requirements Regulation (CRR II)³¹ introduced the new concept of “small and non-complex institutions” (SNCIs) to allow for targeted simplifications of requirements with respect to the application of the principle of proportionality. The targeted simplifications available to SNCIs include less frequent and detailed disclosure requirements, with the aim of reducing the administrative burden for SNCIs. Another simplification relates to a simplified, less granular version of the net stable funding ratio (sNSFR). The sNSFR reduces the complexity of the calculation but is calibrated more conservatively, thereby ensuring that SNCIs still maintain sufficient stable funding.

³⁰ [Regulation \(EU\) No 575/2013](#) of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

³¹ [Regulation \(EU\) 2019/876](#) of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (OJ L 150, 7.6.2019, p. 1).

1.5 The ECB's macroprudential tasks

The ECB continued to engage actively with the national authorities in 2021, in accordance with the macroprudential tasks conferred on it under Article 5 of the SSM Regulation³².

Over 100 macroprudential notifications were received from national authorities in 2021

In 2021 the ECB received over 100 macroprudential policy notifications from national authorities. Most of these notifications concerned quarterly decisions on setting countercyclical capital buffers (CCyB) and decisions on the identification and capital treatment of global systemically important institutions (G-SIIs) or other systemically important institutions (O-SIIs). Several national authorities decided to release buffers in 2020 in order to support lending during the pandemic. In 2021 some national authorities decided to reimpose CCyB requirements to address growing cyclical risk. The ECB also assessed notifications on other macroprudential measures, for example on the setting of systemic risk buffers or measures under Article 458 of the CRR.

Following the methodology developed by the Basel Committee on Banking Supervision, the ECB and national authorities identified eight G-SIIs³³ under European banking supervision that will be required to hold additional capital buffers ranging from 1.0% to 2.0% in 2023. For one G-SII³⁴ the applicable buffer rate increased compared with the previous year's identification exercise. In November 2021 the Financial Stability Board and the Basel Committee on Banking Supervision announced that, in the near term, the Basel Committee will review the implications of developments related to the European banking union for the G-SIB methodology. This will include a targeted review of the treatment of cross-border exposures within the banking union.³⁵

National authorities have identified and set capital buffer rates for 124 O-SIIs. These rates were in line with the floor methodology for setting the O-SII capital buffers, which the ECB has followed since 2016.

In July 2021 the ECB received a call for advice from the European Commission regarding the review of the macroprudential framework. The call was also addressed to the EBA and the ESRB. The European Commission asked all three organisations to provide their responses by the end of March 2022.

ECB Banking Supervision also participated actively in several areas of the work of the ESRB, which is responsible for the macroprudential oversight of the financial system in the EU. This included the ESRB's continued work on restrictions of

³² [Council Regulation \(EU\) No 1024/2013](#) of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

³³ BNP Paribas, Deutsche Bank, Groupe BPCE, Groupe Crédit Agricole, ING Bank, Santander, Société Générale and UniCredit.

³⁴ BNP Paribas.

³⁵ See "[Basel Committee advances work on addressing climate-related financial risks, specifying cryptoassets prudential treatment and reviewing G-SIB assessment methodology](#)", *press release*, Basel Committee on Banking Supervision, 9 November 2021, and "[FSB publishes 2021 G-SIB list](#)", *press release*, Financial Stability Board, 23 November 2021.

distributions. The ESRB adopted Recommendation ESRB/2020/7³⁶ in May 2020, which called on relevant authorities to request financial institutions under their supervisory remit to refrain from distributions until 1 January 2021. The ESRB reviewed and amended its recommendation in December 2020, calling for distributions to remain within conservative thresholds.³⁷ On 24 September 2021 the ESRB announced that it had decided to allow its recommendation to lapse at the end of September 2021.³⁸ As a result of close cooperation between the ESRB and the ECB, the ECB ensured that its own stance on distributions remained fully consistent with the ESRB Recommendation.

1.6 Looking ahead: risks and supervisory priorities for 2022

The risk-identification and priority-setting process plays a key role in developing and formulating ECB Banking Supervision's strategy for the next three years

ECB Banking Supervision assesses and monitors the risks and vulnerabilities faced by institutions under its direct supervision on an ongoing basis. The outcome of this assessment provides the basis for defining the supervisory priorities and corresponding activities for the next three years. The ongoing monitoring enables the priorities to be adjusted whenever the situation justifies it.

Three supervisory priorities for 2022-24 aim to address banks' main vulnerabilities

In 2021 ECB Banking Supervision, in cooperation with the NCAs, assessed the main risks and vulnerabilities faced by SIs and identified three priorities. These priorities aim to ensure that supervised institutions (1) emerge from the pandemic healthy, (2) seize the opportunity to address structural weaknesses via effective digitalisation strategies and enhanced governance, and (3) tackle emerging risks, including climate-related and environmental (C&E) risks, IT and cyber risks (**Figure 1**). For each priority, ECB Banking Supervision developed a set of strategic objectives and underlying work programmes, spanning the period 2022-24, to address the most material vulnerabilities identified during its risk assessment.

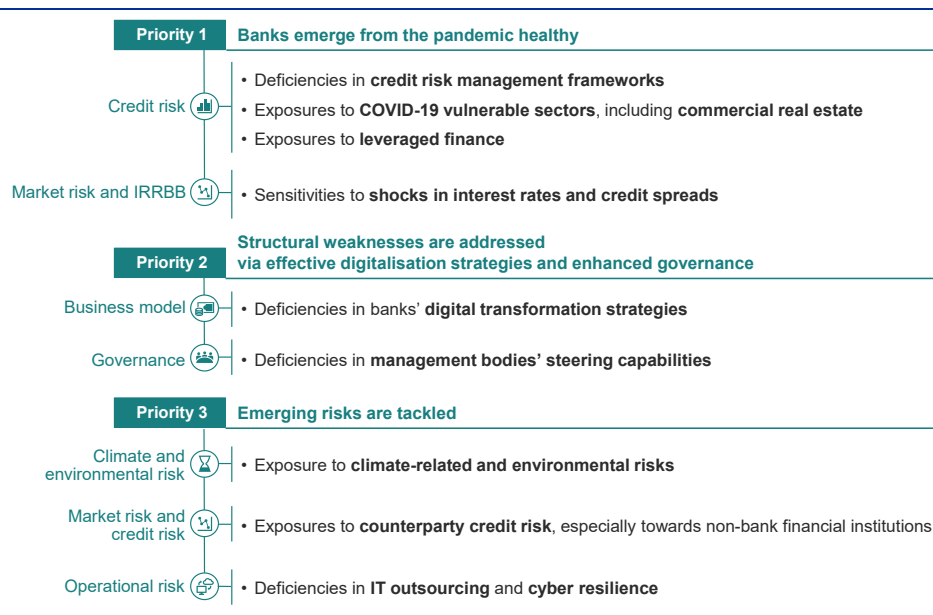
³⁶ Recommendation of the European Systemic Risk Board of 27 May 2020 on restriction of distributions during the COVID-19 pandemic (ESRB/2020/7).

³⁷ Recommendation of the European Systemic Risk Board of 15 December 2020 amending Recommendation ESRB/2020/07 on restriction of distributions during the COVID-19 pandemic (ESRB/2020/15).

³⁸ "The General Board of the European Systemic Risk Board held its 43rd regular meeting on 23 September 2021", *press release*, ESRB, 24 September 2021.

Figure 1

Supervisory priorities for 2022-24 addressing identified vulnerabilities in banks



Source: ECB.

Notes: The figure shows the three supervisory priorities and the corresponding vulnerabilities to be addressed over the coming years through targeted activities by ECB Banking Supervision. Each vulnerability is associated with its overarching risk category. Supervisory activities addressing potential shocks to interest rates/credit spreads and exposures to counterparty credit risk should not be seen in isolation. They will complement and inform each other with a view to addressing broader financial market correction concerns.

Priority 1: Banks emerge from the pandemic healthy

Supervised institutions have been able to withstand the adverse economic shock induced by the outbreak of the pandemic and have shown strong resilience overall. As the pandemic is still weighing on the economic outlook, banks need to be prepared to cope with its short to medium-term impacts, especially those related to potential asset quality deterioration and corrections in financial market valuations.

Banks should strengthen their credit risk management frameworks and address identified deficiencies

The unprecedented policy support measures helped to cushion the impact on banks' asset quality of the sharp decline in economic activity in 2020. However, these actions have also blurred borrowers' creditworthiness and challenged banks' ability to accurately assess it. Therefore, addressing the shortcomings in banks' credit risk management frameworks identified by supervisors over the past year remains a key priority for ECB Banking Supervision. The identification and classification of distressed borrowers, collateral valuation and the adequacy of provisioning practices are sources of particular concern. In this regard, ECB Banking Supervision will engage with banks that reported material deficiencies in the follow-up to the "Dear CEO" letter initiative and ensure that they implement timely remedial action plans. Supervisors will also monitor and review banks' implementation of the [EBA Guidelines on loan origination and monitoring](#), with a particular focus on real estate portfolios.

Supervisors will strengthen their focus on banks' exposures towards COVID-19 vulnerable sectors, including commercial real estate

The improved economic outlook has reduced the risk of widespread insolvencies in the corporate sector, at least in the short run. Nevertheless, highly indebted companies in those sectors most sensitive to the impact of the COVID-19 pandemic might still be adversely affected by the gradual phasing-out of the exceptional public support measures. Against this background, banks' exposures to vulnerable corporates – especially those in accommodation and food services, and the air transport and travel-related sectors – continue to warrant close scrutiny by banks and supervisors. The commercial real estate sector, which experienced a significant downturn during the crisis, also merits particular attention. ECB Banking Supervision will therefore strengthen its focus on banks' exposures towards such vulnerable corporates and will carry out targeted activities to benchmark and challenge banks' risk management practices in this area.

The build-up of unmitigated risks related to leveraged finance should be prevented

The search for yield in an environment characterised by sustained low interest rates, abundant liquidity and extraordinary support measures has contributed to the further build-up of risks in the leveraged loans market. In particular, the increasing risk appetite reported by some large supervised banks – which has been reflected in a loosening of lending standards and accompanied by an increase in leveraged loan issuance – is cause for concern and needs to be closely monitored by supervisors. ECB Banking Supervision will therefore strengthen its efforts to ensure that banks' risk management practices are adequate in order to prevent the build-up of unmitigated risks in the area of leveraged finance. It will also foster banks' adherence to the supervisory expectations laid down in the [ECB Guidance on leveraged transactions](#).

Banks should have sound arrangements in place to manage the impact of interest rate and credit spread shocks

The continued search for yield supported by the ample liquidity in the system and benign funding conditions raises concerns about stretched valuations in several market segments potentially exacerbating the likelihood of repricing in the debt or equity markets. A sudden adjustment in yields, triggered by a change in investors' expectations about inflation and interest rates, could cause asset price corrections. It is therefore essential that banks are prepared for any such corrections and able to adjust their risk management practices promptly. To ensure that banks are adequately prepared to withstand such market shocks, ECB Banking Supervision will increase its supervisory attention on risks posed by the excessive search for yield through regular JST engagement, targeted reviews and on-site inspections.

Priority 2: Structural weaknesses are addressed via effective digitalisation strategies and enhanced governance

Addressing structural weaknesses in the area of digital transformation and in the steering capabilities of banks' management bodies is crucial to support the resilience and sustainability of banks' business models.

Supervised institutions should embrace sound digital transformation

Changes in customer preferences and rising competition from fintech and big tech are putting further pressure on banks to accelerate their adoption of digital technologies. In addition, supervised banks have been struggling with low profitability since the great financial crisis, owing to structural vulnerabilities related to excess

capacity and cost inefficiencies. The accelerated digital transformation of banks' business models provides a good opportunity for banks to improve their sustainability and offers new avenues for income generation. Supervisors will intensify their efforts to assess banks' digitalisation strategies in order to ensure they have adequate arrangements in place to increase their resilience and the sustainability of their business models in the long term.

Supervised banks should address deficiencies in their management bodies' functioning and composition

Long-lasting vulnerabilities in banks' internal governance and risk management continue to be a source of concern for supervisors. Despite some progress over the past few years, a large number of supervised institutions continue to exhibit structural deficiencies in internal control functions, management bodies' functioning or risk data aggregation and reporting capabilities. These weaknesses might impair decision-making and risk governance, and in turn raise concerns about the effectiveness of banks' management boards and strategic steering capabilities. It is crucial that supervised institutions promptly address outstanding supervisory findings and strengthen the effectiveness of their boards. Against this background, ECB Banking Supervision will carry out targeted initiatives to ensure that banks effectively address the identified deficiencies in the functioning and composition of their management bodies, with a particular focus on their collective suitability and diversity.

Priority 3: Emerging risks are tackled

The risk landscape is constantly evolving, producing a number of emerging and intensifying risks to banks both in the short and longer term. Supervisors will aim to ensure that banks proactively mitigate C&E risks, increasing counterparty credit risk towards riskier and less transparent non-bank financial institutions, and operational and IT resilience risks.

Banks should incorporate C&E risks into their business strategies and their governance and risk management frameworks

The impact of C&E risks is expected to be significant and supervised institutions need to take action to deal with the challenges stemming from physical and transition risks.³⁹ It is therefore vital that banks adequately incorporate C&E risks into their business strategies and their governance and risk management frameworks. Against this background, ECB Banking Supervision will conduct a thematic review to assess banks' progress towards achieving this objective, as well as a climate risk stress test to assess banks' resilience and risk management capacity in this area⁴⁰. As banks have made only limited progress towards aligning their disclosure practices with supervisory expectations, supervisors will continue monitoring their development⁴¹ and banks' compliance with upcoming regulatory requirements.

³⁹ "Financial Stability Review", ECB, May 2021.

⁴⁰ "Information on participation in the 2022 ECB Climate Risk Stress Test", Letter to participating banks, ECB Banking Supervision, 18 October 2021.

⁴¹ "The clock is ticking for banks to manage climate and environmental risks", Supervision Newsletter, ECB Banking Supervision, August 2021.

Banks should have sound governance and risk management frameworks in place to cope with increased exposures to counterparty credit risk

The increased volume of capital market services that banks provide to more risky and less transparent non-bank financial institutions (e.g. hedge funds and family offices), as well as the material impact that the possible bankruptcies of these institutions could entail, has highlighted the risks stemming from weak governance and substandard risk management practices in this area. ECB Banking Supervision will carry out targeted reviews and on-site inspections in the area of counterparty credit risk governance and management to identify any relevant deficiencies. Special attention will be paid to prime brokerage activities carried out by a few institutions that are heavily involved in this business. JSTs will follow up with banks on these matters to ensure effective remedial actions are implemented in a timely manner.

Supervisors will foster more robust IT outsourcing arrangements and greater cyber resilience within banks by increasingly challenging their risk management practices

While SIs have demonstrated strong operational resilience throughout the pandemic, the number of cyber incidents reported to the ECB has been increasing since 2020.⁴² The acceleration of banks' digital strategies and their increasing reliance on information technologies make it essential to strengthen their resilience against cyber threats. Moreover, IT outsourcing risks in conjunction with banks' increasing reliance on third-party IT providers raise concerns that warrant a stronger supervisory focus. Against this background, ECB Banking Supervision will gradually increase its focus on assessing banks' practices in these areas and actively follow up with those showing material deficiencies.

Box 3

Follow-up to the ECB Guide on climate-related and environmental risk: stocktake of banks' self-assessments and action plans

In its [Guide on climate-related and environmental \(C&E\) risks](#) published in November 2020, ECB Banking Supervision shared 13 supervisory expectations for how the banks under its direct supervision should integrate climate-related risks into their business models, governance, risk management and disclosures. After the guide was published, the ECB asked banks to assess themselves against these expectations and to submit action plans detailing how they would bring their practices into line with the guide.

In November 2021 the ECB published the results of its supervisory assessment of banks' practices in a [report on the state of climate-related and environmental risk management in the banking sector](#). Covering 112 institutions directly supervised by the ECB with €24 trillion in combined assets, the assessment was an unprecedented stocktake of European banks' preparedness to adequately manage and disclose their exposure to C&E risks.

The report provides a horizontal view of the current trends in addressing and disclosing C&E risks within the euro area banking sector and sets out some of the good practices currently observed in the management of those risks.

The supervisory assessment concluded that although institutions have taken initial steps towards incorporating climate-related risks into their risk management practices, none are close to meeting all the supervisory expectations (**Figure A**). 90% of the institutions that participated in the exercise are only partially – or not at all – aligned with the ECB's supervisory expectations on average.

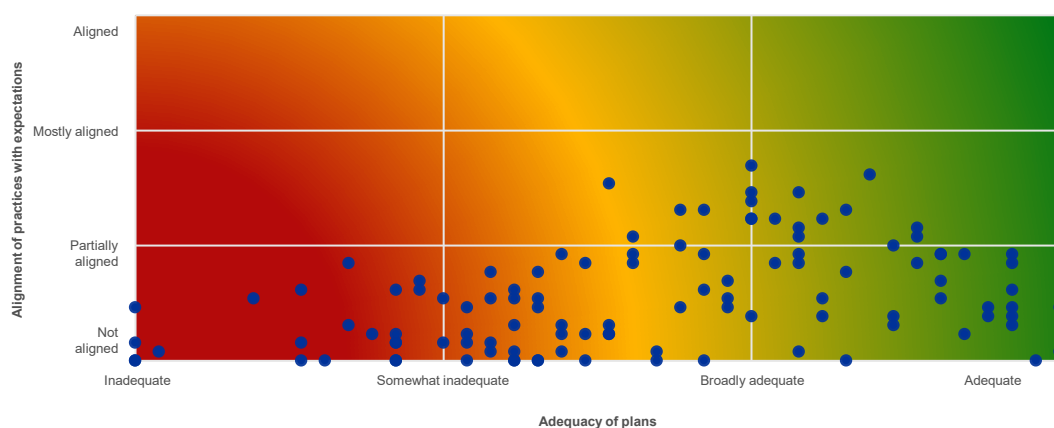
⁴² "IT and cyber risk: a constant challenge", *Supervision Newsletter*, ECB Banking Supervision, August 2021.

