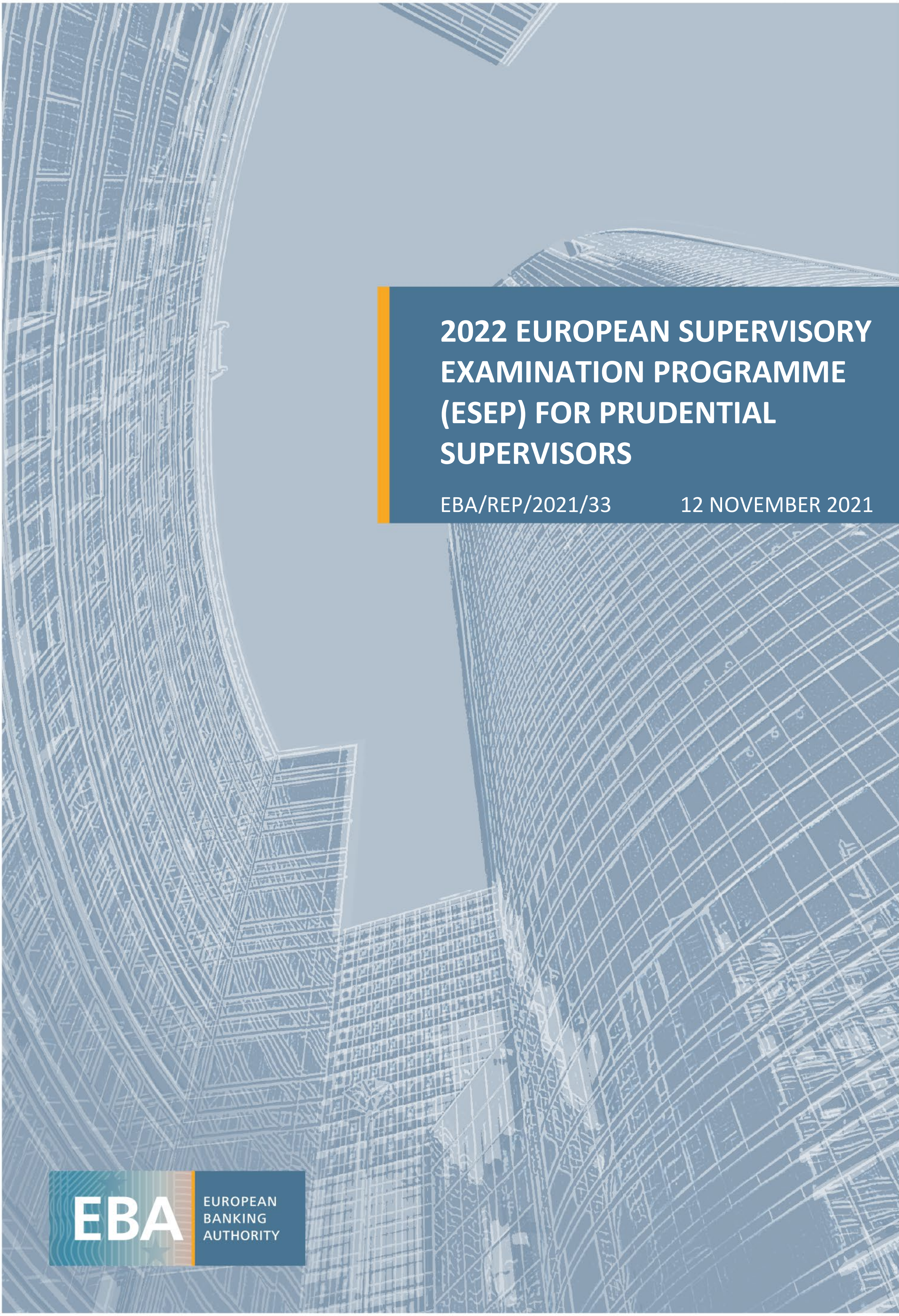

2022 EUROPEAN SUPERVISORY EXAMINATION PROGRAMME (ESEP) FOR PRUDENTIAL SUPERVISORS

EBA/REP/2021/33 12 NOVEMBER 2021

EBA EUROPEAN BANKING AUTHORITY

Contents

Abbreviations

AML/CFT	Anti-money laundering and countering the financing of terrorism
AMLD	Anti-Money Laundering Directive
CA	Competent Authority
CRD	Capital Requirements Directive
CRE	Commercial real estate
EBA	European Banking Authority
EREP	European Resolution Examination Programme
ESEP	European Supervisory Examination Programme
ESRB	European Systemic Risk Board
ESG	Environmental, Social and Governance
EU	European Union
ICT	Information and communication technology
IRB	Internal ratings based approach
KFH	Key function holder
ML/TF	Money laundering/terrorist financing
MREL	Minimum requirement for own funds and eligible liabilities
NPL	Non-performing loans
RWA	Risk Weighted Assets
SEP	Supervisory Examination Programme
SREP	Supervisory Review and Evaluation Process
SME	Small and medium size enterprise
USSP	Union strategic supervisory priorities

Executive Summary

Introduction

1. According to its founding regulation, the European Banking Authority (EBA) shall contribute to enhancing supervisory convergence across the internal market and it shall play an active role in building a common supervisory culture and consistent supervisory practices throughout the European Union[1] (EU).

2. Specifically, in the context of the supervisory review and evaluation process (SREP), this mandate has been further strengthened by the Capital Requirements Directive (CRD)[2], in Article 107, which requires the EBA, i) to develop common procedures and methodologies for the supervisory review; as well as to ii) report annually on the degree of convergence of supervisory practices to the European Parliament and the Council. The EBA not only reports on the degree of convergence, but also proactively drives converging supervisory practices by selecting key topics for prudential supervisory attention based on its expertise in EU-wide risk analysis and policy development.

3. The 2022 European Supervisory Examination Programme or ESEP aims at informing competent authorities' (CAs') planning processes for selecting supervisory priorities for 2022 and shaping their practices concerning the supervision of the selected topics.

4. All CAs are expected to consider these key topics when developing their 2022 supervisory priorities and supervisory examination programme (SEPs) for the credit institutions that they supervise and are invited to involve not only line supervisors in these discussions but also policy and risk experts and/or specialist functions.

