



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Ignazio Angeloni

Member of the Supervisory Board

ECB Banking Supervision Achievements and Challenges

The Adam Smith Society

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The views expressed here are those of the author and should not be attributed to the ECB

- **Banking legislation (2013, under review)**
- **Euro area-wide banking supervisor (2014)**
- **Crisis management framework (2015-2016):**
 - *single resolution authority, resolution fund (**in progress**)*
 - *pan-euro area deposit insurance (**not implemented**)*
 - *competition authority (EU commission)*

The framework is comprehensive but incomplete

- *(Developments of internal structures)*
- **SREP**: methodology for assessing bank risks and for setting prudential requirements *(more below)*
- **Regulatory harmonisation:**
 - ✓ *Options and discretions in CRR/CRDIV*
 - ✓ *Significant shortcomings remain*
- **Action plan on non-performing loans:**
 - ✓ *Fact finding, best practices, consultation, guidelines...*
- **Regular supervision:**
 - ✓ *Supervisory dialogue and implementation (JSTs)*
 - ✓ *Focus on weaker and crisis banks*

Supervisory Review and Evaluation Process (SREP)

SREP methodology at a glance: four key elements

SREP Decision

Quantitative capital measures

Quantitative liquidity measures

Other supervisory measures

Overall SREP assessment – holistic approach

→ Score + rationale/main conclusions

Viability and sustainability of business model

Adequacy of governance and risk management

Categories: e.g. credit, market, operational risk and IRRBB