However, many banks recognise that C&E risks will have a material impact on their risk profiles within the next three to five years, especially in terms of credit, operational and business model risk.

Figure A

The state of C&E risk management in the banking sector in terms of institutions' alignment with expectations and the adequacy of their plans to advance their practices

(y-axis: the level of alignment of 112 institutions' practices with the supervisory expectations set out in the ECB Guide; x-axis: the level of adequacy of 112 institutions' implementation plans to address gaps in their practices)



Source: ECB.

Notes: Weighted average scores are plotted for the 13 supervisory expectations. The sample includes 112 significant institutions at the highest level of consolidation within the Single Supervisory Mechanism.

The ECB sent individual feedback letters to all the banks, calling on them to address the shortcomings identified in the supervisory assessment. In some cases, institutions may receive a qualitative requirement as part of the SREP.

Next steps

The ECB recognises that the challenges linked to the integration of C&E risks in banks' strategies and governance and risk management arrangements are constantly evolving and is committed to continuing its dialogue with them on this topic.

In 2021 ECB Banking Supervision also investigated institutions' climate and environmental risk disclosures. The findings from the investigation will be published in a report and individual feedback has been provided to each bank.

The ECB will also conduct a full review of banks' preparedness to manage climate and environmental risks, including deep dives on the incorporation of C&E risks into their strategies and governance and risk management arrangements. This review will take place in the first half of 2022. ECB Banking Supervision will also conduct a supervisory stress test on climate-related risks. The outcome of these supervisory exercises will be of a qualitative nature. Any possible impact on banks will be indirect, via the SREP scores on Pillar 2 requirements, and no bank-specific results

will be published. In addition, the enhanced regulatory provisions on environmental, social and governance risks, which are contained in the review of EU banking rules proposed by the European Commission, foresee the uniform inclusion of C&E risks in the EBA Guidelines on common procedures and methodologies for SREP and supervisory stress testing. On this basis, the ECB will gradually integrate C&E risks into its SREP methodology, and this will eventually influence Pillar 2 capital requirements.

2 Authorisations, enforcement and sanction procedures

2.1 Authorisations

2.1.1 Annual significance assessment (including comprehensive assessments) and identification of high-impact LSIs

2.1.1.1 Annual significance assessment

The ECB has been directly supervising 115 banks since 1 January 2022, following the annual review of significance and ad hoc assessments

In line with the SSM Framework Regulation⁴³, the annual assessment of whether a bank or banking group fulfils any of the significance criteria⁴⁴ was concluded in November 2021. It was supplemented by ad hoc significance assessments (leading to 48 significance decisions) which were carried out following changes to group structures.

As a result, 115 institutions⁴⁵ were classified as significant as of 30 November 2021, as in the previous annual assessment of significance.

In 2021 three institutions were added to the list of significant supervised entities as a result of the annual assessment: Banca Mediolanum S.p.A. and Finecobank S.p.A., both established in Italy, and Danske Bank A/S, Finland Branch, were classified as significant because their assets exceeded €30 billion. The ECB has been directly supervising these institutions since 1 January 2022. As regards Danske Bank A/S, Finland Branch, the ECB exercises the powers of the competent authority of the host Member State.⁴⁶

Meanwhile, three institutions were removed from the list of significant entities:

- BFA Tenedora De Acciones S.A.U., the former holding company of Bankia S.A., was removed from the list of supervised institutions as a result of the merger by absorption of its only subsidiary, Bankia S.A., into CaixaBank S.A. with effect from 26 March 2021;

⁴³ [Regulation \(EU\) No 468/2014](#) of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17) (OJ L 141, 14.5.2014, p. 1).

⁴⁴ These criteria are set out in Article 6(4) of the SSM Regulation.

⁴⁵ The [list](#) of significant institutions (SIs) and less significant institutions (LSIs) published in December 2021 reflects (i) the significance decisions notified to the supervised institutions before 30 November 2021, and (ii) other changes and developments in group structures effective before 1 November 2021.

⁴⁶ Pursuant to Article 14 of the SSM Framework Regulation and in accordance with Article 4(2) of the SSM Regulation.

- Liberbank S.A. was also removed from the list of supervised institutions, given that it was merged by absorption into Unicaja Banco S.A. with effect from 30 July 2021;
- C.R.H. - Caisse de Refinancement de l'Habitat was classified as less significant because it did not meet any of the significance criteria for three consecutive calendar years; the French Prudential Supervision and Resolution Authority (*Autorité de contrôle prudentiel et de résolution – ACPR*) has been directly supervising it since 1 January 2022.

In addition, the following changes to group structures took place, without affecting the number of significant supervised entities:

- owing to intragroup mergers, Precision Capital S.A. ceased to meet the criterion of significant cross-border activities and, consequently, changed its ground for significance to national economic importance (meeting the relevant thresholds as of 31 December 2020);
- Piraeus Bank S.A. and Alpha Bank AE were withdrawn in the context of group restructurings and the institutions became financial holdings, changing their names to Piraeus Financial Holdings S.A. and ALPHA SERVICES AND HOLDINGS S.A. respectively (in addition, two new credit institutions, Piraeus Bank S.A. and ALPHA BANK S.A. were authorised as subsidiaries of Piraeus Financial Holdings S.A. and ALPHA SERVICES AND HOLDINGS S.A. respectively).

The list of supervised entities is frequently updated. The most recent version of the list can be found on the [ECB's banking supervision website](#).

Table 2

Significant and less significant banking groups or stand-alone banks under European banking supervision following the 2021 annual assessment

	Total assets (EUR billions)	Number of entities at consolidated level ¹⁾	Number of entities at individual level	Average size at consolidated level (EUR billions)
SIs	23,784.4	115	935	206.8
LSIs	5,334.7	2,192	2,465	2.4

Source: ECB.

Notes: "Total assets" refers to the total assets of entities included in the list of supervised entities as published in December 2021 (with a reference date of 30 November 2021 for the significance decisions notified to the supervised institutions resulting from the annual significance assessment, and of 1 November 2021 for other changes and developments in group structures). The reference date for total assets is 31 December 2020 (or the latest available, as used for the latest significance assessment).

1) As of 1 November 2021.

2.1.1.2 Comprehensive assessments

In July 2021 the ECB concluded the comprehensive assessments of two Italian cooperative banking groups (Iccrea Banca S.p.A. – Istituto Centrale del Credito Cooperativo and Cassa Centrale Banca – Credito Cooperativo Italiano S.p.A.) and two Baltic banks (Luminor Bank AS in Estonia and Akcinė bendrovė Siaulių bankas in Lithuania).

Additionally, in August 2021 the ECB launched a comprehensive assessment of three banks on the basis that each fulfils a criterion for being directly supervised by the ECB: Addiko Bank AG in Austria (significant cross-border activities), Agri Europe Cyprus Limited (among the three largest credit institutions in the Member State, Slovenia), and Barclays Bank Ireland PLC in Ireland (size). The exercise is due to be completed towards the end of the first half of 2022.

2.1.1.3 High-impact less significant institutions

Owing to the large number of LSIs, as well as their differences in terms of size, complexity and risk profile, European banking supervision classifies these institutions based on their impact on the financial system and their risk profile. As of 2022, impact criteria and risk criteria are being assessed separately. High-impact LSIs are determined once a year for each of the countries participating in European banking supervision.

An LSI is designated as high-impact if it meets any one of the following criteria.

- **Size**
The institution's total assets are greater than €15 billion.
- **Importance for the economy**
The institution's total assets are greater than 15% of the country's GDP, or it is an "other systemically important institution" (O-SII) within the meaning of the Capital Requirements Directive (CRD).
- **Potentially significant institution**
The LSI is a "large institution" within the meaning of CRR II (an institution that meets one of the significance criteria but is not classified as significant).
- **Cross-border activities**
The LSI owns one or more credit institutions in one or more other participating countries.
- **Business model**
The LSI is a financial market infrastructure with a banking licence, a central savings or central cooperative bank or the central institution of an institutional protection scheme.
- **Minimum coverage rule**
If fewer than three high-impact LSIs are identified in a jurisdiction using the above criteria, the minimum coverage rule applies. The minimum coverage rule requires that additional LSIs are selected by size until three high-impact LSIs are identified.

An LSI that is considered a small and non-complex institution (SNCI) within the meaning of CRR II cannot be designated as a high-impact LSI unless it is the largest LSI in a jurisdiction where all LSIs are SNCIs.

2.1.1.4 Implications of high-impact LSI designation

The designation of an LSI as high-impact is a factor that national competent authorities (NCAs) take into account when determining the frequency and level of detail of their supervisory activities, such as the Supervisory Review and Evaluation Process and on-site inspections, among others. In addition, NCAs are obliged to notify the ECB of any material supervisory procedures or decisions they intend to implement in respect of these institutions, in line with Articles 97 and 98 of the SSM Framework Regulation.

The following table lists the high-impact less significant supervised entities for 2022, as adopted by the Supervisory Board of the ECB. The grounds for the high-impact LSI status for each institution are provided to ensure the transparency of the classification.

Table 3
List of high-impact less significant supervised entities for 2022

Belgium			
Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
549300H2VNRV8LKCTU90	ANBANG BELGIUM HOLDING	5.7	Minimum coverage
549300CBNW05DILT6870	Euroclear SA	26.0	Size
549300TDPXT0OW2AY198	FinAx NV	9.1	Cross-border activities
Bulgaria			
Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
549300615CPXQO52J309	Bulgarian Development Bank	2.1	Importance for the economy
5299002142DS5ONT5540	Central Cooperative Bank AD	3.5	Importance for the economy
549300UY81ESCZJ0GR95	First Investment Bank AD	5.8	Importance for the economy
Germany			
Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
529900T7MYZUMMW4O176	Berliner Volksbank eG	16.9	Size
D2OIGPB6E66YOBJ9GT20	BMW Bank GmbH	28.7	Size
222100GEYIQNDDBR9J43	Clearstream Holding AG	17.0	Size
529900EXG2PM316ISO63	Deutsche WertpapierService Bank AG	0.7	Business model
529900LN3S50JPU47S06	EUREX Clearing Aktiengesellschaft	33.4	Size
21380051GNDG65QWAO66	HSBC Germany Holdings GmbH	29.5	Size
PWEFG14QWWESISQ84C69	IKB Deutsche Industriebank Aktiengesellschaft	16.9	Size
5299002GPCR602QYJC04	KfW Beteiligungsholding	28.2	Size
529900RTSGHDD7OOSO86	Kreissparkasse Köln	28.6	Size
52990050SU0S4QQ4Z793	Landesbank Saar	15.2	Size
391200UEWWKBKD12KP84	LBS Bayerische Landesbausparkasse	15.2	Size
529900FU4WJ2XT7BVE31	LBS Landesbausparkasse Südwest	20.7	Size
529900DEAYRUPP22B339	Mercedes-Benz Bank AG	28.0	Size
529900X200JCQZE8VX28	Mittelbrandenburgische Sparkasse in Potsdam	17.3	Size

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
5299008I0TO44SUINZ71	Oldenburgische Landesbank Aktiengesellschaft	21.5	Size
529900LIN8L1K9MLTR09	ProCredit Holding AG & Co.KGaA	7.3	Cross-border activities
391200L4PK1CJT0VZU55	Sachsen-Finanzgruppe	17.3	Size
52990085XZWOZNLAWJ54	Sparkasse Hannover	18.5	Size
5299001ADI8FLGT0GU28	Sparkasse KölnBonn	27.8	Size
529900JB2S6CH38UQ526	Sparkasse Pforzheim Calw	15.5	Size
529900P7CWBZI0062C32	Stadtsparkasse München	22.1	Size
529900S1KHKOEQL5CK20	Wüstenrot Bausparkasse Aktiengesellschaft	29.2	Size

Estonia

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
529900JG015JC10LED24	AS LHV Group	5.0	Importance for the economy
5493007SWCCN9S3J2748	Bigbank AS	0.8	Minimum coverage
549300EHNXQVOI120S55	Coop Pank AS	0.9	Minimum coverage

Ireland

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
5493000YPN33HF74SN02	Bank of Montreal Europe plc	8.3	Minimum coverage
635400LCCYHUL6ELA34	Elavon European Holdings BV	10.2	Minimum coverage
635400DTNHVYGZODKQ93	permanent tsb Group Holdings plc	21.0	Size

Greece

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
213800FFWYE3BQ1CU978	Attica Bank, S.A.	3.6	Minimum coverage
2138008NSD1X1XFUK750	Optima bank S.A.	1.0	Minimum coverage
213800U41ZQTTURP3V26	Pancreta Bank S.A.	2.1	Minimum coverage

Spain

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
959800LQ598A5RQASA61	Banca March, S.A.	16.1	Size
549300G3C8M0WXQCWH61	Caja Laboral Popular Coop. De Credito	27.3	Size
95980020140005439549	Caja R. de Navarra, S.C.C.	15.6	Size
9598002AYDQER7DXLR16	Grucajrral Inversiones, S.L.U.	13.9	Business model

France

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
969500CJCTMI93QJKK89	AXA Banque	16.7	Size
R11O4YJ0O79SMWVCHB58	Banque Centrale de Compensation	622.9	Size
969500TVVZM86W7W5I94	C.R.H. - Caisse de Refinancement de l'Habitat	25.4	Size
D3K6HXMBBB6SK9OXH394	Dexia SA	114.4	Size
969500C9N2QA9HQUM309	Financiere IDAT	9.3	Cross-border activities

Croatia

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
529900D5G4V6THXC5P79	Hrvatska poštanska banka d.d.	3.4	Minimum coverage
5299005UJX6K7BQKV086	OTP banka d.d.	6.3	Minimum coverage
529900LSO9YYPL05B152	Podravska banka d.d.	0.5	Minimum coverage

Italy

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
81560064085A02B2B297	Banca del Mezzogiorno - Mediocredito Centrale S.p.A.	14.8 ¹⁾	Size
815600A069BDDE109726	Brianza Unione di Luigi Gavazzi e Stefano Lado s.a.p.a.	15.7	Size
529900N2ZB1B52JB2F83	Cassa Centrale Raiffeisen dell'Alto Adige S.p.A.	5.9	Business model

Cyprus

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
549300VB6UM9TUOCYW67	Astrobank Limited	2.9	Importance for the economy
213800HYE2VYP5WKF143	Housing Finance Corporation	1.1	Minimum coverage
213800P1P13ABO5R9V78	Société Générale Bank - Cyprus Ltd	0.8	Minimum coverage

Latvia

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
2138007F5HA5FFJROB80	Akciju sabiedrība "Rietumu Banka"	1.5	Minimum coverage
54930080G2M7EJ097A27	AS BlueOrange Bank	0.7	Minimum coverage
549300OMTXWX1144LP69	Akciju sabiedrība "Reģionālā investīciju banka"	0.3	Minimum coverage

Lithuania

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
2138009QCHFQV9RC4R40	Lietuvos centrinė kredito unija	0.6	Minimum coverage

Luxembourg

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
549300F7FBD744MEP844	Banque Raiffeisen	9.7	Importance for the economy
222100OBGR5ZZKQ35B98	EFG Investment (Luxembourg) S.A.	3.5	Cross-border activities
549300GSSPQ1QSKI1376	Pictet & Cie (Europe) S.A.	10.1	Importance for the economy
5493004K8I4CKF0BO031	Quilvest Wealth Management S.A.	2.5	Cross-border activities

Malta

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
213800A1O379I6DMCU10	APS Bank plc	2.4	Importance for the economy
529900Q2C3I7VILLG45	FIMBank plc	1.5	Minimum coverage
529900UIRB65OY6U4B21	Lombard Bank Malta plc	1.1	Minimum coverage

Netherlands

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
549300772D1G8JPIUR96	Aegon Bank N.V.	17.1	Size
724500BICUQ0LF1AH770	Nationale-Nederlanden Bank N.V.	25.5	Size
7245006WQ4T1GV2W4C98	NIBC Holding N.V.	21.1	Size
724500JIWG886A9RRT57	RBS Holdings N.V.	21.8	Size
724500ZM85SCL0RS8L71	Van Lanschot Kempen N.V.	15.1	Size

Austria

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
5493007BWYDPQZLZ0Y27	HYPO NOE Landesbank für Niederösterreich und Wien AG	16.4	Size
NS54DT27LJMDYN1YFP35	Hypo Vorarlberg Bank AG	15.3	Size
RRUN0TCQ1K2JDV7MXO75	Oberbank AG	24.4	Size
529900SXEWJP1MRRX537	RAIFFEISEN-HOLDING NIEDERÖSTERREICH-WIEN registrierte Genossenschaft mit beschränkter Haftung	29.1	Size
529900VUMWR5RIA1I644	Raiffeisenlandesbank Burgenland und Revisionsverband eGen	4.4	Business model
5299009EHB4RBGMI5828	Raiffeisenlandesbank Kärnten - Rechenzentrum und Revisionsverband, registrierte Genossenschaft mit beschränkter Haftung	3.7	Business model
5299005OACOC1C1OFJ11	Raiffeisen-Landesbank Tirol AG	9.4	Business model
529900FEID5L4H2T2L70	Raiffeisenlandesbank Vorarlberg Waren- und Revisionsverband registrierte Genossenschaft mit beschränkter Haftung	7.0	Business model
529900LU7D396TOO3B50	Raiffeisenverband Salzburg eGen	9.1	Business model
529900QYEJ2GYSWK1F08	RLB-Stmk Verbund eGen	17.7	Size
52990045V2BWJN669Q34	Wüstenrot Wohnungswirtschaft registrierte Genossenschaft mit beschränkter Haftung	7.1	Cross-border activities

Portugal

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
529900H2MBEC07BLTB26	Caixa Central - Caixa Central de Crédito Agrícola Mútuo, CRL	22.8	Size
2138004FIUXU3B2MR537	CAIXA ECONÓMICA MONTEPIO GERAL, CAIXA ECONÓMICA BANCÁRIA, SA	17.9	Size
549300QQJ6BNALGU6806	Banco BIC Português, SA	7.2	Minimum coverage

Slovenia

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
549300H7CCQ6BSQBG72	SKB Banka d.d. Ljubljana	3.7	Minimum coverage

Slovakia

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
315700PLTAXHBHJP5J02	365.bank, a.s.	4.4	Importance for the economy
315700K45LRKNGMUIW27	Prima banka Slovensko, a.s.	4.5	Minimum coverage
097900BEF5000000569	Prvá stavebná sporiteľňa, a.s.	3.0	Minimum coverage

Finland

Legal entity identifier	Name	Total assets as at year-end 2020 (EUR billions)	Grounds for high-impact status
743700GC62JLHFBUND16	Aktia Bank Abp	9.1	Minimum coverage
7437005892K69S3MW344	Säästöpankkiliitto osk	12.1	Minimum coverage
743700FTBNXAUN57RH30	S-Pankki Oy	7.6	Minimum coverage

1) The institution's total assets exceeded €15 billion in the first quarter of 2022.