5. Converging practices and methodologies contribute to achieving more consistency in SREP outcomes across the EU, which is also indispensable in the context of cross-border banking groups. Therefore, colleges of supervisors are also expected to implement these key items through the sharing and discussing of relevant supervisory assessments and outcomes.

6. In the past, the key priorities have been put forward by the EBA in the annual convergence plans. The evolution in the naming reflects ongoing efforts to harmonise, as much as possible, the EBA's convergence initiatives across the supervisory and resolution cycles[3].

7. The EBA will follow up on how the key topics, put forward by this document, are i)

[1] Article 1(fa) and Article 29 of Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.

[2] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

[3] European Resolution Examination Programme or EREP.

embedded in CAs' supervisory priorities for 2022 as well as ii) reflected in CAs' supervisory activities throughout the year. The EBA will use the most appropriate convergence tools at its disposal to conduct the assessment, in particular questionnaire and desk-based review. The EBA, through its participation in supervisory colleges, will also monitor the level of implementation in the work of colleges. The observations collected will feed into the overall conclusions on the degree of convergence of supervisory practices.

8. The EBA will develop, similarly to previous years, objective elements or attention points per key topic with the involvement of the relevant sub-group i) to support CAs in focusing their attention in relation to each key topic, ii) to contribute to comparable supervisory practices across the EU and finally iii) to facilitate the objective assessment at the end of the year by the EBA.

9. The recent evolution of the health situation seems to signal that the full deployment of the supervisory toolkit would be available for CAs in 2022 when pursuing the key topics. Nevertheless, it will be considered by the EBA, in its follow-up, if future developments would impact supervisory activities covering the key topics (e.g. unavailability of physical inspections/meetings).

Selection of the key topics

10. The ESEP puts forward key topics for prudential supervisory scrutiny and implementation for the upcoming year that:
    - rely on the outcome of the EBA's risks and vulnerabilities assessment work;
    - refer to recent and/or relevant policy areas to be implemented;
    - benefit from the practical experience and observations of CAs.