Categories: e.g. short-term liquidity risk, funding sustainability

1. Business model assessment

2. Governance and risk management assessment

3. Assessment of risks to capital

4. Assessment of risks to liquidity and funding

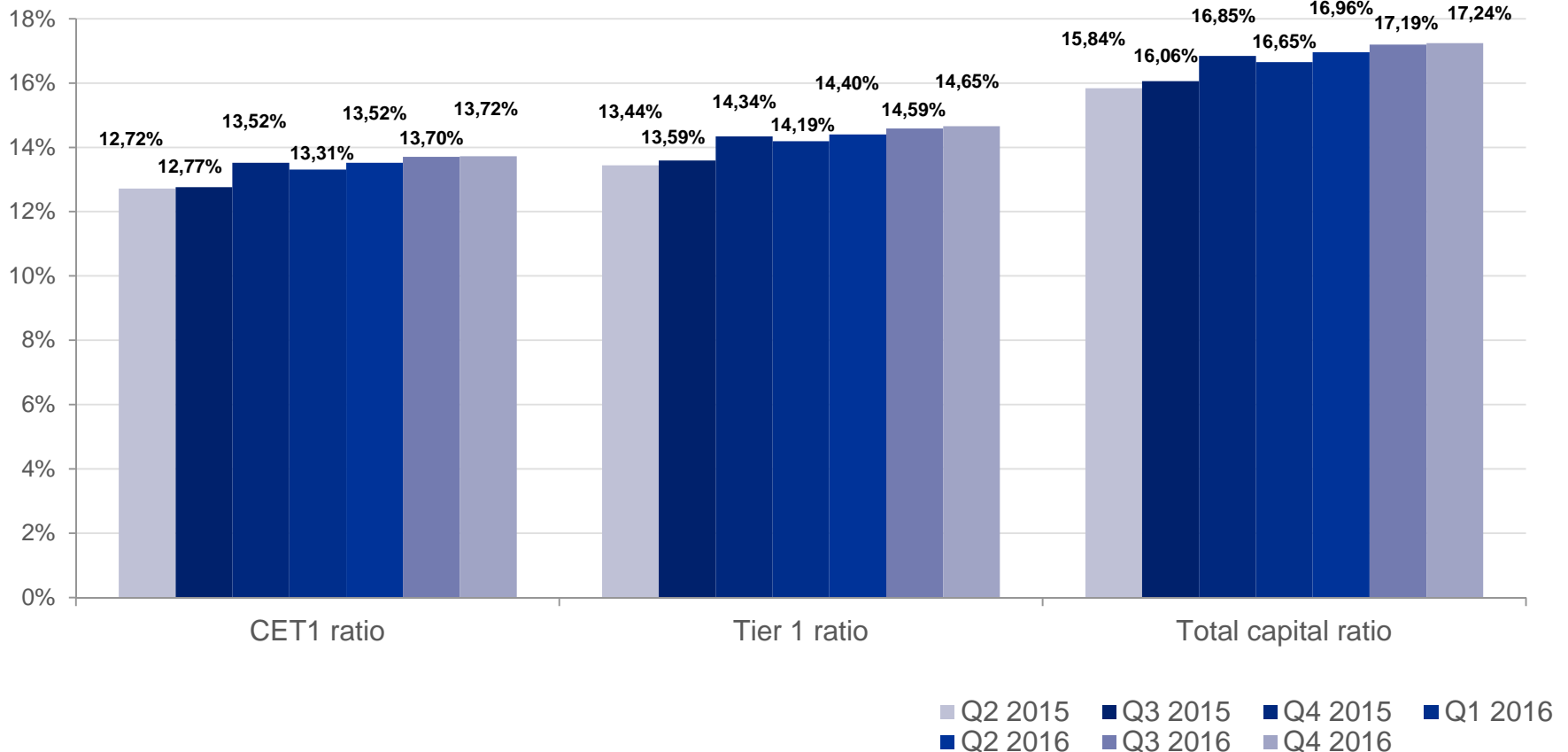


Feeds into the Supervisory Examination Programme (SEP)

Source : SSM SREP Booklet - www.bankingsupervision.europa.eu/ecb/pub/pdf/srep_methodology_booklet_2016.en.pdf

Strengthening of the solvency ratios

Solvency ratios of directly-supervised ECB banks by reference period

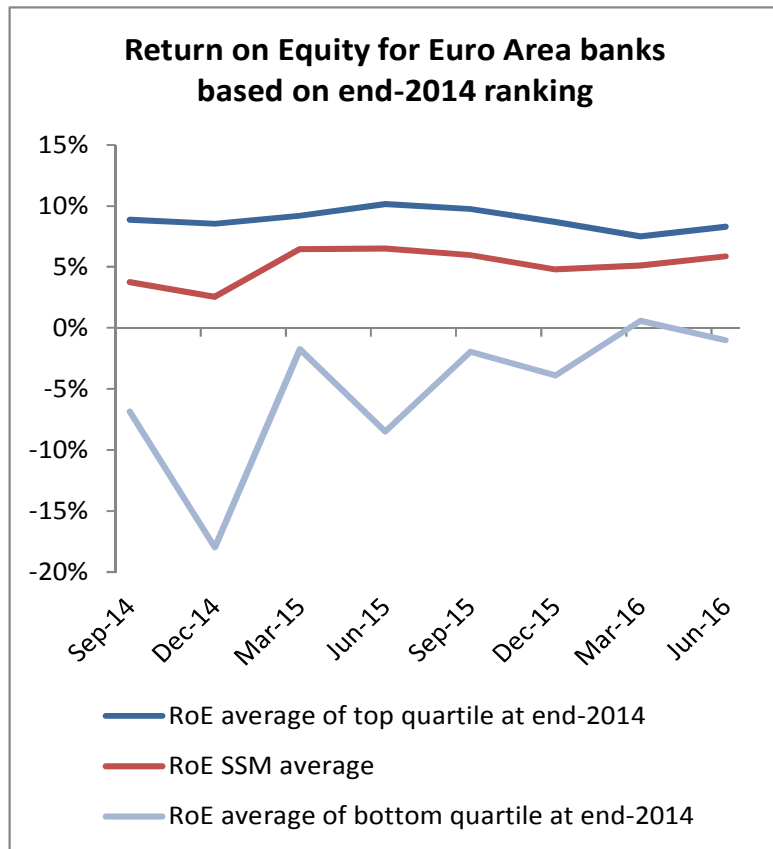


Source: ECB.

Notes: Significant institutions at the highest level of consolidation for which common reporting on capital adequacy (COREP) and financial reporting (FINREP) are available. The list of banks used for the various reference periods may differ as the list of significant institutions changes and as banks start to report under FINREP obligations. Specifically, there are 102 banks in the second and third quarters of 2015, 117 in the fourth quarter of 2015 (increase in FINREP reporting obligations), 123 in the first quarter of 2016, 124 in the second quarter of 2016 (changes in the list of significant institutions and FINREP reporting obligations), 122 in the third quarter of 2016 and 121 in the fourth quarter of 2016. The number of entities per reference period is expected to stabilise in future, with any changes resulting from amendments to the list of SIs following assessments by ECB Banking Supervision, which generally occur on an annual basis.

