



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Evolution of European banking supervision

Civil society seminar



18/07/2023

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European banking supervision: where we come from

2007-2012 Global financial crisis and European sovereign debt crisis

1. Regulatory weaknesses

- Insufficient level and quality of capital and liquidity
- Deficient risk management and excessive risk-taking by banks

2. Weaknesses in crisis management

- Lack of framework for resolution of (cross-border) banks
- “Too big to fail”-problem
- Bank-sovereign nexus – purely national approaches and solutions

3. Weaknesses in supervision

- Not enough prevention, too reactive
- Lack of supervisory cooperation
- Similar banks, same risks – differences in supervision – no supervisory convergence



2012-2014 EU Reforms in response to the crises

➤ New regulatory framework – Single Rulebook

- Higher capital and liquidity standards
- Comprehensive regulatory framework for governance (including remuneration) and risk management
- Instruments to address systemic and macroprudential risks
- New instruments for weak banks

➤ Banking union

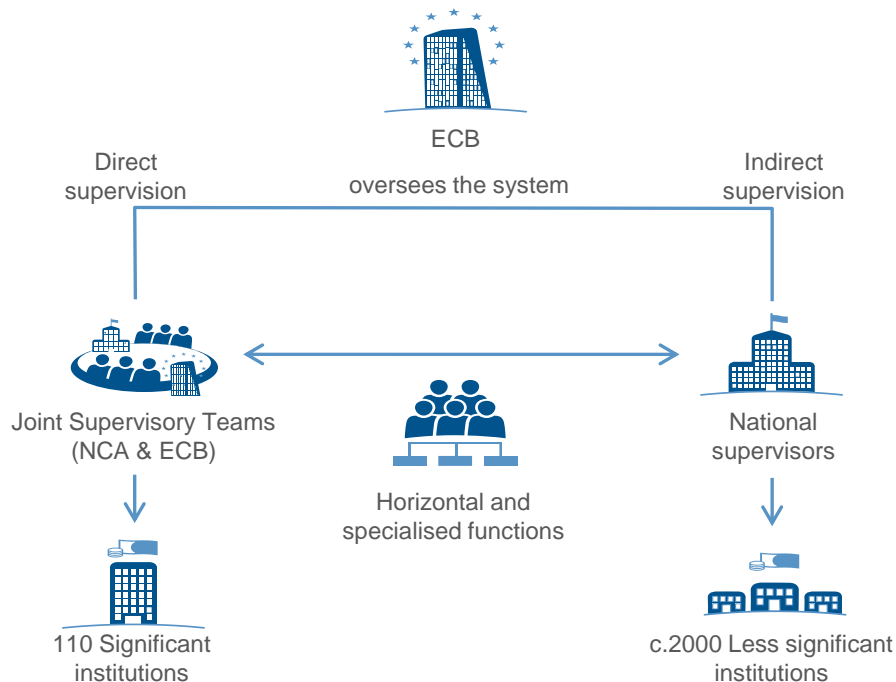
- **Single Supervisory Mechanism (SSM)**
European supervision, benchmarking, peer reviews, best practices
- **Single Resolution Mechanism (SRM)**
European crisis management and bank resolution framework

What is the SSM?

Key SSM facts

1. The Single Supervisory Mechanism (SSM) is one of the **largest banking supervisory authorities in the world**
2. Currently **110 banking groups** in 21 countries under direct ECB supervision, with more than **80%** of banking assets in those countries
3. Around **2,000 smaller institutions** are supervised by the national competent authorities (NCAs), with the ECB being responsible for the system at large.

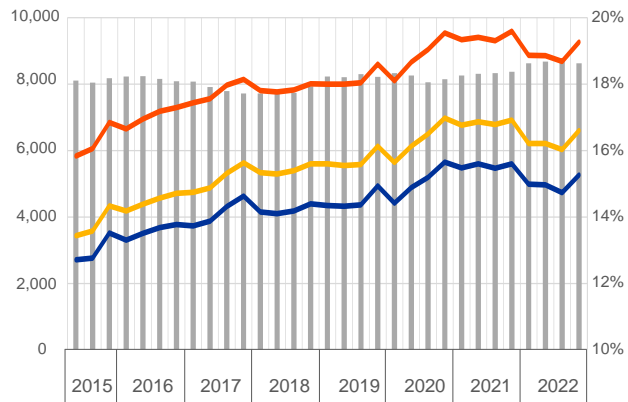
Distribution of tasks within the SSM



Banks' resilience has increased

Capital ratios and their components by reference period

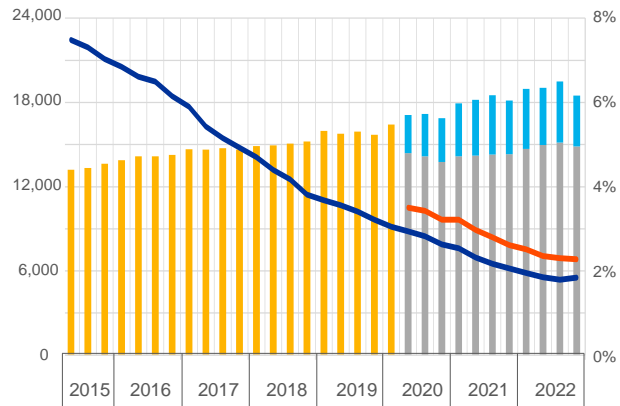
(EUR billions; percentages)