11. CAs are actively involved in the development of the key topics by providing their input on the key concerns and risks they identify for the credit institution under their supervision, as well as by sharing views throughout the development process.

12. The latest macroeconomic projections confirm the economic rebound and point to a further reduction in the level of economic uncertainty, which is improving the reliability of banks' capital projections when compared to the beginning of the pandemic. In this context, the European Systemic Risk Board (ESRB) repealed the Recommendation on restriction of distributions during the COVID-19 pandemic (ESRB/2020/7), as amended by Recommendation ESRB/2020/15, and leaves it to microprudential supervisors to assess banks' capital and distribution plans based on the outcome of the normal supervisory cycle. The EBA concurs with this analysis and has recently made available to the European supervisory authorities a powerful tool, the EU-wide stress test, which will assist competent authorities in assessing the ability of banks to meet applicable prudential requirements and form a solid ground for discussion between the supervisor and the individual banks, including the one connected to their capital plans and their distribution plans in the context of the normal supervisory cycle.

13. With this background, the 2022 ESEP is still focused on some of the implications of the health emergency on banks' asset quality, while at the same time it calls supervisory attention also on other emerging/re-emerging risk elements.

14. The 2022 ESEP ensures continuum in the supervisory work from 2021, as more of the priority areas included in the 2021 Convergence Plan have been preserved for 2022, such as the impact of the COVID-19 pandemic on asset quality; information and communication technology (ICT) risk, in particular ICT security risk; the implementation of digitalisation strategies; but in most cases with dedicated focus. Supervisors are encouraged to explore interaction between the key topics[4] when devising the SEP for credit institutions.

15. The selection of the key topics for a given year and its follow-up ideally creates a feedback cycle, as the conclusion feeds into the selection process for the upcoming year. Considering, however, that the evaluation of the progress in convergence based on the key topics takes place at the end of the year[5], while the development of the priorities for the next cycle is warranted in the third quarter of the year, it is not possible to channel all conclusions from the implementation of the previous cycle. Therefore, if conclusions from the 2021 cycle[6] would warrant any potential refinement of the 2022 ESEP, that will be ensured early in the year (2022).

16. The EBA has been mandated with the ESA's review to also establish Union strategic supervisory priorities (USSPs) to facilitate policy implementation by establishing forward-looking considerations that reflect future developments. The priorities set, for the first time in 2020 for a three-year period, are *business models' sustainability* and *adequate governance structures*. The selection of the key topics for supervisory attention for 2022 is closely aligned with the USSPs to ensure that the supervisory work undertaken on a day-to-day basis is driven by the strategic and long-term priorities. The implications of COVID-19 and information and communication technology (ICT) risks are key short-term risks in the banking sector, and their effective management is of the utmost importance to ensure medium-term sustainability, which represents the overarching link between the USSPs and the ESEP in 2022.

17. Furthermore, the business models' sustainability USSP is reflected in the 2022 ESEP via the special focus on digital transformation strategies and their implementation, FinTech players and the Environmental, Social and Governance (ESG) risk in the business strategies, which all should contribute towards sustainable operation of institutions. The attention on the governance-related aspects of anti-money laundering and countering the financing of terrorism (AML/CFT) requirements as well as the respective ESG considerations, as described in the ESEP, form further key elements of the sound governance practices, as put forward by the USSPs.

[4] e.g. between ICT security risk and digitalisation.

[5] Once all supervisory activities could be taken into account in the follow-up.

[6] Expected to be available year-end or early next year.

Key topics identified for the 2022 ESEP

1. Impact of the COVID-19 pandemic on asset quality and adequate provisioning

Focus areas:

- **Loans exiting moratoria and concentrations in vulnerable sectors**
- **Potential inadequate developments of estimates or realised IRB parameters**
- **Adequate provisioning and management of NPLs**
- **Role of internal control function**
- **Robust underwriting standards – loan origination practices**

18. Against the improving macroeconomic outlook, the aftermath of COVID-19 is still unclear and the potential further deterioration of asset quality remains a key risk in the banking sector. A high share of banks expects a deterioration in the asset quality of their portfolios. According to the EBA Risk Assessment Questionnaire[7], more than 70% of the banks expect the asset quality of SME[8] loans to deteriorate, followed by consumer credit (around 65%) and CRE[9] exposures (around 55%). However, it also needs to be added that the expectation on asset quality slightly improved for the first time since spring 2019. Specifically, the share of banks expecting a deterioration of asset quality declined slightly for almost all portfolios.