2.1.2 Authorisation procedures

In 2021 ECB Banking Supervision was notified of a total of 651 authorisation procedures

In 2021 ECB Banking Supervision was notified of a total of 651 authorisation procedures (Table 4). These notifications comprised 29 licence applications, 24 licence withdrawals, 52 lapsing of authorisations, 111 acquisitions or increases of qualifying holdings, 404 passporting procedures and 31 authorisations of financial holding companies. Following the entry into force of the new framework for the supervision of investment firms in June 2021, NCAs and the ECB were also involved in authorising investment firms as credit institutions.

Table 4
Notifications of authorisation procedures submitted to the ECB

	Authorisation procedures (SIs and LSIs)					
	Licensing	Withdrawal of licence	Lapsing of authorisation	Qualifying holdings	Passporting	Financial holding companies
2017	24	41	52	160	448	N/A
2018	43	26	82	100	419	N/A
2019	34	15	36	110	407	N/A
2020	28	18	49	101	361	N/A
2021	29	24	52	111	404	31

Source: ECB.

In 2021 200 authorisation procedure decisions⁴⁷ were finalised. Of these, the Supervisory Board submitted 90 draft decisions which were then approved by the Governing Council. The remaining 110 were approved by senior management within the framework for delegation.⁴⁸ These 200 authorisation procedure decisions account for 8% of all ECB individual supervisory decisions in 2021.

Two authorisation procedures led to negative decisions. Furthermore, seven licence applications and eight notifications of acquisitions or increases in qualifying holdings were withdrawn prior to a decision being finalised owing to a negative assessment.

⁴⁷ Some decisions cover more than one authorisation assessment (e.g. acquisitions of qualifying holdings in different subsidiaries resulting from a single transaction). Some authorisation procedures do not require a formal ECB decision, including passporting and lapsing procedures.

⁴⁸ These are procedures which are subject to the delegation frameworks approved under Decision (EU) 2021/1438 of the European Central Bank of 3 August 2021 on delegation of the power to adopt fit and proper decisions and the assessment of fit and proper requirements (ECB/2021/34), and Decision (EU) 2021/1440 of the European Central Bank of 3 August 2021 on delegation of the power to adopt decisions on passporting, acquisition of qualifying holdings and withdrawal of authorisations of credit institutions (ECB/2021/36).

Compared with 2020, the number of notified authorisation procedures in 2021 remained largely unchanged, taking into account applications made in the context of the new framework for authorising (mixed) financial holding companies.

2.1.2.1 Developments in common procedures

The number of notifications of common procedures submitted to the ECB remained similar to the previous year

Overall, in 2021 the number of notifications of common procedures for licensing, qualifying holdings and withdrawals submitted to the ECB remained similar to the previous year.

A high number of qualifying holdings were assessed by ECB Banking Supervision. In a few procedures, following concerns raised by supervisors during the initial assessment or the issuance of a negative decision by the ECB, applicants decided to withdraw their notifications or to exercise their right to be heard. In other cases, applicants decided to withdraw their applications owing to the prolonged uncertain macroeconomic environment or for case-specific reasons. Several qualifying holdings procedures stemming from internal reorganisations were subject to the simplified qualifying holdings assessment approach. As in previous years and despite emerging transformation and active consolidation dynamics, only limited cross-border consolidation was observed.

The vast majority of licensing procedures in 2021 were associated with the establishment of new LSIs. As in previous years, the main driver of new applications was the increased use of digital innovations to provide services to EU clients (e.g. fintech business models).

Since the introduction in 2017 of a “specialised banking licence”, the surge of licence applications from Lithuania continued. In this context, Lietuvos bankas and the ECB continued to challenge the business models submitted by applicants, which resulted in a significantly higher number of applications withdrawn by the applicant or rejected by the NCA. Moreover, some licensing applications in Germany involving innovative technologies were withdrawn during the initial assessment.

The few licensing procedures concerning significant institutions (SIs) resulted primarily from the need to extend bank licences for additional regulated activities planned by the banks.

Withdrawal procedures arose mainly from voluntarily terminations of business activity and mergers or other types of restructuring. Four LSIs exited the market by involuntary liquidation procedures, including insolvency proceedings.

2.1.2.2 Developments in passporting procedures, investment firms and (mixed) financial holding companies

For the first time investment firms classified as credit institutions under the revised CRD/CRR notified their passporting activities under the new regime

The ECB and NCAs handled 404 passporting procedures in 2021. For the first time investment firms classified as credit institutions under the revised CRD/CRR notified their passporting activities under the new regime.

The ECB and NCAs also continued their work on the authorisation of investment firms. In June 2021 a new framework for the supervision of investment firms entered into force, introducing criteria under which investment firms must apply for authorisation as credit institutions. Such authorisation needs to be obtained based on both qualitative (activities carried out) and quantitative (value of assets) criteria, either on a solo or a group basis. In 2021 and 2022 a grandfathering regime applies to investment firms qualifying for authorisation as credit institutions. Approximately 20 institutions are expected to fall within the scope of the bank licence requirement. So far, NCAs have informed the ECB of 11 applications submitted.

Article 21a of CRD V introduced a new supervisory regime for parent (mixed) financial holding companies⁴⁹ in supervised groups. When approved, these financial holding companies are responsible for the supervised group's compliance with prudential requirements on a consolidated basis. For significant supervised groups, the ECB is responsible for granting approval or exempting these parent (mixed) financial holding companies. In 2021 the ECB received 31 applications and issued 23 decisions (covering one newly established and 22 existing (mixed) financial holding companies in supervised groups): nine (mixed) financial holding companies were approved while 14 (mixed) financial holding companies were exempted from approval.

2.1.2.3 IMAS portal

In 2021 a significant share of fit and proper procedures were processed via the IMAS portal

The IMAS portal is the online platform which facilitates interactions and exchange of information between supervisors and supervised entities/third parties. The IMAS portal is part of the strategy to digitalise SSM supervisory processes and covers the entire supervisory cycle.⁵⁰

Since January 2021 a significant share of fit and proper procedures have been processed via the IMAS portal. Passporting notifications and acquisitions/increases of qualifying holdings were onboarded in 2021. In 2022 licensing applications, voluntary withdrawals of authorisations and authorisations of financial holding

⁴⁹ A "mixed financial holding company" is defined in Article 2(15) of the Financial Conglomerates Directive (2002/87/EC) – to which Article 2(5) of the CRR refers – as "a parent undertaking, other than a regulated entity, which together with its subsidiaries, at least one of which is a regulated entity which has its head office in the Community, and other entities, constitutes a financial conglomerate". Under Article 2(20)(c) of the SSM Framework Regulation, a "mixed financial holding company" qualifies as "supervised entity" provided it fulfils the conditions laid down in Article 2(21)(b) of the same regulation.

⁵⁰ From 2022 onwards supervisors and banks also started using the IMAS portal for other procedures (such as non-material model changes, as described in Section 5.8.2).

companies will be added to the IMAS portal. Against this background, the submission of requests and transactions via the IMAS portal is constantly increasing.

2.2 Fit and proper procedures

In 2021 ECB Banking Supervision was notified of a total of 2,627 fit and proper procedures⁵¹ (individual assessments of management and supervisory board members, key function holders⁵² and third-country branch managers) (**Table 5**).

Table 5
Fit and proper procedures submitted to the ECB

	Fit and proper procedures submitted by SIs
2016	2,544
2017	2,301
2018	2,026
2019	2,967
2020	2,828
2021	2,627

Source: ECB.

Notes: The sample includes all significant institutions (within the Single Supervisory Mechanism) which submitted fit and proper applications.

Around 67% of all fit and proper procedures received in 2021 concerned members of the management body in its supervisory function. The remaining 33% concerned members of the management body in its management function (around 28%), key function holders (4%) and third-country branch managers (1%).

The overall processing time of the fit and proper procedures completed in 2021 was, on average, 3.7 months, which is shorter than the maximum period of four months established in paragraph 179 of the [Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders](#).

2.2.1 Developments in fit and proper assessments

Reflecting its stricter and more intrusive approach to fit and proper assessments and efforts to strengthen the governance of supervised banks, the ECB identified concerns regarding one or more of the fit and proper criteria for 58% of the members of management bodies that were assessed. This is an increase of 8% compared with 2020. The most common issues were related to board members' experience, conflicts of interest and time commitment. As a follow-up, the ECB imposed conditions, obligations or recommendations on SIs to remedy the concerns identified.

⁵¹ This also includes a small number of requests for additional non-executive directorships.

⁵² As of 30 December 2020, Italy joined other SSM countries and started assessing key function holders under Italian law (Ministerial Decree 169/2020).

In its fit and proper assessments, the ECB works with the relevant NCAs, as well as with the supervised entities directly. If doubts or concerns are raised about the suitability of an appointee, the respective fit and proper application is often withdrawn. This supervisory dialogue with banks pre-empts negative fit and proper decisions by the ECB. In 2021 52 applications were withdrawn in this manner, an increase of 30 compared with 2020.

The ECB carried out 17 reassessments in 2021

In 2021 the ECB also carried out 17 reassessments for several members of the management bodies of credit institutions. Five of these reassessments were related to the anti-money laundering framework, four to criminal proceedings, two to civil proceedings and six to other issues such as bankruptcy and fraud.

Relevant information referring to money laundering/terrorist financing was also considered when assessing the suitability of board members in a total of 36 applications.

The ECB strives to make its fit and proper processes more efficient, particularly by exploring the use of suptech tools. The IMAS portal, which supervised entities use to submit their fit and proper applications to the NCAs and the ECB, has proved to be a useful tool for improving efficiency.

Box 4

The ECB's revised Fit and Proper Guide

ECB Banking Supervision continuously strives to raise the bar for governance supervision and increase transparency in this area. In this context, the ECB recently revised its Guide to fit and proper assessments (the “Fit and Proper Guide”) and developed a new Fit and Proper Questionnaire in order to improve the quality and efficiency of fit and proper processes and assessments.

The revised Fit and Proper Guide introduces the concept of individual accountability, whereby severe supervisory findings may have an impact on the suitability of an appointee, even if they were not directly responsible for those findings. In addition, the Fit and Proper Guide details how board members will be reassessed if new facts emerge which cast doubt on their suitability.

The Fit and Proper Guide also encourages specific credit institutions that are required under national law to adopt an ex-post assessment regime to provide the ECB with information related to their suitability assessments of executive members of the management body before making appointments. As a follow-up, 61 credit institutions in participating Member States received a letter from the ECB formalising this invitation.

Finally, reference is made in the Fit and Proper Guide to members' expertise in climate-related and environmental risks and to diversity (including gender diversity), given their increased relevance as areas of supervisory attention.

On 15 June 2021 the ECB published for consultation⁵³ the drafts of these documents with a view to collecting feedback from market participants and other interested parties. A public hearing was conducted on 15 July 2021 with 200 participants. The public consultation ended on 2 August 2021.

The final [Fit and Proper Guide](#) and [Fit and Proper Questionnaire](#) were published on 8 December 2021, together with a [feedback statement](#) responding to the more than 700 comments received, including from credit institutions, market and banking associations and consultancy firms. Their publication was announced in the Supervision Newsletter in November 2021, and discussed in more detail in several speeches by the Chair⁵⁴ and other members of the ECB's Supervisory Board⁵⁵, as well as in a podcast by the Vice-Chair in December 2021⁵⁶.

2.3 Whistleblowing, enforcement, sanctions and other pecuniary measures

2.3.1 Enforcement and sanctioning measures

The ECB handled eight proceedings in 2021, five of which were finalised at year-end

Under the SSM Regulation and the SSM Framework Regulation, the allocation of enforcement and sanctioning powers between the ECB and the NCAs depends on the nature of the alleged breach, the person responsible and the measure to be adopted (see [ECB Annual Report on supervisory activities 2014](#)). In accordance with the applicable legal framework, the penalties imposed by the ECB within the remit of its supervisory tasks are published on the [ECB's banking supervision website](#). The penalties imposed by the NCAs at the request of the ECB are published on the same website.

In 2021 the ECB handled eight sanctioning proceedings, four of which had been ongoing in 2020 ([Table 6](#)). These eight proceedings led to five ECB decisions.

Table 6
ECB enforcement and sanctioning activity in 2021

	Enforcement and sanctioning proceedings
Ongoing proceedings at year-end 2020	4
Proceedings opened during 2021	4
Proceedings handled during 2021, of which	8
finalised with ECB decisions imposing penalties	2

⁵³ [Public consultation](#) on draft Fit and Proper Guide and new Fit and Proper Questionnaire.

⁵⁴ See, for example, "[The effectiveness of European banks' boards: progress and shortcomings](#)", speech by Andrea Enria, Chair of the Supervisory Board of the ECB, at the Florence School of Banking and Finance online seminar "Banks' Board Members and Policy Makers: A Conversation", Frankfurt am Main, 28 May 2021.

⁵⁵ See, for example, "[What does the ECB expect from banks' leaders?](#)", speech by Edouard Fernandez-Bollo, Member of the Supervisory Board of the ECB, at the Florence School of Banking and Finance online seminar "Fit and Proper Assessment: Better Boards for Better Banks?", Frankfurt am Main, 19 February 2021.

⁵⁶ "[Making sure banks are run by the right people](#)", *The ECB Podcast*, Episode 24, 10 December 2021.

finalised with ECB requests addressed to NCAs to open proceedings	1
proceedings closed	2
ongoing proceedings at year-end 2021	3

Source: ECB.

In 2021 the ECB imposed two pecuniary penalties amounting to €615,000

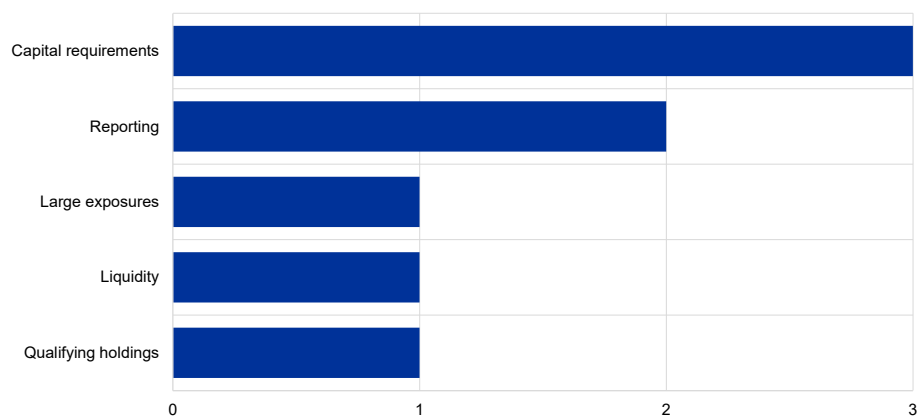
Of the eight proceedings handled in 2021, seven were related to suspected breaches of directly applicable EU law (ECB decisions and regulations included) committed by seven SIs. Two of these proceedings were finalised in 2021 with two ECB decisions imposing penalties amounting to €615,000 on two supervised entities of the same banking group. Two proceedings related to breaches of directly applicable EU law were closed in 2021, one of which owing to proportionality considerations and the other owing to the absence of established negligence. Another three proceedings were still ongoing at the end of 2021.

The remaining proceeding handled in 2021 related to suspected breaches of national law implementing an EU directive committed by an LSI and was finalised with an ECB request addressed to the relevant NCA to open proceedings.

Chart 18.

Chart 18

Suspected breaches subject to enforcement and sanctioning proceedings in 2021



Source: ECB.

Following previous ECB requests to open proceedings and having assessed the cases in accordance with their national law, the relevant NCAs imposed two pecuniary penalties amounting to €24.7 million in 2021

Following previous requests from the ECB to open proceedings and having assessed the cases in accordance with their national law, the relevant NCAs imposed two pecuniary penalties amounting to €24.7 million in 2021.

Detailed information, including comprehensive statistics on the sanctioning activities related to breaches of prudential requirements carried out in 2021 by the ECB and NCAs in the context of the European banking supervision will be presented in the Annual Report on Sanctioning Activities in the SSM in 2021. The report will be published on the ECB's banking supervision website in the second quarter of 2022.

2.3.2 Other pecuniary measures

Under the SSM Regulation, for the exclusive purpose of carrying out its supervisory tasks, the ECB also exercises the powers available to NCAs pursuant to relevant national laws.