Weak low profitability; differences across banks

Weak bank profitability amid narrowing margins, but large variance across banks...

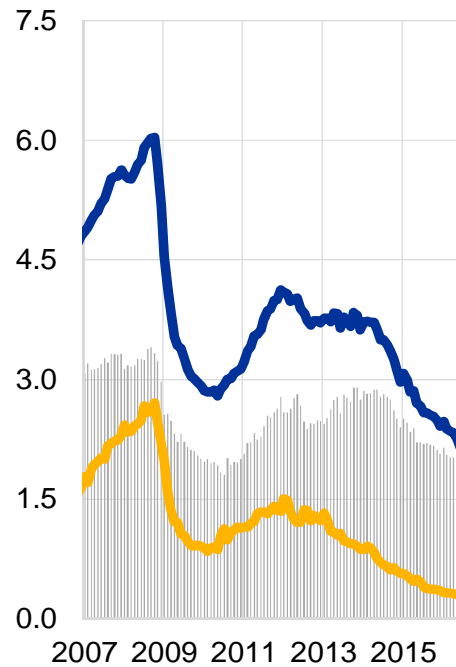


Source: ECB, FINREP and ECB calculations. Notes: top and bottom quartile banks were kept fix based on end-2014 RoE. The chart then tracks the evolution of the average RoE for these two groups as well as the average for the entire sample of Euro Area banks (93 significant institutions). Subsidiaries of foreign institutions have been excluded from the sample.

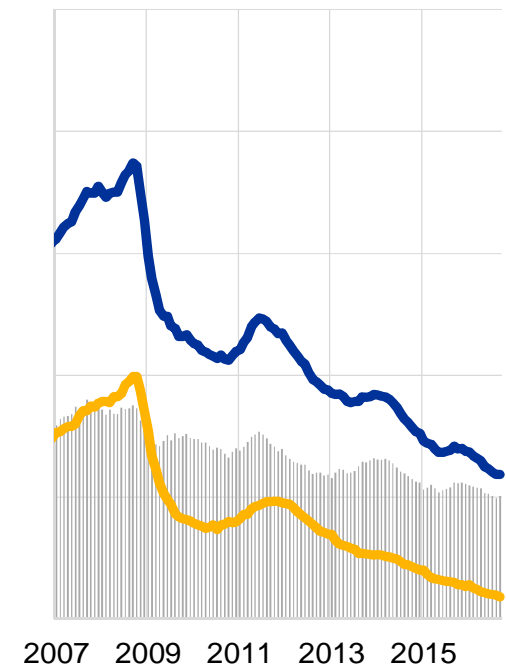
Loan and deposit interest rates and margins on new business (percentage per annum)