19. According to the Joint Committee Report on Risks and Vulnerabilities in the EU financial system[10], financial institutions and supervisors should be prepared for an expected deterioration of asset quality. So far, banks reported that the non-performing loans (NPL) ratio has been rather stable in the pandemic, mainly driven by an increase in total lending. Efforts of banks to dispose of NPL portfolios are also contributing to a stable NPL ratio. Yet several other metrics[11] indicate that asset quality is deteriorating. Therefore, the close monitoring of the impact of the COVID-19 pandemic on asset quality will continue to be a key part of the supervisory activities in 2022, in particular in the **segments of SME, consumer credits and CRE**.

20. Payment breaks and further policy measures, such as public guarantee schemes, are of a temporary nature and the phaseout of these measures will most likely negatively affect asset quality with increasing NPLs and rising cost of risk. Special attention should be paid to the **loans exiting moratoria,** as it is expected that some of the borrowers will be unable to resume repayment when the moratorium ends. **Concentrations in sectors**

[7] EBA (2021) Risk Assessment Questionnaire – Summary of Results.

[8] Small and medium-sized enterprise

[9] Commercial real estate

[10] Joint Committee of the European Supervisory Authorities. (2021). Joint Committee Report on Risks and Vulnerabilities in the EU Financial System – March 2021.

[11] e.g., forbearance ratio.

vulnerable to the COVID-19 pandemic are also an area that warrants supervisory monitoring in 2022.

21. For IRB[12] banks, due to the same reason, supervisors should pay attention to **potential inadequate developments of estimates or realised IRB parameters.** In particular, they should carefully take into account potential downward calibration of PD estimates or downturn LGD estimates as an implication of decreased default rates, which are observed in some cases as a result of the application of the moratoria. Supervisors should be vigilant about potentially lower long-run average default rates, where they include the most recent data, that may be excessively driven by the extraordinary COVID-19 support measures.

22. It is essential to review whether institutions **adequately provision NPLs** and have proper models in place for the estimation of provisioning. The EBA's *IFRS 9 benchmarking exercise* will supports CAs in challenging banks' models in this regard. Realistic and updated strategies for the resolution of NPLs should be in place. The *Guidelines on management of non-performing and forborne exposures (EBA/GL/2018/06)*[13] provide supervisors with the necessary and effective tools to oversee the management of non-performing exposures (NPEs) by banks and ensure their timely recognition and provisioning as well as promote supervisory convergence in the treatment of NPEs across EU banks. CAs are expected to continue to follow closely the provisions of these guidelines.

23. **Internal control functions** have a role to play to ensure that credit risk management is functioning well and adequately assess the impact of the COVID-19 pandemic as well as the appropriateness of the procedures for the identification, measurement, management, and monitoring of credit risk, including the provisioning and staging.

24. Some institutions may engage in aggressive risk taking to compensate the effects of the low interest rate environment and the COVID-19 pandemic on their earnings, so CAs should continue to review whether credit institutions have **robust and prudent standards for credit risk taking** and ensure that institutions **improve loan origination practices** in line with the *EBA's GLs on loan origination and monitoring (EBA/GL/2020/06)*[14] in a pragmatic and proportionate manner.

[12] Internal ratings-based approach

[13] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2425705/371ff4ba-d7db-4fa9-a3c7-231cb9c2a26a/Final%20Guidelines%20on%20management%20of%20non-performing%20and%20forborne%20exposures.pdf

[14] https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20loan%20origination%20and%20monitoring/884283/EBA%20GL%202020%2006%20Final%20Report%20on%20GL%20on%20loan%20origination%20and%20monitoring.pdf

2. ICT security risk and ICT outsourcing risk, risk data aggregation

Focus areas:

- **Cyber risk, cyber testing, security awareness and management**
- **Inherent risks in material outsourced ICT services**
- **Risk data aggregation capabilities**

25. The usage of information and communication technology (ICT) and digitalisation has further increased with the pandemic, and the crisis is accelerating the technological transformation at banks. While this transformation is vital for the future competitiveness and efficiency of banks, it also increases technology-related risks. ICT risks represent a key challenge for banks and underline the importance of ICT and security risk management according to the EBA Risk Assessment of the European Banking System[15]. It also refers to cyber risk and data security issues as the most prominent drivers of increased operational risk. Thus, ICT risk should continue being one of the top supervisory topics that demand scrutiny.