In this regard, in 2021 the ECB imposed on two significant supervised entities administrative measures available to an NCA under its national law implementing the CRD. The national administrative measures imposed were not punitive in nature and consisted of payments of interest amounting to approximately €21.5 million for breaches of large exposure limits requirements. The supervised entities have lodged appeals against the ECB decisions with the Court of Justice of the European Union.

2.3.3 Whistleblowing

In 2021 the ECB received 152 whistleblowing reports, a 27% decrease from the previous year

Under Article 23 of the SSM Regulation, the ECB is required to ensure that effective mechanisms are put in place to enable any person to report breaches of relevant EU law (a process commonly referred to as whistleblowing). Accordingly, the ECB operates a whistleblowing mechanism which includes a [pre-structured web platform](#) that is accessible via the ECB's banking supervision website.

The ECB ensures full confidentiality of the whistleblowing reports received through the web platform or other channels (e.g. email or post) and takes into account all available information when carrying out its supervisory tasks.

The ECB received 152 whistleblowing reports in 2021, a decrease of 27% compared with the previous year. Of these reports, 78 referred to alleged breaches of relevant EU law, 72 of which were considered to be within the ECB's supervisory remit and six within that of the NCAs. The remainder referred mainly to alleged breaches of non-prudential requirements (e.g. consumer protection) and therefore fell outside the scope of the whistleblowing mechanism.

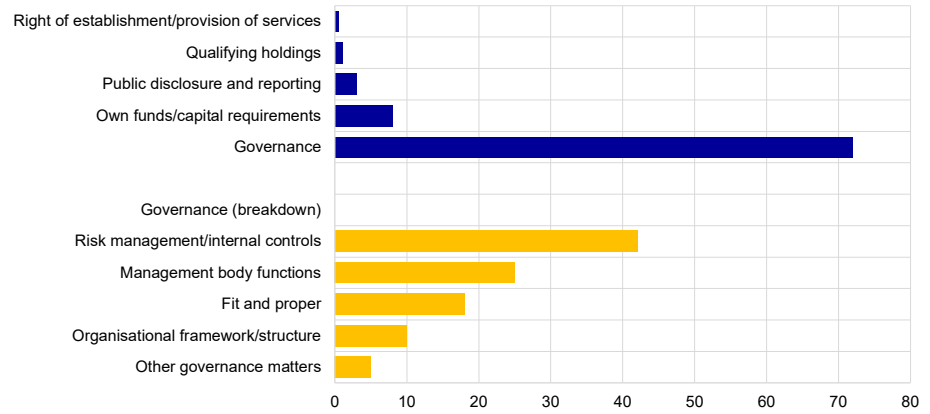
Among the most common alleged breaches reported were governance issues (72%) and inadequate calculation of own funds and capital requirements (8%). The complete breakdown is shown in [Chart 19](#). Governance-related issues mainly concerned risk management and internal controls, management body functions, fit and proper requirements, and organisational structure.⁵⁷

⁵⁷ "Risk management and internal controls" comprises the mechanisms or processes that an entity needs to have in place for the adequate identification, management and reporting of the risks it is or might be exposed to. "Management body functions" refers to the extent to which the persons who effectively direct the business of an institution – or those who are empowered to set the institution's strategy, objectives and overall direction, and oversee and monitor management decision-making – comply with their responsibilities.

Chart 19

Alleged breaches reported via the whistleblowing mechanism

(percentages)



Source: ECB.

The relevant Joint Supervisory Teams were made aware of the information reported via the whistleblowing mechanism. The information was given appropriate consideration and followed up on by the ECB as part of its supervisory tasks. The main investigatory actions taken in 2021 in relation to whistleblowing reports on breaches of relevant EU law included:

- internal assessment based on existing documentation (43%);
- request for documents or explanations from the supervised entity (27%);
- request for an internal audit or on-site inspection (19%).

3 Contributing to crisis management

3.1 Interaction with the Single Resolution Board

Close cooperation between ECB Banking Supervision and the SRB continued throughout 2021

In 2021 close collaboration between ECB Banking Supervision and the Single Resolution Board (SRB) continued at all levels. The Chair of the SRB was invited by the ECB's Supervisory Board to participate as an observer in its meetings for items related to the responsibilities of the SRB. Similarly, an ECB representative participated as an observer in all of the SRB's Executive and Plenary Sessions. Moreover, there were regular exchanges between the Chairs as well as senior and middle management of the ECB and SRB on topics of common interest, such as the Supervisory Review and Evaluation Process (SREP), recovery and resolution planning and policy work related to crisis management. Finally, in line with the Memorandum of Understanding in place between the SRB and the ECB, both organisations shared a broad set of relevant data and information already at their disposal with each other. This helped to ease the reporting burden on banks.

The ECB and SRB also exchanged views on potential improvements to the crisis management policy framework. Examples of the topics discussed include the toolkit available to the relevant authorities and the use of external funds in resolution. These regular exchanges with the SRB also helped to enrich the ECB's own contribution to the European Commission's targeted consultation on the review of the bank crisis management and deposit insurance framework.⁵⁸

Furthermore, as in the past, the ECB participated in the SRB dry-run crisis simulation exercises. These were designed to test procedures and international cooperation and to enhance the understanding of each authority's decision-making and operational processes within a resolution college.

Additionally, joint training events on various topics (e.g. recovery planning, SREP methodology and the revised SRB policy on the minimum requirement for own funds and eligible liabilities (MREL)) were organised. These aimed to strengthen collaboration and cultivate a common understanding between the authorities in various aspects of their work.

Moreover, regular interaction between the ECB's Joint Supervisory Teams and the SRB's Internal Resolution Teams continued to be a key part of the cooperation between the two organisations. This included close cooperation for institutions under the ECB crisis management framework, i.e. institutions with deteriorating financial conditions, and the participation of the SRB in respective crisis management teams to ensure full alignment of supervisors and resolution authorities in a crisis situation.

In line with the regulatory framework, the SRB was consulted on the recovery plans submitted by the significant institutions to ECB Banking Supervision. The SRB's observations were taken into account when assessing these plans and preparing

⁵⁸ See "ECB contribution to the European Commission's targeted consultation on the review of the crisis management and deposit insurance framework", ECB, Frankfurt am Main, 2021.

feedback for the supervised entities. Those observations related to, among other things, the feasibility of recovery options and the calibration of the thresholds of recovery indicators related to the MREL.

Finally, the SRB consulted ECB Banking Supervision on draft resolution plans in accordance with the SRM Regulation⁵⁹. As in the past, this consultation covered, inter alia, the determination of the MREL and resolvability assessments. As in previous years, the SRB also consulted ECB Banking Supervision on the calculation of the ex ante contributions to the Single Resolution Fund, with the ECB's assessment focusing on observations from a supervisory and going-concern perspective.

3.2 Crisis management involving less significant institutions

Crisis management involving less significant institutions (LSIs) requires close cooperation between the relevant national competent authority (NCA) and the ECB. Although the NCA is directly responsible for supervisory actions aimed at LSIs, the need for intensified cooperation and information-sharing arises when an LSI approaches the point of non-viability. At this stage, the ECB, as the competent authority for common procedures, liaises with the NCA on a potential licence withdrawal.

In 2021 the ECB and the NCAs cooperated closely and exchanged information on several LSIs identified as facing financial deterioration or being in crisis. NCAs notified the ECB of seven new cases concerning the financial deterioration of LSIs. The ECB and the NCAs also continued to collaborate closely and to exchange information on 29 active cases of financial deterioration. 15 cases were subject to intensified cooperation between the ECB and the NCAs, with seven requiring dedicated crisis management contact groups to be set up. As in previous years, these groups ensured that supervisory actions and decisions were taken in a timely and coordinated manner.

In 2021 NCAs also notified the ECB of 12 cases related to withdrawals of authorisation for LSIs. Out of these cases, two were related to mergers or integration, three were liquidation-related and seven were voluntary terminations. In four of these 12 cases, the ECB adopted a decision on licence withdrawal, while the remaining eight cases are still under assessment.

Unviable business models, continuously low profitability leading to solvency issues and deficient governance systems (including inadequate frameworks against money laundering) were the main causes of financial deterioration of LSIs in 2021; accounting fraud emerged as an additional driver of financial deterioration.

In 2021 the ECB and the NCAs intensified cooperation to deal with 15 LSI crisis cases

⁵⁹ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

4 Cooperating across borders

4.1 European and international cooperation

4.1.1 The ECB and banking supervisory colleges

The ECB acts as the consolidating supervisor for European banking groups headquartered in a country participating in the Single Supervisory Mechanism (SSM). This allows the ECB to implement comprehensive and consistent supervision on a level playing field for all the entities (subsidiaries or branches) of a banking group, even if they are located in EU Member States that do not participate in the SSM or non-European countries.

As the consolidating supervisor for significant banking groups, the ECB establishes colleges to interact with all relevant supervisory authorities

One of the ECB's responsibilities is to ensure regular interaction with all relevant banking and non-banking supervisory authorities, and it does so through the establishment of colleges of supervisors. When a banking group is headquartered outside the banking union and the ECB supervises at least one of the group's global subsidiaries or branches because they are located in a Member State participating in the SSM, the ECB follows cooperation arrangements with the authorities of the extra-EU country in question. In most cases, the consolidating authority pursues international cooperation via colleges of supervisors, but each authority's timelines and decision-making processes may differ owing to local requirements and confidentiality rules.

As a host authority, the ECB participates in colleges of banking groups whose parent entity is established outside the SSM

A transversal team composed of representatives from the three vertical Directorates General provides ongoing support to the Joint Supervisory Teams in fulfilling their cooperation-related obligations in accordance with European regulation and directives (e.g. mapping of group entities, exchange of key financial indicators between competent authorities, supervisory examination programme for colleges). The transversal team also fosters harmonisation and promotes best supervisory practices related to international cooperation.

In 2021 this team contributed to the review of 13 written cooperation agreements for colleges of supervisors in order to take account of the Prudential Regulation Authority's post-Brexit change in status as a third-country authority.

4.1.2 Strengthening cooperation with third-country authorities

In 2021 supervisory cooperation with third countries was extended to the APRA and the NYDFS by means of MoUs

The ECB continuously monitors developments in cross-border banking and assesses the need for reinforced cooperation arrangements with prudential authorities from third countries, which can take the form of memoranda of understanding (MoUs), supervisory colleges, and case-by-case arrangements. In the course of 2021 the ECB concluded additional MoUs with the New York State Department of Financial Services (NYDFS) and the Australian Prudential Regulation

Authority (APRA). These arrangements are considered relevant because of the significant cross-border linkages between the banking sectors covered by European banking supervision and those of the State of New York and Australia, respectively.

Both MoUs provide for cooperation between the authorities for the purpose of performing their respective supervisory tasks in respect of cross-border credit institutions. Under the MoUs, cooperation is envisaged on a best-efforts basis, and can be initiated at the authorities' request or on their own initiative where appropriate. It covers any type of information that could be of assistance to the authorities in order to promote the safe and sound functioning of supervised entities.

4.1.3 Strengthening cooperation with securities market supervisory authorities

The MoU with the SEC made it possible for significant banking groups to be subject to the SEC's substituted compliance regime

The ECB and the US Securities and Exchange Commission (SEC) signed an MoU on 16 August 2021 to prepare for the registration of significant institutions as security-based swap dealers or major security-based swap participants in the United States. [US regulation](#) requires non-US security-based swap dealers and major security-based swap participants with significant business in the United States to register with the SEC by 1 November 2021 and 1 December 2021, respectively. The SEC may permit such entities to satisfy certain US requirements by complying with comparable EU and national requirements. To make this possible, the SEC and the relevant supervisory and market authorities need to sign cooperation agreements.

Under this MoU, the ECB and the SEC will communicate and exchange information on the security-based swap activities that ECB-supervised entities conduct in the United States. This cooperation will provide a basis for relevant SSM entities to minimise the duplication of compliance efforts and to continue focusing on compliance with EU requirements, while ensuring compliance with US requirements.

At EU level, in 2021 the ECB concluded an MoU with the *Autorité des Marchés Financiers* (AMF) in its capacity as the competent authority responsible for markets in financial instruments in France.

4.1.4 Publication of supervisory memoranda of understanding

21 supervisory MoUs were published on the ECB's website in 2021

In May 2020 the ECB approved a policy regarding the publication of existing and future MoUs entered into by the ECB in its capacity as banking supervisor. The publication of these MoUs is subject to the parties' consent, as well as to potential restrictions regarding access to confidential information in line with the applicable law. On 19 February and 30 April 2021 the ECB published on its [website](#) 18 MoUs that it had concluded in its capacity as banking supervisor since 2014. These included MoUs with banking and market supervisors in third countries, including the MoU signed in 2019 with the Bank of England/Prudential Regulation Authority in the context of Brexit. In addition, in the second half of the year the ECB published three

additional MoUs that it had recently concluded with the SEC, the NYDFS and the AMF.

4.1.5 Close cooperation in the SSM

The ECB, Hrvatska narodna banka and the Bulgarian National Bank worked together closely on day-to-day supervision

In 2021 cooperation with Bulgaria and Croatia – the two most recent members of the banking union, having joined in October 2020 – was very smooth. Hrvatska narodna banka and Българска народна банка (Bulgarian National Bank) were integrated into the SSM's structure and their representatives contributed to decision-making in the Supervisory Board, leading to seamless ECB supervision throughout the banking union. The staff of the two NCAs were closely engaged in day-to-day supervision, not only of the subsidiaries of European banks in Bulgaria and Croatia, but also of their parent entities and respective banking groups. The ECB also integrated Bulgarian and Croatian less significant institutions (LSIs) into its LSI oversight activities with the aim of fostering the consistent application of high-quality supervisory standards to LSIs in both countries. Throughout the year, seminars and workshops were conducted with a view to supporting the joint work. This collaborative supervision is key for a more integrated banking sector.

4.1.6 IMF Financial Sector Assessment Programs

ECB Banking Supervision has implemented many of the recommendations of the IMF FSAP for the euro area

The Financial Sector Assessment Programs (FSAPs) of the International Monetary Fund (IMF) are comprehensive in-depth assessments of a country's financial sector.

The 2018 IMF euro area FSAP examined the banking supervision and resolution architecture in the euro area. ECB Banking Supervision has already implemented many of the IMF's recommendations in its supervisory practices; in parallel, EU co-legislators have been and are currently addressing the recommendations that require modifications to EU law.

National FSAPs do not include assessments by European banking supervision

In 2021 the IMF launched the national FSAPs for Germany, Ireland and Finland. These national FSAPs assess non-banking topics, such as domestic insurance and macroprudential frameworks, and entail a holistic assessment of banking issues, especially those that fall under the remit of national authorities supervising LSIs or aspects related to anti-money laundering and combating the financing of terrorism. Moreover, in 2021 the IMF completed its regular FSAP review, which resulted in an updated list of jurisdictions with systemically important financial sectors that are subject to periodic mandatory assessments.

The ECB is involved in national IMF Article IV consultations

The ECB's involvement in national IMF Article IV consultations for countries participating in European banking supervision relates to microprudential and macroprudential issues, in line with the ECB's responsibilities in these areas.

4.2 Contribution to developing the European and international regulatory framework

4.2.1 Contributing to the work of the Financial Stability Board

In 2021 the Financial Stability Board (FSB) maintained its focus on international cooperation to address the challenges resulting from the coronavirus (COVID-19) pandemic and preserve financial stability.

In 2021 the ECB contributed to the FSB's agenda in a number of areas, including the identification of lessons learned from the COVID-19 pandemic

As a member of the FSB, ECB Banking Supervision actively contributed to the identification of the initial lessons learned from the COVID-19 pandemic in terms of financial stability via a dedicated report.

The ECB also contributed to broader issues on the FSB's agenda, such as (i) the annual identification of global systemically important banks (G-SIBs) in consultation with the Basel Committee on Banking Supervision, including a planned review of the implications of developments related to the banking union for the G-SIB methodology; ii) the finalisation of the report on cyber incident reporting; (iii) the coordination of a roadmap for addressing climate-related financial risks; and (iv) the preparation of policy proposals to enhance the resilience of money market funds. In this context, ECB Banking Supervision participated in the meetings of the FSB Plenary, the Standing Committee on Standards Implementation and the Standing Committee on Supervisory and Regulatory Cooperation. It also participated in the Resolution Steering Group and the FSB's Regional Consultative Group for Europe.

ECB Banking Supervision will continue to contribute to the FSB's work programme in a number of areas, including international cooperation, the coordination of the COVID-19 response, follow-up work on digital innovation, and addressing financial risks stemming from climate change.

4.2.2 Contributing to the Basel process

As a member of the BCBS, ECB Banking Supervision promoted international cooperation and the coordination of policy measures, for example on climate-related financial risks

In 2021 the Group of Central Bank Governors and Heads of Supervision, which is the oversight body of the Basel Committee on Banking Supervision (BCBS), endorsed the BCBS's strategic priorities and work programme for 2021 and 2022. High priority was placed on the implementation and evaluation of previously agreed reforms, on scanning and assessing emerging risks and vulnerabilities (i.e. digitalisation and climate-related financial risks) and on developing supervisory cooperation. The ECB actively contributed to these efforts.

In this context, the ECB co-chairs the BCBS's Task Force on Climate-related Financial Risks and the BCBS's Policy and Standards Group, which is responsible for developing and implementing common prudential standards.

Moreover, the BCBS initiated work on reviewing the assessment methodology for G-SIBs. ECB Banking Supervision actively contributed to the [Committee's decision](#)

to review the implications of developments related to the banking union for the G-SIB methodology (i.e. focusing in particular on the treatment of cross-border exposures within the banking union).