- CET1 Ratio (right-hand scale)
- Tier 1 Ratio (right-hand scale)
- Total capital ratio (right-hand scale)
- Total exposure amount (left-hand scale)

Non-performing loans by reference period

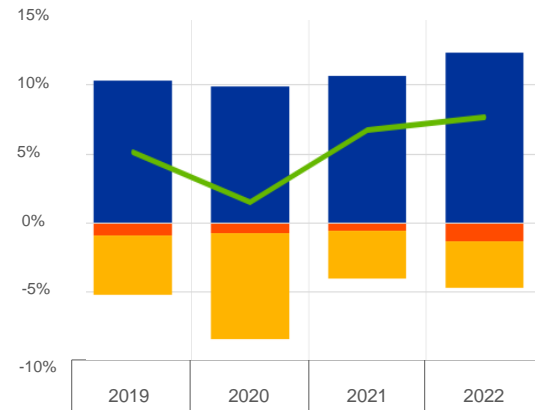
(EUR billions; percentages)



- Non-performing loans ratio, incl. cb (right-hand scale)
- Total loans, incl. cb (left-hand scale)
- Non-performing loans ratio, excl. cb (right-hand scale)
- Total loans, excl. cb (left-hand scale)
- Cash balances (left-hand scale)

Aggregate return on equity broken down by income and expense source

(Percent of equity)



- Net interest income before impairment, provisions, and taxes over equity
- Impairments and provisions over equity
- Other income and taxes over equity
- Return on equity

Source: ECB. Note: "cb" = cash balances at central banks and other demand deposits.

ECB banking supervision is evolving

The early years



Focus on harmonisation and convergence



Codification of practices into detailed manuals, guidelines and regulations

Key milestones:



Comprehensive assessment



NPL reduction



Targeted Review of Internal Models

As a maturing supervisory authority



Focus on risk-prioritisation, agility and accountability



Flexibility for supervisors to focus on strategic priorities and bank-specific vulnerabilities

Key initiatives:



Risk tolerance framework and multi-year SREP



Increasing **transparency** of SREP methodologies



Clearer **communication** of SREP outcomes to banks

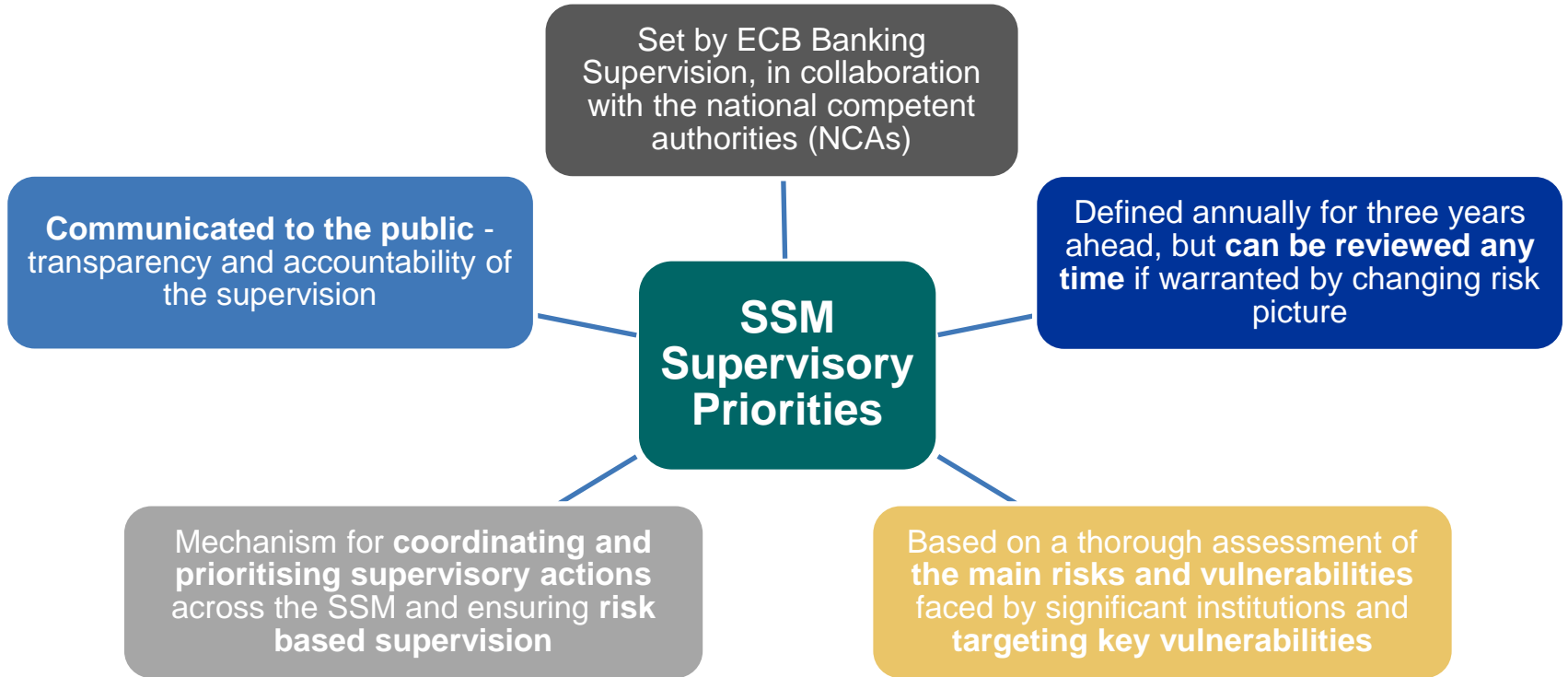


Internal reorganisation (JSTs organised by business model of banks; Supervisory Risk and Second Line of Defence function; new specialist support divisions; dedicated Directorate General for on-site inspections).



Implementing findings of **Expert Group on SREP**

Our risk-identification and priorities setting process



Supervisory priorities for 2023-2025


Priority 1: Strengthening resilience to immediate macro-financial and geopolitical shocks


Shortcomings in **credit risk management**, including exposures to vulnerable sectors  Credit risk

Lack of **diversification in funding sources** and **deficiencies in funding plans**  Funding risk

Priority 2: Addressing digitalisation challenges and strengthening management bodies' steering capabilities

Deficiencies in **digital transformation strategies**  Business model

Deficiencies in **operational resilience frameworks**, namely IT outsourcing and IT security/cyber risk  Operational risk

Deficiencies in **management bodies' functioning** and steering capabilities
Deficiencies in **risk data aggregation and reporting**  Governance

Priority 3: Stepping up efforts in addressing climate change

Material exposures to **physical and transition risk drivers**  Climate-related and environmental risk

EU SIs in light of the 2023 banking market turmoil

- March 2023 US banking turmoil underscored the need for **sound risk management and governance** from banks' managers and boards, **strong supervision**, and **effective regulation** of all banks.
- Events raised particular questions on **interest rate risk** and **liquidity risk** in the current monetary policy environment.
- Unlike US regional banks at heart of recent turmoil, **global banking rules apply to all banks in the EU regardless of size**.

Interest rate risk in the banking book (IRRBB)

- **ECB increased focus on IRRBB at end of 2021.**
- **Euro area banks do not exhibit comparable vulnerabilities to banks such as Silicon Valley Bank** (e.g. large amounts of unrealised losses on investment securities and/or reliance on a concentrated, uninsured deposit base).
- **No room for complacency:** ECB regularly tests banks' sensitivity to interest rate shocks. JSTs and on-site inspectors assess banks' risk management and require remedial actions where needed.
- **Stress test** assesses vulnerabilities to very harsh macro scenarios, including increases in interest rates.

Liquidity risks

- **Funding costs increasing since 2022Q3.** While banks' profitability has improved in current interest rate environment, refinancing at higher rates puts pressure on earnings.
- **ECB recently finalised review of banks' preparedness for phase-out of Targeted Long-term Refinancing Operations:** all banks reviewed have exit strategies in place, but ECB following-up with banks that are more reliant on this funding source.
- **ECB conducting broader analysis of banks' liquidity and funding plans this year:** we will review contingency planning and collateral optimisation strategies and banks' governance around asset-liability management.

March 2023 Turmoil: takeaways for supervisors

- **We see the main takeaways as being for supervision (more effective), not regulation.**
 - Supervisors need to escalate findings quickly and ensure banks take timely remedial actions.
 - Escalation highlighted in Fed report on SVB and report of Expert Group on SREP.
 - ECB placing strong focus on governance and risk management.
- **But we welcome targeted follow-up work at Basel Committee and Financial Stability Board.**
 - There may be scope in Basel to fine tune regulation of IRRBB and liquidity risk to account for impact of new technologies and social media on depositor behaviour.
 - FSB should explore implications for the international resolution framework.
 - Need to avoid devising ever-more complex regulations, which make it hard for banks and supervisors to identify and prioritise key risks.
 - Enhancing preparedness is key, e.g. developing alternative options to address different types of crisis, and conducting dry-run exercises.

Thank you for your attention!