26. Based on the EBA's monitoring of this area and ongoing discussions with CAs, this document further specifies the ICT risks to which dedicated supervisory attention should be given:

    - **ICT security risk**: cyber risk and other external ICT-related threats have become increasingly relevant with the outbreak of the pandemic, thus supervised institutions and competent authorities should pay increasing attention to ICT security aspects covering **cyber risk, cyber testing, system vulnerabilities, security management, and security awareness.** Supervisors should investigate whether the information security measures taken by banks are adequate to mitigate cyber risks and are in line with the requirements set for financial institutions in the EU by the *EBA Guidelines on ICT and security risk management (EBA/GL/2019/04)*[16] in relation to the mitigation and management of their ICT and security risks.

    - **ICT outsourcing risk:** given the growing dependency on certain third-party providers, as well as various related governance aspects (such as intra-group outsourcing, conclusion of contracts, risk identification, risk assessment, risk mitigation and risk monitoring), management of ICT outsourcing risk should be closely monitored and strengthened to ensure that inherent risks in material outsourced ICT services are properly identified, measured, and ultimately mitigated by the institutions. CAs should monitor and seek assurance on the **level of compliance of the outsourcing service providers with the financial institution's security objectives, measures and performance targets**. The *revised Guidelines on*

[15] EBA (2020) Risk Assessment of the European Banking System.

[16] https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/GLs%20on%20ICT%20and%20security%20risk%20management/872936/Final%20draft%20Guidelines%20on%20ICT%20and%20security%20risk%20management.pdf

outsourcing (EBA/GL/2019/02)[17] remain an attention point with specific provisions for governance of outsourced activities and the related supervisory expectations and processes. This also includes monitoring of concentration risk at group level for institutions and at national level for CAs.

- **Risk data aggregation capabilities**: in line with the EBA Guidelines on internal governance and the EBA Guidelines on ICT and security risk management, competent authorities should assess whether institutions' information and communication technologies are effective and reliable and whether these systems fully support risk data aggregation capabilities at normal times as well as during times of stress.

3. Digital transformation and FinTech players

Focus areas:
- **Digital transformation strategies and the role of the management body**
- **Implementation of the digital transformation strategy**
- **Approach towards innovative FinTech solutions**

27. The pandemic appears to have fast-forwarded the **digital transformation** within institutions, along with an increased shift towards digitalisation projects to allow outreach to both retail and business customers and offer of digital services and solutions.

Digital transformation strategies and the role of the management body

28. Setting and overseeing digital transformation strategies are a key responsibility of the management body. These digital strategies, which have to be aligned with and be an integral part of institutions' overall business strategies, influence their overall risk strategies and risk profiles. CAs therefore should **review the digital strategy setting process** and whether **collective suitability of the management body** sufficiently takes into account adequate knowledge of digital transformation opportunities and threats and whether the **management body in its management function** drives and implements the digital strategy, while the **management body in its supervisory function** monitors and constructively challenges that. This is to ensure that adequate capital and human resources are foreseen to support the strategy implementation and **that the investment spent on digital efforts achieves actual transformations**, i.e. not only impacts internal workflows[18] and outsourcing arrangements, but also ensures a more customer-centric approach, including new products and services designed to fulfil current and foreseen customer expectations. Supervisory attention is also warranted to assess whether the digital transformation is driven by sufficient agility and innovation culture, while the

[17] https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2551996/38c80601-f5d7-4855-8ba3-702423665479/EBA%20revised%20Guidelines%20on%20outsourcing%20arrangements.pdf?retry=1

[18] Including legacy systems.

institution is equipped with appropriate risk awareness to identify and manage new, emerging risks.