ECB Banking Supervision also participated in other regular policy discussions, providing expertise in BCBS working groups, cooperating with BCBS members within the EU and across the globe, and supporting relevant impact analyses. This work included (i) the assessment and development of potential measures to address climate-related financial risks to the global banking system; (ii) the [publication of principles for operational resilience](#), which aim to strengthen banks' capacity to withstand, adapt to and recover from severe adverse events; and (iii) a public consultation on preliminary proposals for [the prudential treatment of banks' crypto-asset exposures](#).

4.2.3 Contributing to the work of the EBA

The ECB worked closely with the EBA on several projects, including the EU-wide stress test 2021

In 2021 ECB Banking Supervision continued to work closely with the European Banking Authority (EBA) to promote consistent supervision across the European banking sector and to foster the safety and soundness of credit institutions as well as the stability of the financial system. Joint projects included the [EBA's 2021 EU-wide stress test](#), for which the ECB provided quality assurance. The EBA and ECB also worked together on the follow-up to the [COVID-19 crisis](#), the preparation of the response to the Commission's [call for advice on digital finance](#) and the EBA's [report on the supervisory independence of competent authorities](#). The ECB and EBA also circulated [a joint letter](#) in September reaffirming the importance of finalising the implementation of the outstanding Basel III standards in the EU in a full, timely and faithful manner.

Moreover, the ECB contributed to the conclusion of the 2021 EU-wide transparency exercises carried out by the EBA by ensuring the timely provision of accurate supervisory data for 99 significant institutions under the direct supervision of the ECB. The exercise provided market participants with detailed information on the financial conditions of banks participating in European banking supervision, including the impact of the COVID-19 crisis.

The ECB also helped the EBA fulfil its mandate to prepare a feasibility report on the integration of statistical, resolution and prudential reporting, as required by Article 430c of the Capital Requirements Regulation. The report, which was published on 16 December 2021, considers a common data dictionary across all reporting domains to be a key building block and prerequisite for easing the reporting burden on banks, improving data quality and paving the way for further integration of the reporting framework. The report also recommends establishing a joint committee comprising European authorities, national competent authorities and, where appropriate, the banking industry, to steer the integration process. In this context, the ECB cooperated with the EBA and other stakeholders by promoting a common understanding and putting forward concrete proposals on how to establish a

semantically integrated data dictionary, with the aim of fostering the convergence of reporting requirements.

Regarding the EBA's comply-or-explain procedure⁶⁰, in 2021 ECB Banking Supervision notified the EBA of its compliance status with respect to 23 guidelines, as documented on the [ECB's banking supervision website](#). ECB Banking Supervision is committed to complying with all applicable guidelines issued by the EBA or the Joint Committee of the European Supervisory Authorities.

Box 5

Update to the ECB's policies on options and discretions

On 29 June 2021 the ECB launched a public consultation on changes to its policies and guidance relating to how it exercises various options and discretions (O&Ds) under EU law when supervising banks. The updates to the ECB's O&D policies were set out in four draft policy instruments:

- a draft revised version of the ECB Guide on options and discretions available in EU law;
- a draft ECB Regulation amending Regulation (EU) 2016/445 of the European Central Bank on the exercise of options and discretions available in EU law;
- a draft Recommendation amending Recommendation ECB/2017/10 on common specifications for the exercise of some options and discretions available in EU law by national competent authorities in relation to less significant institutions;
- a draft Guideline amending Guideline (EU) 2017/697 of the European Central Bank on the exercise of options and discretions available in EU law by national competent authorities in relation to less significant institutions.

The ECB's O&D policies were originally published in 2016 and 2017. The need to review and revise them arose mainly because of new legislation adopted since, notably the Capital Requirements Regulation II (CRR II) and Capital Requirements Directive V (CRD V), which introduced a number of new O&Ds and amended or removed others. In addition, the ECB proposed introducing some changes to its O&D policies on the basis of the supervisory experience gained since their original publication.

The consultation covered O&Ds in several policy areas including liquidity, own funds, the scope of prudential consolidation, the leverage ratio, and exemptions from the large exposures limit. The largest number of changes relate to liquidity policy. This is in part because CRR II introduced the net stable funding ratio as a new binding liquidity requirement rulebook, bringing with it several new O&Ds for competent authorities to exercise.

The public consultation, which ended on 30 August 2021, was an opportunity to collect feedback from market participants and other interested parties. The ECB received and assessed comments from ten respondents, mainly industry associations. Publication of the final versions of the revised O&D policies together with a feedback statement was scheduled for 28 March 2022.

⁶⁰ Article 16 of [Regulation 1093/2010](#) of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

5 Organisational set-up of ECB Banking Supervision

5.1 Discharging accountability requirements

In 2021 ECB Banking Supervision continued to engage closely with the European Parliament and the EU Council

This Annual Report constitutes one of the main accountability channels for ECB Banking Supervision vis-à-vis the European Parliament and the Council of the European Union (EU Council), as stipulated by the SSM Regulation. The Regulation provides that the ECB's supervisory tasks must be subject to appropriate transparency and accountability requirements. The ECB attaches great importance to maintaining and fully applying the accountability framework that is set out in further detail in the Interinstitutional Agreement between the European Parliament and the ECB and in the Memorandum of Understanding (MoU) between the EU Council and the ECB.

In 2021 all interactions between the European Parliament's Committee on Economic and Monetary Affairs (ECON) and the Chair of the Supervisory Board took place in a virtual format owing to the coronavirus (COVID-19) pandemic. The Chair of the Supervisory Board spoke before the ECON Committee in a public hearing to present the ECB Annual Report on Supervisory Activities 2020 on 23 March 2021, as well as at two ordinary public hearings on 1 July and 1 October 2021. The discussions mostly focused on the supervisory measures taken by the ECB in response to the COVID-19 pandemic. Moreover, challenges in the banking sector such as the sustainability of banks' business models, banks' profitability, the management of climate-related risks and the impact of digitalisation were discussed. Other issues included the strengthening of the banking union, with a focus on implementing Basel III, home-host issues, the bank crisis management and deposit insurance framework, and leveraged finance.

The Chair of the Supervisory Board responded to eight written questions from MEPs in 2021

In 2021 the Chair of the Supervisory Board responded to eight written questions from Members of the European Parliament (MEPs) on banking supervision matters and, in line with the ECB's reporting requirement with respect to national parliaments, two replies to written questions from members of national parliaments. All letters of reply were published. The letters covered a variety of topics, such as credit risk management, IT and cyber risks, governance issues and the prudential monitoring of institutional protection schemes.

In line with the Interinstitutional Agreement, the ECB also made the records of proceedings of its Supervisory Board meetings available to the European Parliament.

With regard to interaction with the EU Council in 2021, the Chair of the Supervisory Board participated in two exchanges of views with the Eurogroup, on 21 May and 4 October, in both cases in a virtual format. The ECB published an overview of relevant ECB supervisory activities in advance of the discussions with the Eurogroup. The ECB's supervisory measures on credit risk and other emerging risks,

such as the risks posed by leveraged finance, were among the main topics discussed.

The ECB contributed to the audit of the EU's anti-money laundering policy in the banking sector

In 2021 the ECB also contributed to the audits of the European Court of Auditors (ECA) related to banking supervision, namely the ECA audit of the European Union's anti-money laundering policy in the banking sector, together with the Commission and the European Banking Authority (EBA). The audit was concluded in June 2021. The ECB is working to address the recommendations on the efficiency of the EU's framework for anti-money laundering and combating the financing of terrorism to the extent that it falls within the remit of its supervisory functions. In addition, the ECB is currently cooperating with the ECA to support its audit on the operational efficiency of the ECB in supervising banks' management of non-performing loans.

Box 6

The ECB and anti-money laundering: ECB follow-up to the ECA's 2021 audit on the effectiveness and comprehensiveness of the EU's anti-money laundering policy

Although the responsibility for the supervision of credit and financial institutions in the area of anti-money laundering and combating the financing of terrorism (AML/CFT) lies at the national level and the ECB's tasks explicitly exclude AML/CFT supervision, the ECB needs to consider the outcomes of AML/CFT supervision when performing its prudential supervisory tasks and share relevant information gathered or created in the exercise of those tasks with AML/CFT authorities.⁶¹ In this context, in 2021 the ECB was audited by the ECA.

In June 2021 the ECA published its special audit report on the effectiveness and comprehensiveness of AML/CFT policy within the EU. In the report the ECA highlights the good work done by the ECB in integrating money laundering and terrorism financing risks into prudential supervision and how the ECB is actively exchanging information with AML/CFT authorities. The ECA also recommends that the ECB simplify its processes for exchanging information with AML/CFT authorities, and update its internal processes for integrating money laundering and terrorism financing risks into prudential supervision following the publication of the EBA's revised SREP Guidelines.

The ECB has actively worked to address the ECA's recommendations in the following ways.

1. A significantly simplified procedure is being implemented for exchanging information under the multilateral agreement signed by the ECB and the national AML/CFT supervisors of credit and financial institutions pursuant to the fifth AML Directive⁶².

⁶¹ In particular, the ECB shares information under the [Multilateral Agreement on the practical modalities for exchange of information pursuant to Article 57a\(2\) of Directive \(EU\) 2015/849](#).

⁶² [Directive \(EU\) 2018/843](#) of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU (OJ L 156, 19.6.2018, p. 43).

2. In addition, the internal processes developed to facilitate the exchange of information within the AML/CFT colleges, which are currently being established by the respective AML/CFT supervisory authorities and which the ECB will participate in as an observer⁶³, include a simplified decision-making procedure to improve the timeliness and efficiency of information exchange between the ECB and the AML/CFT supervisory authorities. The ECB is in the process of formalising its participation in all these colleges on the basis of terms of reference that have been circulated to all the relevant AML/CFT authorities.
3. Other policy work conducted at EBA level, like the recently published [Cooperation Guidelines](#) under Article 117(6) of Directive 2013/36/EU and the draft [Regulatory Technical Standards](#) on a central AML/CFT database under Article 9a of Regulation (EU) No 1093/2010, will further regulate information exchanges with AML/CFT authorities and support the ECB in addressing the ECA's recommendations.
4. The ECB will update its SREP methodology following the publication of the amended EBA SREP guidelines.

In this context, the ECB very much welcomes the publication of the Commission's legislative proposals to strengthen the EU's AML/CFT framework.⁶⁴ While a number of improvements have already been made, the ECB shares the view that further changes are necessary to help to prevent the European Union's financial system from being used for money laundering or terrorist financing and to underpin the EU's position in the global financial system. The ECB will be issuing its opinions on the proposed legislation in due course.

The ECB is supporting the ECA audit on the operational efficiency of the ECB in supervising banks' management of non-performing loans

Furthermore, the MoU signed by the ECB and the ECA in 2019 facilitated practical information-sharing arrangements between the two institutions in the context of the follow-up to ECA audits on ECB Banking Supervision. The implementation status of ECA recommendations addressed to the ECB is followed up on by the ECB, and the ECA also conducts follow-up exercises on the implementation of previously issued recommendations. In this context, the ECA carried out a review in the fourth quarter of 2021 of the actions taken by the ECB to address the findings and recommendations contained in the first ECA report on the functioning of the SSM and in the second ECA report on crisis management⁶⁵.

5.2 Transparency and communication

The ECB increased its use of visuals and simple, accessible language, and revamped its banking supervision website

Given the ongoing COVID-19 pandemic, in 2021 ECB Banking Supervision continued to rely heavily on digital channels and platforms to disseminate information in a timely, transparent and effective way. To connect better with the wider public,

⁶³ See "[Joint guidelines on cooperation and information exchange for the purpose of Directive \(EU\) 2015/849 between competent authorities supervising credit and financial institutions \(JC 2019 81\)](#)", Joint Committee of the European Supervisory Authorities, 16 December 2019.

⁶⁴ "[Anti-money laundering and countering the financing of terrorism legislative package](#)", Financial Stability, Financial Services and Capital Markets Union, European Commission, 20 July 2021.

⁶⁵ "[Single Supervisory Mechanism – Good Start but further improvements needed](#)", *ECA Special Report*, No 29, 2016, and "[The operational efficiency of the ECB's crisis management for banks](#)" *ECA Special Report*, No 2, 2018.

the ECB increased its use of visuals as well as simple and accessible language. It also used a variety of formats, such as social media swipe posts, videos, podcasts and blog posts to explain supervision and banking to audiences with varied educational and professional backgrounds and different levels of knowledge and understanding. One major milestone was the launch of the ECB's revamped banking supervision website. The new look follows modern digital design approaches, with a focus on storytelling and visuals, enhanced readability and more appealing ways to present technical topics.

These innovative communication tools also helped to amplify key messages disseminated through traditional means such as speeches and interviews. In 2021 the Chair and Vice-Chair gave 26 speeches and the ECB representatives to the Supervisory Board gave 12 speeches. Together, they gave 18 media interviews and posted six blog posts and opinion pieces. The Chair of the Supervisory Board also held a press conference on the 2020 Supervisory Review and Evaluation Process results and the latest developments related to the COVID-19 situation. ECB Banking Supervision published 23 press releases and 44 other items, including letters to MEPs, guidance to banks and supervisory statistics. The quarterly Supervision Newsletter, a digital publication with almost 9,000 subscribers, provided information and updates on ongoing supervisory projects and findings.

ECB Banking Supervision published the results of the EBA-led stress test in July 2021. On this occasion and for the first time, the ECB disclosed high-level data points pertaining to medium-sized banks that were not part of the EBA sample. Furthermore, the ECB started to publish MoUs with national and international authorities; 21 such cooperation arrangements were published in 2021.

ECB Banking Supervision also launched three public consultations, including on updates to options and discretion policies and fit and proper supervision. The biennial flagship conference, the ECB Forum on Banking Supervision, was held in 2021 in an online format with key speeches and expert-level discussions on the topics of credit and climate change risks and banking union.

To foster dialogue between ECB Banking Supervision and industry-wide market professionals involved in issues related to the banking sector, the ECB set up a new Banking Supervision Market Contact Group (BSMCG). The group, whose first meeting took place in July 2021, is headed by the Chair of the ECB's Supervisory Board. It discusses developments in the banking sector, structural and regulatory trends, and the impact of ECB Banking Supervision activities. In this way, it gathers market intelligence and thereby contributes to the ECB's analysis of the main risks and vulnerabilities of banks, while offering a dedicated channel for communication with market stakeholders in the banking sector. ECB Banking Supervision aims to keep the composition of the group balanced, seeking to involve a wide range of institutions and banking market stakeholders and planning to rotate membership over time. Documents related to the BSMCG's activities, including meeting agendas, lists of participants and summaries of the various meetings held, will be regularly made available on the ECB's banking supervision website.

In 2021 the ECB responded to 1,264 public enquiries on banking supervision topics, such as general supervisory information, complaints about banks or alleged breaches of European law, authorisations, the climate risk stress test and the response to the COVID-19 crisis. Thanks to the introduction of virtual activities at the Visitor Centre, the ECB hosted six virtual lectures on banking supervision, attended by 176 participants in total, and welcomed 892 virtual visitors, who were introduced to the key tasks of the ECB and the basics of European banking supervision.

5.3 Completing the reorganisation of ECB Banking Supervision

An endeavour in change management

With the new organisational structure becoming effective on 1 October 2020, several change management activities were conducted to facilitate its implementation. These included the establishment of the Change Agents group as well as work on sourcing staff to fill all vacant positions in the newly created structure.

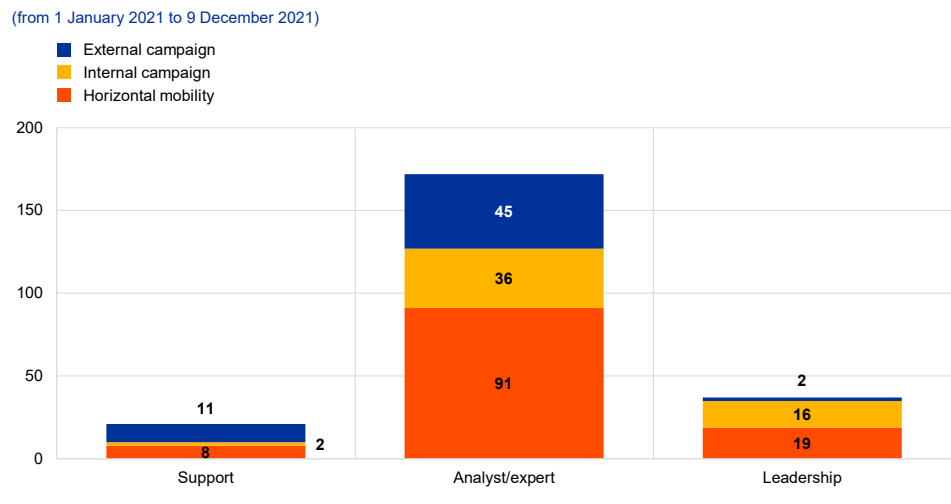
The Change Agents group was composed of volunteers from all ECB Banking Supervision business areas and from all levels of hierarchy. Volunteers were involved in four distinct project workstreams.

1. Collaboration with NCAs – aimed at facilitating collaboration with NCAs, sharing expertise and fostering transparency across European banking supervision. The implementation part of this project stream relied on measures such as brownbag seminars open to all European banking supervision staff, swap programmes between the ECB and some NCAs, virtual SSM-wide collaboration tools and facilitated access to SSM IT tools in the IT landscape.
2. Clarity of responsibilities and tasks – aimed at taking stock of all stable working groups, networks and expert groups across the SSM, defining the target operating model and mandate of all business areas and creating a functional phone book to make it easier to identify experts in given areas. The functionalities of SSMnet, an online information and knowledge-sharing platform for supervisors, facilitated the implementation of this workstream's objectives.
3. Processes – aimed at visualising the key steps and timelines for all internal banking supervision processes along with information on the relevant tools and experts involved in these processes. The implementation of these measures is ongoing and relies on the functionalities of SSMnet.
4. Collaboration across directorates general – aimed at enhancing the visibility of work undertaken by different business areas as well as their achievements, breaking silos and promoting team spirit across business areas. To fulfil these objectives, the workstream relied on measures such as roadshows, interactive fairs and internal working visits.