Implementation of the digital transformation strategy

29. While this has an overlapping element with the ICT risk management and operational resilience, including vulnerabilities related to cyber attacks, supervisory attention should also focus on the **impact of the implementation of institutions' digitalisation strategies on the business model and risk profile**. Supervisors should review the strategy implementation to understand whether investments drive real and effective digital transformation. In this regard, supervisory attention should also focus on how institutions measure the success of their digital strategy by developing adequate metrics[19] and extracting adequate financial data to build up their cost-benefit analysis. Institutions should perform adequate cost-benefit analysis, along with risk/control assessment, to understand the potential impact and risks entailed by accelerating their digital strategies.

Approach towards innovative FinTech solutions

30. The introduction of new players such as FinTech[20] operators posed new opportunities as well as threats to banks. According to the most recent EBA Risk Assessment Questionnaire[21], banks continue considering FinTech firms more as a threat than an opportunity in the area of payments and retail brokerage. The area of retail banking seems to bring both opportunities and threats from the involvement of FinTech firms, while opportunities seem to prevail in the areas of commercial banking and trading and sales. Considering that these new market entrants will impact existing business models and, inevitably, credit institutions' risk profiles[22], supervisors should review, within the framework of the business model analysis, **credit institutions' approach to innovative FinTech solutions** and whether and how those are transforming their business model as well as inducing their services and risk profiles.

[19] e.g. revenue streams, metrics to measure customers' experience and satisfaction, etc.

[20] According to the EBA's FinTech Discussion Paper, FinTech is defined at the EU and international standard-setting levels as 'technologically enabled financial innovation that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services'. Available at: https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1919160/7a1b9cda-10ad-4315-91ce-d798230ebd84/EBA%20Discussion%20Paper%20on%20Fintech%20%28EBA-DP-2017-02%29.pdf?retry=1

[21] EBA (2021) Risk Assessment Questionnaire – Summary of Results.

[22] Discussion Paper on the EBA approach to financial technology (FinTech) (EBA/DP/2017/02): https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1919160/7a1b9cda-10ad-4315-91ce-d798230ebd84/EBA%20Discussion%20Paper%20on%20Fintech%20%28EBA-DP-2017-02%29.pdf?retry=1

4. ESG risk

Focus areas:

- **ESG risk in business strategies**
- **ESG factors considered in the overall governance framework**
- **Risk appetite and loan origination practices take ESG risk into account**

ESG risk in business strategies

31. The EBA Report on ESG risks management and supervision (published in June 2021)[23] emphasises the importance for institutions of considering ESG risks when assessing, designing, or modifying their business model and strategies, notably due to the potential impact ESG factors may have on the institution's financial resilience in the short, medium, and longer-term horizon. In that context, supervisors are expected **to promote institutions' understanding of ESG risks they are exposed to due to their business model** and the key vulnerabilities which may stem from these factors and affect the long-term resilience of institutions.

ESG factors considered in the overall governance framework

32. As part of the overall internal control framework, institutions should have a holistic institution-wide risk management framework which should consider that ESG risk factors may affect debtors, service providers and may drive their prudential risks, including credit risks. All relevant risks thus should be encompassed in the risk management framework with appropriate consideration of both financial and non-financial risks.

33. CAs are expected **to start observing how banks consider ESG factors, in particular climate-related and broader environmental factors and risks in their internal governance framework** and overall business model.

Risk appetite and loan origination practices take ESG risk into account

34. The *EBA GLs on loan origination and monitoring (EBA/GL/2020/06)* outline specific processes and procedures that institutions should have in place to take into account the risks associated with ESG factors, including processes for assessing and monitoring counterparties' eligibility for sustainable lending. Supervisors are expected to check that the **credit strategy is fully aligned and properly reflects the underlying ESG risk appetite** and that responsibilities for implementing and monitoring ESG targets are set.

[23] EBA/REP/2021/18:https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2021/1015656/EBA%20Report%20on%20ESG%20risks%20management%20and%20supervision.pdf

5. AML/CFT

Focus areas:
- **Exchange of adequate AML/CFT information within the institution**
- **AML aspect in the suitability assessment of members of the management body**

35. **Prudential supervisors and AML/CFT supervisors are expected to cooperate closely** and exchange information relevant for their respective tasks as per CRD Article 117 (5), in particular, if they identify shortcomings in the aspects described below:

Exchange of adequate AML/CFT information within the institution

36. Following the publication of the *revised Guidelines on internal governanc*e (EBA/GL/2021/05)[24] under the CRD and the *Joint Guidelines on the assessment of the suitability of members of the management body and KFHs*[25] *(EBA/GL/2021/06)*[26], CAs should focus on necessary exchange **of adequate AML/CFT information between the management body of the institution, the business lines and the internal control functions** in particular, the compliance function and the AML/CFT compliance function[27] where established, and within the group between the parent level and subsidiaries and branches. The *revised Guidelines on internal governance* (EBA/GL/2021/05) stress that identifying, managing, and mitigating money laundering and financing of terrorism risk is part of sound internal governance arrangements and the risk management frameworks of credit institutions.

AML aspect in the suitability assessment of members of the management body

37. CAs should also focus on the ongoing monitoring of the suitability of members of the management body and KFHs, including the link with ML/FT risks. At all institutions, the management body is responsible overall for ensuring that the institution complies with AML/CFT requirements, and therefore the **anti-money laundering aspect is relevant for the suitability assessment of all members of the management body** in all institutions. In particular, where CAs have reasonable grounds to suspect an increased money laundering/terrorist financing (ML/TF) risk at a credit institution, the **management body must have a high level of competence and relevant experience in this area** to be able to ensure strong controls and compliance with the requirements under the AMLD[28].

[24] https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/G.uidelines/2021/1016721/Final%20report%20on%20Guidelines%20on%20internal%20governance%20under%20CRD.pdf

[25] Key function holders.

[26] https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2021/EBA-GL-2021-06%20Joint%20GLs%20on%20the%20assessment%20of%20suitability%20%28fit%26propoer%29/1022127/Final%20report%20on%20joint%20EBA%20and%20ESMA%20GL%20on%20the%20assessment%20of%20suitability.pdf

[27] Draft Guidelines on the role of AML/CFT compliance officers.

[28] Anti-Money Laundering Directive (Directive (EU) 2015/849).

Further considerations

38. While there are various areas that will warrant the attention of EU prudential supervisors in 2022, the ESEP puts forward a handful of key items that, in the view of the EBA, will be the key driving forces of the banks' risk profiles in 2022.
39. It is also equally important to channel the institution-specific considerations into the SREP assessment and dedicate heightened attention to relevant risks and/or risks controls, although not included separately in this document. Supervisors will have to keep a close eye on some institutions due to potentially upcoming litigation risks in the context of COVID-19 measures, such as risks related to public guarantee schemes. Also, exceptionally favourable market valuations may not last and could give rise to swift market corrections. This could entail another institution-specific element which could be the poor risk management processes related to exposures to non-bank financial institutions, especially to highly leveraged ones, as revealed by some recent failures. If market risk and the impact of market volatility are material for certain institutions, supervisors will also closely monitor these risks in 2022. Under a tightening of conditions, the hypothesis of rate normalisation would also put pressure on both interest rate risk and on credit spread risk. Therefore, credit institutions must have the necessary procedures in place that allow them to adequately manage a scenario reflecting a rise in rates and spreads.
40. Even though some governance aspects are embedded in most of the key topics, governance, in its entirety, will also be subject to supervisory scrutiny. CAs should thrive to strengthen credit institutions' internal governance and strategic steering capabilities through targeted and effective supervisory initiatives that address management bodies' effectiveness and diversity.
41. While capital management was not singled out as a stand-alone key topic for 2022 as part of the ESEP, the likely deterioration of asset quality will presumably result in an increase in credit risk-weighted assets (RWAs) and in an erosion of capital. Thus, CAs need to closely follow whether individual credit institutions can absorb increasing credit losses, even if EU banks' capital positions overall seem to be strong enough. Additionally, individual institutions must be prepared to implement the final Basel III standards. Concerning the liability management related to the minimum requirement for own funds and eligible liabilities (MREL) which is a key topic for supervisory attention for 2021, the EBA shifts the focus from the supervisory to the resolution side, as MREL targets continue to remain a point of attention as part of the EREP.

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