One of the larger endeavours of the reorganisation was the filling of vacant positions in the newly created structure. To this end, in 2021 a series of sourcing activities were undertaken and several rounds of mobility calls, a facilitated internal swap

programme as well as internal and external recruitment campaigns were launched. Besides finding the right talent to fill vacant positions, this sourcing exercise also provided ECB Banking Supervision business areas with an opportunity to meet the gender targets set in the ECB’s gender strategy.⁶⁶

Chart 20
Number of appointments per staff group



Source: ECB.

5.4 SSM integration

There are two initiatives to enhance integration across the SSM: a staff swap programme between the ECB and national supervisors, and an SSM-Hub

In 2021 further efforts were made to enhance integration across European banking supervision in the form of two initiatives: an SSM staff swap programme between the ECB and national supervisors, and an SSM-Hub.

The SSM swap programme involves swaps between ECB Banking Supervision and staff from the NCAs and national central banks. The programme will facilitate mobility within European banking supervision and promote career paths within the SSM in line with the call of Article 31 of the SSM Regulation for “appropriate exchange and secondment of staff” among all NCAs and the ECB as a way of establishing a common supervisory culture. For European banking supervision, mobility is a driver for enhanced collaboration, versatility and organisational resilience, as well as for diversity and inclusion.

The staff swap programme aims to further a common supervisory culture as well as enhance collaboration, versatility and organisational resilience

In the course of 2021, the first pilot with the French Prudential Supervision and Resolution Authority (*Autorité de contrôle prudentiel et de résolution – ACPR*) saw six pairs of staff members, across several levels of seniority, swap for an expected duration of two years. Staff members remain subject to the staff rules of the home institution and must follow the existing rules of the host institution with reference to working hours, teleworking, operating policies and procedures. At the end of the exchange period, staff members will return to their home institution with additional

⁶⁶ Data on the ECB’s gender targets are published periodically on the ECB’s website.

skills and a broadened perspective and use their experience to foster a common supervisory culture.

The first SSM-Hub coordinated by an NCA was established to ensure that directly supervised banks comply with the requirements for risk retention, transparency and resecuritisation

In addition, the first SSM-Hub coordinated by an NCA was established following the [ECB's acceptance of new competences to supervise risk retention, transparency and resecuritisation requirements](#), as set out under Articles 6, 7 and 8 of the EU Securitisation Regulation. In order to assist the ECB in supervising compliance with these requirements, the SSM-Hub was formed in accordance with Article 6(7) of the SSM Regulation.⁶⁷ It is led by staff from a “coordinating NCA”, which will vary over time, with staff from volunteering NCAs⁶⁸ and additional ECB staff operating as a “Joint Team”.

The SSM-Hub will conduct day-to-day supervision and assist the ECB in its tasks. Overall responsibility will remain with the ECB, which is the authority that takes the measures needed in respect of supervised entities according to its usual decision-making processes, ensuring a uniform application of the legal provisions. The SSM-Hub will also provide technical support as needed and carry out consistency reviews.

As a first milestone, a non-binding [Guide on the notification of securitisation transactions](#) was drafted for public consultation. The Guide clarifies the information that the ECB expects directly supervised banks acting as originators or sponsors of securitisation transactions to provide to their supervisors. Banks are expected to follow the Guide with respect to all securitisation transactions issued after 1 April 2022, which is when the SSM-Hub will start its operations.

5.5 Decision-making

5.5.1 Meetings and decisions of the Supervisory Board and Steering Committee

The ECB's Supervisory Board is composed of a Chair (appointed for a non-renewable term of five years), a Vice-Chair, four ECB representatives and the representatives of the NCAs. If the NCA is not a national central bank, the representative of the NCA may be accompanied by a representative from their national central bank. In such cases, the representatives are together considered as one member for the purposes of the voting procedure.

The ECB's Supervisory Board met 16 times in 2021. Owing to the pandemic, all formal meetings were held via videoconference. However, the virtual format of the meetings did not hinder the Supervisory Board's deliberations and discussions. In addition, and upon invitation by Nationale Bank van België/Banque Nationale de Belgique, the Supervisory Board held a strategic retreat in Brussels in October 2021,

The Supervisory Board held 16 meetings in 2021, all in remote format

⁶⁷ As approved by the Supervisory Board on 25 October 2021 (SB/X/21/1110).

⁶⁸ ACPR, Banco de España, Banca d'Italia, Deutsche Bundesbank, De Nederlandsche Bank and the Austrian Financial Market Authority (*Finanzmarktaufsicht*).

where the members met in compliance with all local COVID-19 measures to exchange views on SSM risks and priorities for 2022, supervisory challenges in the post-pandemic environment and how to better integrate the SSM. Regarding the latter, it was agreed to launch some initiatives to enhance collaboration within European banking supervision, focusing on areas such as common culture and career paths, integrated planning, working more closely through the supervisory cycle, and tools, technology and training.

The Steering Committee⁶⁹ of the Supervisory Board held ten meetings in 2021, all of which were held via videoconference.

The Steering Committee held ten regular meetings, and 14 additional meetings to discuss key themes

The Steering Committee held 14 additional meetings with a focus on digitalisation and simplification of SSM processes, as well as SSM integration. All of these meetings were held via videoconference and participation was open to all Supervisory Board members who expressed an interest.

⁶⁹ The Steering Committee supports the activities of the Supervisory Board and prepares the Board's meetings. It is composed of the Chair of the Supervisory Board, the Vice-Chair of the Supervisory Board, one ECB representative and five representatives of national supervisors. The five representatives of national supervisors are appointed by the Supervisory Board for one year based on a rotation system that ensures a fair representation of countries.

Supervisory Board

Chair	Andrea Enria
Vice-Chair	Frank Elderson (since 24 February 2021)
ECB representatives	Kerstin af Jochnick Edouard Fernandez-Bollo Pentti Hakkarainen (until 31 January 2022) Elizabeth McCaul Anneli Tuominen (from 1 June 2022)
Belgium	Tom Dechaene (Nationale Bank van België/Banque Nationale de Belgique)
Bulgaria	Radoslav Milenkov (Bulgarian National Bank)
Germany	Felix Hufeld (Bundesanstalt für Finanzdienstleistungsaufsicht) (until 31 March 2021), Mark Branson (Bundesanstalt für Finanzdienstleistungsaufsicht) (since 3 August 2021), Joachim Wuermeling (Deutsche Bundesbank)
Estonia	Kilvar Kessler (Finantsinspeksioon), Veiko Tali (Eesti Pank)
Ireland	Ed Sibley (Central Bank of Ireland)
Greece	Ilias Plaskovitis (Bank of Greece)
Spain	Margarita Delgado (Banco de España)
France	Denis Beau (Banque de France)
Croatia	Martina Drvar (Hrvatska narodna banka) (until 1 October 2021), Renata Samodol (since 5 October 2021)
Italy	Alessandra Perrazzelli (Banca d'Italia)
Cyprus	Angelos Kapatais (Central Bank of Cyprus) (until 17 August 2021), George Ioannou (since 18 August 2021)
Latvia	Kristīne Černāja-Mežmale (Finanšu un Kapitāla Tīrgus Komisija), Māris Kālis (Latvijas Banka)
Lithuania	Jekaterina Govina (Lietuvos bankas) (until 21 September 2021), Simonas Krėpšta (since 22 September 2021)
Luxembourg	Claude Wampach (Commission de Surveillance du Secteur Financier), Eric Cadihac (Banque centrale du Luxembourg)
Malta	David Eacott (Malta Financial Services Authority) acting SB member (until 12 September 2021), Joseph Gavin (Malta Financial Services Authority) (since 13 September 2021) Oliver Bonello (Central Bank of Malta)
Netherlands	Thijs van Woerden (De Nederlandsche Bank) (until 31 March 2021), Steven Majoor (since 1 April 2021)
Austria	Helmut Ettl (Oesterreichische Finanzmarktaufsicht), Gottfried Haber (Oesterreichische Nationalbank)
Portugal	Ana Paula Serra (Banco de Portugal)
Slovenia	Irena Vodopivec Jean (Banka Slovenije)
Slovakia	Vladimír Dvořáček (Národná banka Slovenska)
Finland	Anneli Tuominen (Finanssivalvonta) Päivi Tissari (Suomen Pankki – Finlands Bank)

In 2021 the ECB issued 2,362 supervisory decisions⁷⁰ addressed to specific supervised entities (**Figure 2**). Of these, 1,162 decisions were adopted by the ECB heads of work units in line with the general framework for delegating decision-making powers for legal instruments related to supervisory tasks. 1,200 decisions were adopted by the Governing Council under the non-objection procedure on the basis of a draft proposal of the Supervisory Board. In addition to these supervisory

⁷⁰ These decisions refer to decisions that were finalised or adopted in the reporting period (i.e. outgoing decisions). The number of supervisory decisions does not correspond to the number of authorisation procedures that were officially notified to the ECB in the reporting period (i.e. incoming notification procedures).

decisions, the ECB also implicitly approved 177⁷¹ operations (such as the establishment of branches) by not objecting within the legal deadlines.

The bulk of the supervisory decisions were related to fit and proper assessments (49.2%), internal models (11.2%), own funds (9.5%), national powers (9.5%) and qualifying holdings (3.8%) procedures.

The Supervisory Board decided on several horizontal issues, most notably the application of common methodologies and frameworks in specific areas of supervision

In addition to the bank-specific final draft decisions submitted to the Governing Council for non-objection, the Supervisory Board decided on several horizontal issues, most notably the application of common methodologies and frameworks in specific areas of supervision. Some of these decisions were prepared by temporary structures mandated by the Supervisory Board. These structures comprised senior representatives from the ECB and the NCAs and carried out preparatory work on topics such as securitisation requirements for banks and the development of methodologies for the climate-risk stress test in 2022 in order to assess how extreme weather events might affect banks, how vulnerable banks are to sharp increases in the price of carbon emissions, and how banks can respond to different transition scenarios over the next 30 years.

Moreover, some decisions by the Supervisory Board resulted in public guides and reports, such as the ECB Guide to fit and proper assessments, the Guide to the method of setting administrative pecuniary penalties and the Report on the supervisory review of banks' approaches to manage climate and environmental risks.

Based on lessons learned, a technical review of delegation schemes was concluded in 2021

To simplify the decision-making process, the ECB has several delegation schemes in place for fit and proper decisions, significance decisions and own funds decisions, as well as for decisions concerning national powers, passporting and common procedures. Based on the lessons learned from the practical implementation of the existing delegation schemes since 2017, a technical review of these delegation schemes was concluded in 2021. This resulted in the refinement of several delegation criteria, the extension of the delegation schemes to instructions under close cooperation and the alignment of the different schemes, thereby further increasing their efficiency and consistency. In addition, a new delegation scheme for internal models, and for the extension of deadlines in general, was adopted.

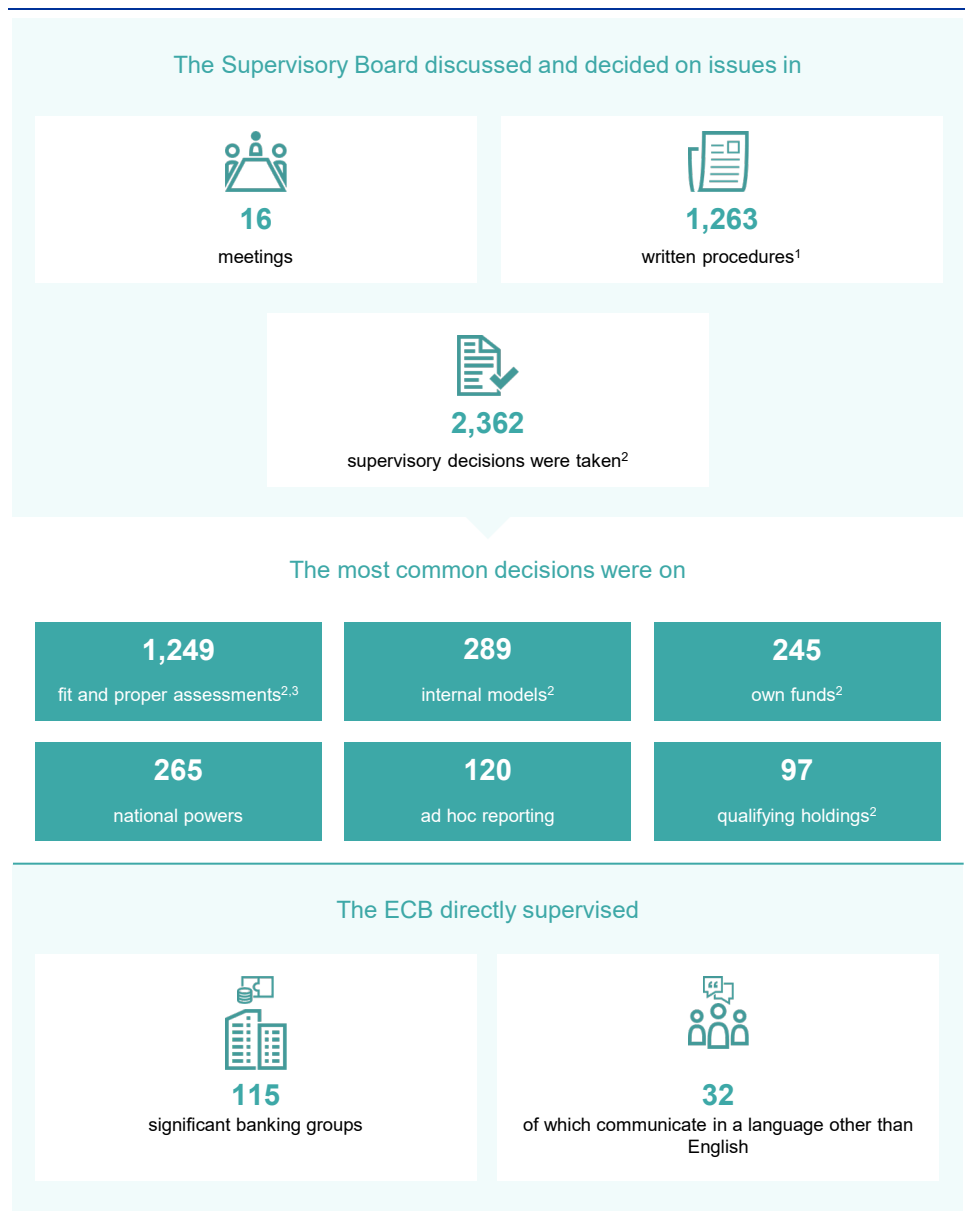
The Supervisory Board took the majority of its decisions by written procedure.⁷²

Of the 115 banking groups directly supervised by the ECB in 2021, 32 asked to receive formal ECB decisions in an EU official language other than English (compared with 33 in 2020).

⁷¹ Of these, 146 were approved by senior management within the framework for delegation.

⁷² Under Article 6.7 of the [Supervisory Board's Rules of Procedure](#), decisions may also be taken by written procedure, unless at least three members of the Supervisory Board who have a voting right object. In such cases, the item is put on the agenda of the subsequent Supervisory Board meeting. A written procedure normally requires at least five working days for consideration by the Supervisory Board.

Figure 2
Decisions by the Supervisory Board in 2021



Notes:

- 1) This figure includes written procedures for individual supervisory decisions and for other issues such as common methodologies and consultations of the Supervisory Board. One written procedure may contain several supervisory decisions.
- 2) This is the number of individual supervisory decisions addressed to supervised entities, or their potential acquirers, and instructions to NCAs on significant institutions or less significant institutions. In addition, 177 operations were approved implicitly. One decision may contain several supervisory approvals.
- 3) The 1,249 decisions on fit and proper assessments cover 2,627 individual procedures (see Section 2.2).

5.5.2 Activities of the Administrative Board of Review

In 2021 the Administrative Board of Review (ABoR)⁷³ adopted one opinion on a request filed for an administrative review (**Table 7**). In that opinion, the ABoR proposed that the Supervisory Board abrogate the contested decision.

The opinion addressed issues related to the ECB's power to adopt supervisory measures based on national law, with the ABoR highlighting the need to apply the principle of proportionality when adopting any supervisory decision as well as the principle that action must be taken within a reasonable time.

The year was also marked by several changes in the composition of the ABoR. Following a call for expression of interest published in the Official Journal of the EU, the Governing Council appointed Pentti Hakkarainen as new member as of 1 February 2022 and Christiane Campill and Damir Odak as new alternates as of 1 December 2021. The composition of the ABoR at the time of drafting this report is therefore as follows: Chair: to be designated; Vice-Chair: Concetta Brescia Morra; Members: Javier Arístegui, André Camilleri, Pentti Hakkarainen and René Smits; Alternates: Christiane Campill and Damir Odak.

2021 was marked by several changes in the composition of the ABoR

Table 7
Number of reviews performed by the ABoR

	2021	2020	2019	2018	2017	2016	2015	2014
ABoR opinions finalised	1	2	5*	4	4	6	6	3
ABoR opinions proposing to replace the contested decision with a decision of identical content		1	1	3	4	1	2	2
ABoR opinions proposing to replace the contested decision with an amended decision or with improved reasoning		-	1	1	-	2	4	1
ABoR opinions proposing to abrogate the contested decision and to replace it with a new decision			1					
ABoR opinions proposing to abrogate the contested decision	1	-			-	-	-	-
ABoR opinions finding request inadmissible		1	2	-	-	3	-	-
Request withdrawn		-	-	1	-	1	2	1
ABoR proposal for suspension		1	-	-	-	-	-	

Source: ECB.
* One opinion covered two ECB decisions.

5.5.3 Selection of a new ECB representative to the Supervisory Board

Pentti Hakkarainen's successor as representative to the Supervisory Board, Anneli Tuominen, has been appointed and will take up her duties in June 2022

When the term of Pentti Hakkarainen officially came to an end on 31 January 2022, one position of ECB representative to the Supervisory Board became vacant. Pursuant to the SSM Regulation and ECB Decision 2014/4⁷⁴, the ECB's Governing Council was responsible for appointing Mr Hakkarainen's successor.

⁷³ The ABoR is an ECB body comprising members who are individually and collectively independent from the ECB and are entrusted with the task of reviewing decisions adopted by the Governing Council on supervisory matters upon an admissible request for review.

⁷⁴ Decision of the European Central Bank of 6 February 2014 on the appointment of representatives of the European Central Bank to the Supervisory Board (ECB/2014/4).

Following a call for expressions of interest published in November 2021⁷⁵, on 16 December 2021 the Governing Council appointed Anneli Tuominen, who currently serves as Director General of the Finnish Financial Supervisory Authority (*Finanssivalvonta*), as ECB representative to the Supervisory Board for a non-renewable term of five years. Ms Tuominen will join Edouard Fernandez-Bollo, Elizabeth McCaul and Kerstin af Jochnick on the team of ECB representatives as of 1 June 2022.

In her daily work, Ms Tuominen will support the Chair and Vice-Chair of the Supervisory Board and – at the request of the Chair of the Supervisory Board – represent ECB Banking Supervision internally and externally.

5.6 Implementing the Code of Conduct

In accordance with Article 19(3) of the SSM Regulation, the ECB has established an ethics framework for high-level ECB officials, management and staff. It comprises the single [Code of Conduct for high-level ECB officials](#), a dedicated chapter in the [ECB Staff Rules](#) and the [Guideline establishing the SSM Ethics Framework](#)⁷⁶. The implementation and further development of the framework has been supported by the ECB Ethics Committee, the Compliance and Governance Office (CGO) and the Ethics and Compliance Officers Task Force (ECTF).

In 2021, in accordance with its mandate, the Ethics Committee assessed the Supervisory Board members' [Declarations of Interest](#) prior to their publication on the ECB's banking supervision website. In line with its transparency policy, the ECB continued to publish the [opinions of the Ethics Committee](#) for all cases of conflict of interest and for cases of post-mandate gainful employment⁷⁷. The Committee issued four opinions related to high-level ECB officials involved in banking supervision, the majority of which were related to private activities.

The CGO also organised its regular compliance monitoring exercise on staff members' and high-level ECB officials' private financial transactions. The exercise only identified a limited number of instances of non-compliance, approximately half of which were related to ECB Banking Supervision staff. None of these instances involved intentional misconduct or other serious cases of non-compliance.

In addition to organising specialised training courses, e-learning programmes and information campaigns on the ethics framework, such as Ethics Awareness Week and Open Ethics Days for newcomers, the CGO responded to around 2,050 requests on a wide range of topics, approximately 45% of which were submitted by ECB Banking Supervision staff. Almost 54% of these requests concerned staff

In 2021 the Ethics Committee issued four opinions related to high-level ECB officials involved in banking supervision, most of which were related to conflicts of interest

⁷⁵ See [Vacancy notice: ECB representative to the Supervisory Board](#).

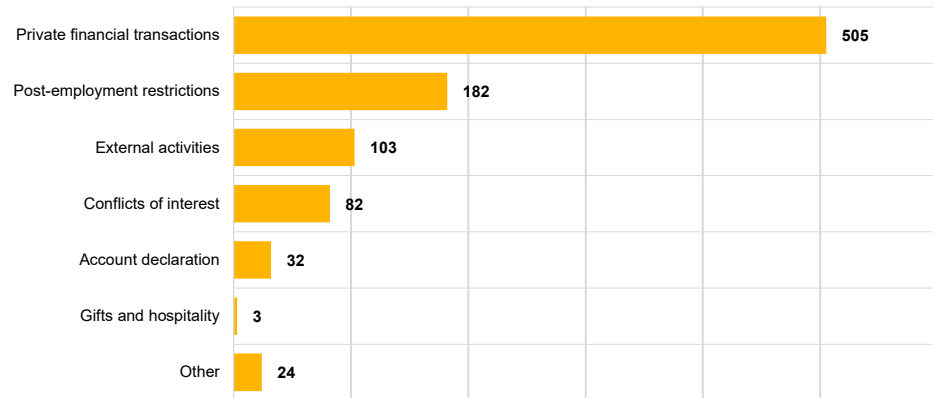
⁷⁶ Guideline (EU) 2015/856 of the European Central Bank of 12 March 2015 laying down the principles of an Ethics Framework for the Single Supervisory Mechanism (ECB/2015/12) (OJ L 135, 2.6.2015, p. 29).

⁷⁷ Articles 11, 12 and 17 of the single Code of Conduct for high-level ECB officials.

members' private financial transactions, followed by requests on post-employment restrictions and external activities (**Chart 21**).

Chart 21

Overview of requests received from ECB Banking Supervision staff in 2021



Source: ECB.

Of those members of staff involved in banking supervision who resigned from their posts in 2021, one case triggered a cooling-off period in line with the ethics framework.

Revised SSM Guideline will further enhance and harmonise the ethics regimes of the NCAs

As part of its efforts to build a strong common ethics culture, in 2021 the ECTF, which has since been transformed into the Ethics and Compliance Conference to better reflect the increasing relevance of matters of good conduct and good governance, made significant steps towards enhancing and harmonising the ethics regimes of NCAs through the substantive revision of the [Guideline establishing the SSM Ethics Framework](#)⁷⁸, which was adopted by the Governing Council. With a view to addressing conflicts of interest more effectively, the Guideline strengthens pre-employment and post-employment provisions as well as the rules on private financial transactions. The ECB and the NCAs will implement the new requirements by June 2023.

5.7 Applying the principle of separation between monetary policy and supervisory tasks

In 2021 the principle of separation between monetary policy and supervisory tasks was mainly applied to the exchange of information between different policy areas.

⁷⁸ Guideline (EU) 2021/2256 of the European Central Bank of 2 November 2021 laying down the principles of the Ethics Framework for the Single Supervisory Mechanism (ECB/2021/50) (OJ L 454, 17.12.2021, p. 21).

In line with Decision ECB/2014/39 on the implementation of separation between the monetary policy and supervision functions of the ECB⁷⁹, this exchange of information was subject to a need-to-know requirement: each policy area had to demonstrate that the information requested was necessary to achieve its policy goals.

In most cases, access to confidential information was granted directly by the ECB policy function that owned the information. This was done in line with Decision ECB/2014/39, which allows access to information pertaining to anonymised data or non-policy sensitive information to be granted by the policy functions directly. Intervention by the Executive Board to resolve possible conflicts of interest was not necessary.

Under Decision ECB/2014/39, the involvement of the Executive Board was nonetheless required in a few instances to allow for the exchange of non-anonymised information relating to individual banks or policy-sensitive assessments. Access to the data was granted on a need-to-know basis after assessing the business case, and for a limited period of time, to ensure that the need-to-know requirement was met at all relevant points in time.

With regard to data related to the COVID-19 pandemic, the emergency provision in Article 8 of Decision ECB/2014/39 was activated by the Executive Board in March 2020. This removed the need for the Executive Board to approve the sharing of COVID-19-related information, subject to a strict need-to-know requirement. In 2021 this exemption was applied to several data exchanges on bank data collected in the context of COVID-19. As above, access to the data was granted on a need-to-know basis after assessing the business case, and for a limited period of time, to ensure that the need-to-know requirement was fulfilled at all times.

Separation at the decision-making level did not raise concerns, and no intervention by the Mediation Panel was required.

In 2021 an emergency provision concerning requests for access to COVID-19 data was applied

5.8 Data reporting framework

5.8.1 Developments in the data reporting framework

In 2021 changes introduced to the EU supervisory reporting framework resulted in the existing Commission Implementing Regulation⁸⁰ being replaced by several new ones⁸¹. The changes specified by the EBA in taxonomy 3.0 were successfully implemented by the ECB in collaboration with the NCAs, also reflecting the modifications made at the level of the reporting banks. These allow for the collection of information on, among other things, the revised leverage ratio, the revised net

New reporting frameworks were implemented following regulatory changes

⁷⁹ Decision (ECB/2014/39) of the European Central Bank of 17 September 2014 on the implementation of separation between the monetary policy and supervision functions of the European Central Bank (2014/723/EU) (OJ L 300, 18.10.2014, p. 57).

⁸⁰ Commission Implementing Regulation (EU) No 680/2014.

⁸¹ Commission Implementing Regulation (EU) 2021/451, Commission Implementing Regulation (EU) 2021/453, and Commission Implementing Regulation (EU) 2021/763.

stable funding ratio, counterparty credit risk, the new minimum requirements for total loss-absorbing capacity and own funds and eligible liabilities, and the fundamental review of the trading book.

A new centralised submissions platform for ad hoc data collection was introduced

The ECB also introduced a new way of collecting supervisory data from external parties via the dedicated application CASPER (Centralised Submission Platform), which makes use of the ECB Identity Portal for the central identification, authentication and account management of users. CASPER allows external organisations to securely submit structured data to the ECB. The data are automatically validated and the results can be discussed with the relevant ECB teams using the platform. The ECB will progressively use CASPER to collect ad hoc supervisory requests from banks, which are currently collected by the Joint Supervisory Teams via different processes, such as email exchanges or shared folders. This new feature is expected to greatly improve the efficiency of the overall data collection and validation process.

In 2021 the Task Force on the Harmonisation of the Sequential Approach⁸² drafted detailed business requirements following the Supervisory Board's approval of the guiding principles and high-level requirements in October 2020. The final business requirements to be implemented by the ECB and NCAs aim to create a minimum set of common standards to harmonise the approaches taken across the SSM for the collection, validation and dissemination of supervisory data, and create a level playing field for supervised institutions.

The SSM-wide data collection database⁸³ aims to reduce the reporting burden on banks by eliminating duplicate data requests sent by supervisors within the SSM. In 2021 the database was amended to gather additional information on the number of data points of each data request for further analysis. To help reduce the reporting burden on supervised entities, and to allow data point duplicates to be identified more easily, all ECB horizontal data requests were modelled using the ECB's corporate data dictionary.

The ECB published a new interactive dashboard showing key banking sector indicators, and Pillar 3 data on measures applied in response to the COVID-19 crisis

The ECB further increased the transparency and availability of supervisory data published in the [supervisory data](#) section of the ECB's banking supervision website: a new [interactive dashboard](#) was introduced, which provides the public with an overview of key indicators. For the first time, the ECB also published individual entity Pillar 3 information on exposures subject to legislative and non-legislative moratoria, and on newly originated exposures subject to public guarantee schemes (pursuant to the EBA Guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis). The ECB carried out a reconciliation exercise between the selected Pillar 3 disclosures and regulatory reporting, which resulted in substantial improvements in data consistency.

⁸² The Task Force on the Harmonisation of the Sequential Approach aims to provide a level playing field across the SSM. It does this by identifying the best practices of each country and proposing harmonised best practices that can be adopted by all NCAs and the ECB.

⁸³ The [SSM-wide data collection database](#) is an initiative to streamline the supervisory reporting requirements set by the ECB and NCAs and improve internal governance. It collects information on all of the data requests sent to directly supervised institutions, which is then used to increase the transparency of data requests sent to banks and to analyse the reporting burden.

5.8.2 Information management

The SSM Information Management System (IMAS) is the core IT system that supports all European banking supervisors in their daily work and provides the information they need. In 2021 several supervisory procedures were added to IMAS, including the new methodology for the Supervisory Review and Evaluation Process, the risk-by-risk approach to determining additional own funds requirements, the assessment of triggers for early intervention measures, and the new approval procedures for (mixed) financial holding companies.

The IMAS portal is an important step in the SSM digitalisation process, increasing transparency for supervised institutions

The new IMAS portal launched in October 2020 allows for online interaction and exchange of information between supervisors and supervised entities. Since January 2021 significant institutions have been using the IMAS portal to submit their applications for fit and proper assessments, verify the status of their assessments online and exchange related information with the supervisors. In this regard, the IMAS portal is a very important step in the SSM digitalisation process, increasing transparency for the supervised institutions, reducing operational risk for both supervisors and banks, and bringing efficiency gains. In addition to fit and proper assessments, other supervisory procedures added to the IMAS portal in 2021 include the submission of passporting notifications, applications for acquisition of qualifying holdings and notifications of non-material model changes.

Moreover, several changes were introduced to the reporting module IDRA (IMAS Data Reporting and Analytics). These changes were aimed at making new supervisory datasets available for extraction and exploration as well as equipping the module with modern reporting tools for data visualisation.

In 2021 ECB Banking Supervision started to integrate the SSM core systems in the context of the SSM Digital Agenda, with the objective of positioning the SSM as a leading adopter of advanced technologies in banking supervision.

6 Reporting on budgetary consumption

6.1 Expenditure for 2021

ECB expenditure in 2021 was slightly less than estimated

The SSM Regulation requires the ECB to dispose of adequate resources to carry out its supervisory tasks effectively. These resources are financed via a supervisory fee borne by the entities subject to ECB supervision.

The expenditure incurred for supervisory tasks is separately identifiable within the ECB's budget. The expenditure incurred consists of the direct expenses of the **ECB Banking Supervision function**. The supervisory function also relies on shared services provided by the ECB's existing support business areas.⁸⁴

The budgetary authority of the ECB is vested in its Governing Council. The Governing Council adopts the ECB's annual budget, following a proposal by the Executive Board in consultation with the Chair and the Vice-Chair of the Supervisory Board for matters related to banking supervision. The Governing Council is assisted by the Budget Committee (BUCOM), which consists of members from all the national central banks of the Eurosystem and the ECB. BUCOM assists the Governing Council by providing it with evaluations of the ECB's reports on budget planning and monitoring.

In 2021 the actual annual expenditure for ECB supervisory tasks was €577.5 million, 2.9% less than the estimate of €594.5 million communicated in March 2021.

Core supervisory task expenditure continued to be lower than the pre-pandemic level

Spending on core supervisory tasks continued at lower than normal levels in 2021. The 7.9% increase in expenditure compared with 2020 mainly reflects the onboarding of new IT systems dedicated to banking supervision, which are included in the horizontal tasks and specialised services category. More information on these activities can be found in Section 5.8.

Table 8
Cost of the ECB's supervisory tasks by function (2019-21)

(EUR millions)

	Actual expenditure		
	2021	2020	2019
Direct supervision of significant institutions	274.4	274.6	317.5
Oversight of less significant institutions	15.7	19.9	34.1
Horizontal tasks and specialised services	287.4	240.8	185.5
Total expenditure for banking supervision tasks	577.5	535.3	537.0

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

⁸⁴ These are broken down as premises and facilities services, human resources services, shared information technology services, shared legal, audit and administrative services, communication and translation services and other services.

The classifications provided in [Table 8](#) are used to identify the split of the annual costs to be recovered through annual supervisory fees from supervised entities based on their supervisory status as significant or less significant. The methodology defined in Article 8 of the Fees Regulation⁸⁵ for the split of annual supervisory fees provides that the costs associated with horizontal tasks and specialised services are allocated proportionally, based on the full cost for the supervision of significant institutions and the cost of overseeing the supervision of less significant institutions, respectively. For each grouping, the costs reported include the allocation of shared services provided by the ECB's support business areas.

In line with the ECB's commitment to transparency and accountability, adjustments have been made to the reporting of ECB's expenditure on supervisory tasks. [Table 9](#) provides more granular information on the expenditure based on the activities performed, in particular:

- off-site supervision and surveillance, incorporating the costs of the ECB's participation in Joint Supervisory Teams and the oversight activities of less significant banks or banking groups;
- the ECB's participation in on-site inspections, including cross-border missions;
- policy, advisory and regulatory functions, including significance assessments, authorisations, cooperation with other agencies, methodology and planning, supervisory quality assurance, and enforcement and sanctioning procedures;
- crisis management;
- macroprudential tasks, including those related to stress testing and supervisory policies;
- supervisory statistics relating to the data reporting framework;
- decision-making of the Supervisory Board, its Secretariat and legal services.

⁸⁵ [Regulation \(EU\) No 1163/2014](#) of the European Central Bank of 22 October 2014 on supervisory fees (ECB/2014/41).

Table 9**Expenditure incurred for ECB supervisory tasks**

(EUR millions)

	Actual expenditure 2021	Actual expenditure 2020
Prudential supervision, of which	443.1	429.8
off-site supervision and surveillance	243.4	249.3
on-site inspections	46.7	45.2
policy, advisory and regulatory functions	151.6	130.6
crisis management	1.3	4.7
Macroprudential tasks	22.4	12.4
Supervisory statistics	45.6	46.2
Supervisory Board, secretariat, supervisory law	66.4	47.0
Total expenditure for banking supervision tasks	577.5	535.3

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

With respect to the developments in IT systems, the increases in expenditure seen in the policy, advisory and regulatory functions as well as macroprudential tasks relate to the SSM information management system (IMAS) and the Stress Test Account Reporting platform (STAR). The main increase in expenditure in the Supervisory Board, secretariat and supervisory law section resulted from significant investment in 2021 in supervisory technologies (suptech), which exploit the potential of artificial intelligence and other pioneering suptech in the context of banking supervision, for internal and external stakeholders.

To supplement its internal resources, the ECB engages external consultancy support services to provide either specialised expertise or integrated consultancy under qualified internal guidance to address temporary resource shortages. In 2021 the ECB spent €38.9 million on consultancy services for core supervisory tasks, an increase of €8.5 million compared with 2020. Of this amount, €23.7 million relates to external resources spent on developments in IT systems, €7.9 million on comprehensive assessments and €6.4 million for the conduct of “regular” on-site supervision tasks, including cross-border missions. More information on these activities can be found in Chapter 1.

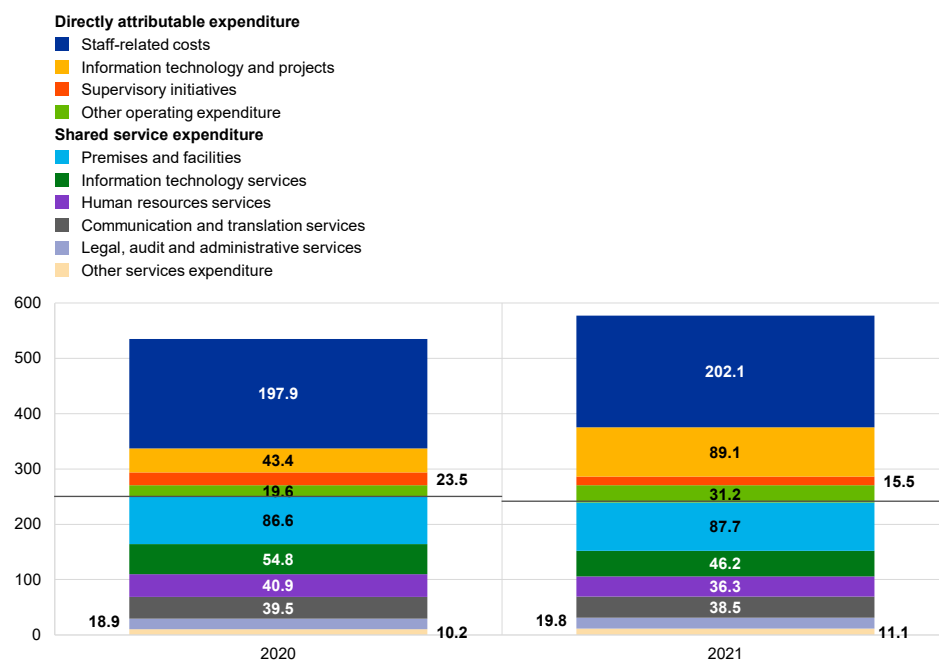
In 2021 the decrease in expenditure on business travel related to direct supervision activities for significant institutions and less significant institutions continued, with expenditure amounting to €0.3 million, reflecting the ongoing effects of the pandemic on travel.

In the 2020 Annual Report on supervisory activities the ECB introduced reporting that focuses on the purpose of the expenditure, showing the split of costs by cost category, based on costs and shared services that are directly attributable to ECB Banking Supervision.

Chart 22

Cost of ECB supervisory tasks by cost category

(EUR millions)



Source: ECB.

The directly attributable expenditure is composed of core supervisory staff costs, supervisory initiatives (including costs related to comprehensive assessments), other operating expenditure such as business travel and training, dedicated information technology such as IMAS and STAR and related projects, and supotech.

The shared services category encompasses services that are used by both the central banking function and the banking supervision function, clustered as follows: premises and facilities services, human resources services, shared information technology services, shared legal, audit and administrative services, communication and translation services, and other services. The cost of these shared services is split between each function using a cost allocation mechanism applying industry standard metrics such as full-time equivalents (FTEs), office space and number of translation requests. As the ECB is committed to rigorously pursuing efficiency improvements, it routinely refines the cost allocation metrics.

In 2021 total actual expenditure was €577.5 million. Directly attributable expenditure amounted to €337.9 million, and shared services amounted to €239.6 million, respectively 58.5% and 41.5% of the actual expenditure incurred.

The amortisation of IMAS and STAR contributed to increased expenditure on directly attributable information technology and related projects, amounting to €17.0 million. Directly attributable expenditure on supotech accounted for €14.9 million.

In 2021 expenditure on shared services decreased by €11.2 million compared with 2020. There continued to be sustained high demand for premises and facilities

Directly attributable costs increased, mainly owing to continuing IT development

services to ensure that a safe working environment could be maintained at the ECB's premises. However, this was more than offset by the reduction in shared information technology and human resources services, reflecting improved direct allocation of services.

6.2 Outlook for banking supervision fees in 2022

The ECB continues its conservative approach to estimating supervisory fees for 2022

Based on the lower level of actual costs for supervisory tasks as seen in the last two years, the ECB has continued its conservative approach to estimating expenditure for 2022, resulting in an estimated supervisory fee for 2022 of €624.1 million. The ECB's full planned expenditure on supervisory tasks for 2022 is €678.9 million. This takes into consideration the expected return to more normal levels of activity, ongoing investment in the development of information technology systems related to banking supervision, including the internalisation of consultancy costs related to STAR, as well as higher staff costs related to the 25 FTEs approved by the Governing Council in 2020 for the SSM and related shared services.

The ECB will remain flexible in its response to external factors in the event that conditions allow more normal levels of activity to resume in 2022.

In line with its commitment to move towards cost stability in the medium term, as of 2023 the ECB envisages stabilisation in planned expenditure for its current mandates related to European banking supervision.

Table 10
Estimated cost of ECB Banking Supervision in 2022 by function

(EUR millions)

	Estimated expenditure 2022	Actual expenditure 2021	Actual expenditure 2020
Direct supervision of significant institutions	306.4	274.4	274.6
Oversight of less significant institutions	14.0	15.7	19.9
Horizontal tasks and specialised services	303.7	287.4	240.8
Total expenditure for banking supervision tasks	624.1	577.5	535.3

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

The annual supervisory fee for 2022, to be levied in 2023, will only be known at the end of the fee period and will comprise the actual expenditure for the full year 2022 adjusted for amounts reimbursed to or collected from individual banks for previous fee periods, late payment interest and non-collectible fees. The ratio of the total amount to be levied to each category is estimated to be 95.6% for significant institutions and 4.4% for less significant institutions.

Table 11**2022 estimate of expenditure for the ECB's supervisory tasks**

(EUR millions)

	Estimated expenditure 2022	Actual expenditure 2021	Actual expenditure 2020
Fees for significant entities or significant groups	596.9	546.1	499.1
Fees for less significant entities or less significant groups	27.2	31.4	36.2
Total expenditure for banking supervision tasks	624.1	577.5	535.3

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

6.3 Fee framework for 2021

The ECB finalised the implementation of the new supervisory fee framework

Together with the SSM Regulation, the Fees Regulation provides the legal framework within which the ECB levies an annual supervisory fee for the expenditure it incurs while conducting its supervisory tasks. The Fees Regulation and associated Decision⁸⁶ establish the methods for: (i) determining the total amount of the annual supervisory fee; (ii) calculating the amount to be paid by each supervised institution; and (iii) collecting the annual supervisory fee.

In 2021 the ECB finalised the implementation of the changes stemming from the 2019 review of its supervisory fee framework. The new language regime, under which ECB fee notices are issued in all official languages of the EU, was implemented in April 2021. This allowed institutions to receive the fee notice for 2020 in their preferred EU language. The procedure related to the notification of intention to exclude the assets and/or risk exposure of subsidiaries established in non-participating countries was successfully automated, allowing banks to efficiently notify the ECB of their intentions by the deadline of 30 September 2021. Furthermore, since the ECB moved to ex post invoicing of actual costs in 2020, there is no longer a surplus or deficit carried forward from previous years.

6.4 Total amount to be levied for the fee period 2021

The ECB will levy €577.5 million in supervisory fees for 2021

The annual supervisory fee to be levied for the fee period 2021 amounts to €577.5 million. This is almost completely composed of the actual annual cost for 2021, amounting to €577.5 million, with an adjustment of €47,000 for late payment interest received.

The annual supervisory fee can also be adjusted for (i) amounts reimbursed to individual banks for previous fee periods and (ii) amounts written off that were not collectible. In 2021 such adjustments were not necessary.

⁸⁶ [Decision \(EU\) 2019/2158](#) of the European Central Bank on the methodology and procedures for the determination and collection of data regarding fee factors used to calculate annual supervisory fees (ECB/2019/38) (OJ L 327, 17.12.2019, p. 99).

The amount to be recovered via annual supervisory fees is split into two parts. This split is related to the status of supervised entities as either significant or less significant, reflecting the varying degrees of supervisory scrutiny they are subject to by the ECB.

In 2021 the total amount to be levied to significant institutions is €546.1 million; for less significant institutions it is €31.4 million. The allocation of expenditure is supported by an improved system that allows costs to be allocated to the categories more precisely. For 2021, significant institutions will pay 94.6% of the total cost of banking supervision for the fee period and less significant institutions will pay 5.4%.

Table 12
Total income from banking supervision tasks

(EUR millions)

	Actual income 2021	Actual income 2020
Supervisory fees, of which	577.5	514.3
fees for significant entities or significant groups	546.1	477.2
fees for less significant entities or less significant groups	31.4	37.1
Other	0.6	-
Total income from banking supervision tasks	578.1	514.3

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

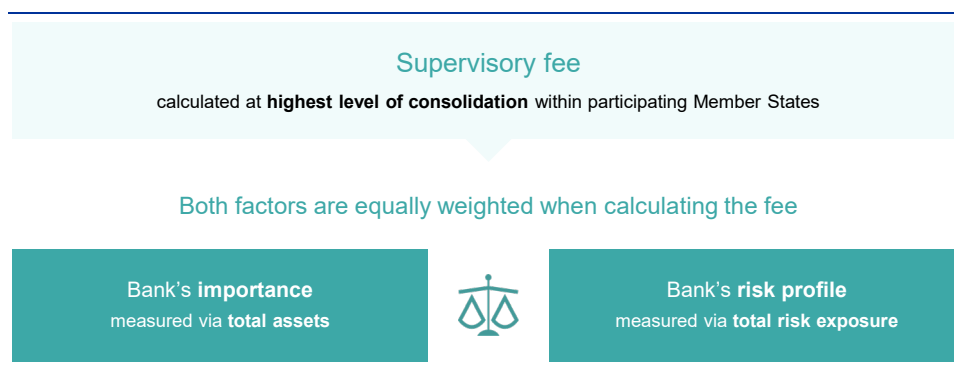
6.5 Individual supervisory fees

At bank level, the fees are calculated according to a bank's importance and risk profile using annual fee factors for the supervised banks. For most banks the reference date for the data is 31 December of the previous year. For banks that are newly supervised at the highest level of consolidation within the fee period, the ECB takes into account the total assets and total risk exposure reported by the bank at the reference date closest to 31 December. It then uses these figures to calculate a variable fee component for all months for which a supervisory fee is payable by the fee debtor.⁸⁷ The supervisory fee calculated per bank is then charged via annual payments.

⁸⁷ For entities established after 1 October, the supervisory fee charged consists of a minimum fee component for the number of full months supervised only.

Figure 3

The variable fee component is determined by a bank's importance and risk profile



The supervisory fee is set at the highest level of consolidation within Member States participating in the SSM. It contains a variable fee component and a minimum fee component. The latter applies equally to all banks and is based on 10% of the total amount to be recovered. For the smallest significant banks, with total assets of €10 billion or less, the minimum fee component is halved. As of 2020, smaller less significant banks with total assets of €1 billion or less also benefit from a halving of the minimum fee component.

Article 7 of the Fees Regulation provides that the following changes in the situation of an individual bank require an amendment of the corresponding supervisory fee: (i) a change in the supervisory status of the supervised entity, i.e. the entity is reclassified from significant to less significant or vice versa; (ii) a new supervised entity is authorised; or (iii) an existing authorisation is withdrawn. The move to ex post invoicing meant that the majority of changes related to Article 7 that occurred within the year were included in the standard fee calculations. As a result, the ECB did not adopt additional supervisory fee decisions in 2021 to be included in the annual supervisory fees to be invoiced in 2022.

More information on [supervisory fees](#) is available on the ECB's banking supervision website. These pages are updated regularly with useful, practical information and are published in all official EU languages.

6.6 Other income related to banking supervisory tasks

The ECB is entitled to impose administrative penalties on supervised entities for failure to comply with obligations under EU banking prudential regulation (including ECB supervisory decisions). The related income is not taken into account in the calculation of the annual supervisory fees. The Fees Regulation ensures that neither damages payable to third parties nor administrative penalties (sanctions) payable to the ECB by supervised entities have any influence on the supervisory fee. The administrative penalties on supervised entities are recorded as income in the ECB's profit and loss account. In 2021 the income arising from penalties imposed on supervised entities amounted to €0.6 million.

The ECB also reimburses supervised entities if the court annuls administrative penalties imposed on them earlier. In 2021 reimbursements amounting to €4.8 million were made. These were related to administrative penalties imposed earlier by the ECB on three supervised entities within the same group, in respect of which the relevant decisions were partially annulled by the court. These expenses are not included in the calculation of the annual supervisory fees but are recorded in the profit and loss account of the ECB and reduce its net result.

7 Legal instruments adopted by the ECB

The legal instruments adopted by the ECB include regulations, decisions, guidelines, recommendations and instructions to NCAs (mentioned in Article 9(1)(3) of the SSM Regulation and Article 22 of the SSM Framework Regulation). This section lists the legal instruments concerning banking supervision that were adopted in 2021 by the ECB and published in the Official Journal of the European Union and/or on the ECB's website. It covers legal instruments adopted pursuant to Article 4(3) of the SSM Regulation and other relevant legal instruments.

7.1 ECB Regulations

ECB/2021/24

[Regulation \(EU\) 2021/943](#) of the European Central Bank of 14 May 2021 amending Regulation (EU) 2015/534 on reporting of supervisory financial information (OJ L 210, 14.6.2021, p. 1)

7.2 ECB instruments other than regulations

ECB/2021/7

[Decision \(EU\) 2021/432](#) of the European Central Bank of 1 March 2021 amending Decision (EU) 2017/1198 on the reporting of funding plans of credit institutions by national competent authorities to the European Central Bank (OJ L 86, 12.3.2021, p. 14)

ECB/2021/8

[Decision \(EU\) 2021/490](#) of the European Central Bank of 12 March 2021 on the total amount of annual supervisory fees for 2020 (OJ L 101, 23.3.2021, p. 107)

ECB/2021/27

[Decision \(EU\) 2021/1074](#) of the European Central Bank of 18 June 2021 on the temporary exclusion of certain exposures to central banks from the total exposure measure in view of the COVID-19 pandemic and repealing Decision (EU) 2020/1306 (OJ L 230I, 30.6.2021, p. 1)

ECB/2021/31

[Recommendation](#) of the European Central Bank of 23 July 2021 repealing Recommendation ECB/2020/62 (OJ C 303, 29.7.2021, p. 1)

ECB/2021/33

[Decision \(EU\) 2021/1437](#) of the European Central Bank of 3 August 2021 amending Decision (EU) 2017/934 on the delegation of decisions on the significance of supervised entities (OJ L 314, 6.9.2021, p. 1)

ECB/2021/34

[Decision \(EU\) 2021/1438](#) of the European Central Bank of 3 August 2021 amending Decision (EU) 2017/935 on delegation of the power to adopt fit and proper decisions and the assessment of fit and proper requirements (OJ L 314, 6.9.2021, p. 3)

ECB/2021/35

[Decision \(EU\) 2021/1439](#) of the European Central Bank of 3 August 2021 amending Decision (EU) 2018/546 on delegation of the power to adopt own funds decisions (OJ L 314, 6.9.2021, p. 8)

ECB/2021/36

[Decision \(EU\) 2021/1440](#) of the European Central Bank of 3 August 2021 amending Decision (EU) 2019/1376 on delegation of the power to adopt decisions on passporting, acquisition of qualifying holdings and withdrawal of authorisations of credit institutions (OJ L 314, 6.9.2021, p. 14)

ECB/2021/37

[Decision \(EU\) 2021/1441](#) of the European Central Bank of 3 August 2021 amending Decision (EU) 2019/322 on delegation of the power to adopt decisions regarding supervisory powers granted under national law (OJ L 314, 6.9.2021, p. 17)

ECB/2021/38

[Decision \(EU\) 2021/1442](#) of the European Central Bank of 3 August 2021 on delegation of the power to adopt decisions on internal models and on extension of deadlines (OJ L 314, 6.9.2021, p. 22)

ECB/2021/39

[Decision \(EU\) 2021/1396](#) of the European Central Bank of 13 August 2021 amending Decision ECB/2014/29 on the provision to the European Central Bank of supervisory data reported to the national competent authorities by the supervised entities pursuant to Commission Implementing Regulations (EU) No 680/2014 and (EU) 2016/2070 (OJ L 300, 24.8.2021, p. 74)

ECB/2021/40

[Decision \(EU\) 2021/1443](#) of the European Central Bank of 26 August 2021 nominating heads of work units to adopt delegated internal models and extension of deadlines decisions (OJ L 314, 6.9.2021, p. 30)

ECB/2021/42

[Decision \(EU\) 2021/1486](#) of the European Central Bank of 7 September 2021 adopting internal rules concerning restrictions of rights of data subjects in connection with the European Central Bank's tasks relating to the prudential supervision of credit institutions (OJ L 328, 16.9.2021, p. 15)

[Corrigendum to Decision \(EU\) 2021/1074](#) of the European Central Bank of 18 June 2021 on the temporary exclusion of certain exposures to central banks from the total exposure measure in view of the COVID-19 pandemic and repealing Decision (EU) 2020/1306 (ECB/2021/27) (Official Journal of the European Union L 230 I of 30 June 2021) (OJ L 234, 2.7.2021, p. 102)

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PDF ISBN 978-92-899-5096-1, ISSN 2443-5805, doi:10.2866/089717, QB-BU-22-001-EN-N
HTML ISBN 978-92-899-5079-4, ISSN 2443-5805, doi:10.2866/640181, QB-BU-22-001-EN-Q