■ lending rates
 ■ deposit rates
 ■ margins

Vulnerable countries



Other countries

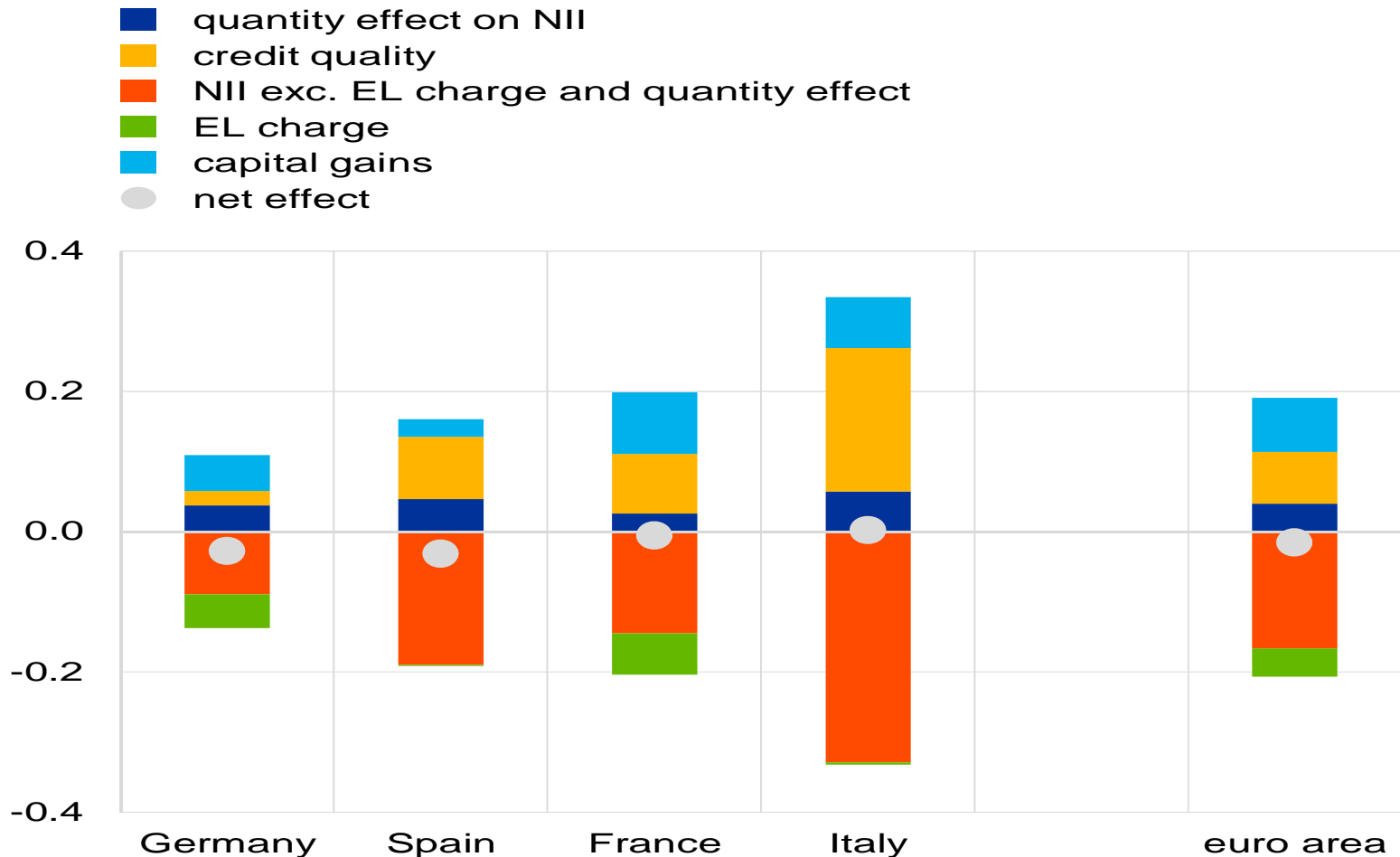


Sources: ECB and ECB calculations.

Notes: Loan and deposit composite rates are calculated using the corresponding outstanding amount volumes as weights.

Impact of monetary policy on bank profitability

Estimated effect of monetary policy on bank profitability over the period 2014-17
(percentage point contribution to return on assets)



Sources: ECB and ECB calculations. Capital gains are based on consolidated data for 68 euro area banking groups under direct ECB supervision and in the 2014 EU-wide stress test. Euro area figures are weighted average for the countries included in the sample using the ECB's consolidated banking data for the weight of each country's banking system in the euro area aggregate. NII stands for net interest income and EL for excess liquidity.

Credit risks and bank costs across countries

Non-performing loan burdens focused in a few jurisdictions

(2016Q3 data, EUR million and percentages)

Country	Total Loans	Gross NPLs	Gross NPL ratio	Impairments on NPLs	Coverage ratio	Net NPL ratio	Cost to income ratio
AT	248,516	12,088	4.9%	6,188	51.2%	2.4%	65.2%
BE	428,506	15,501	3.6%	6,585	42.5%	2.1%	58.9%
CY	51,718	20,833	40.3%	8,015	38.5%	24.8%	51.0%
DE	2,357,014	63,045	2.7%	25,402	40.3%	1.6%	77.3%
EE	14,755	212	1.4%	60	28.3%	1.0%	n / a
ES	2,324,159	136,099	5.9%	60,447	44.4%	3.3%	51.8%
FI	269,136	4,018	1.5%	1,070	26.6%	1.1%	49.4%
FR	3,670,920	137,742	3.8%	69,104	50.2%	1.9%	68.7%
GR	242,402	114,060	47.1%	55,026	48.2%	24.4%	49.5%
IE	212,941	37,803	17.8%	14,372	38.0%	11.0%	56.8%
IT	1,690,028	271,337	16.1%	128,318	47.3%	8.5%	67.6%
LT	17,010	693	4.1%	230	33.3%	2.7%	45.6%
LU	61,932	1,130	1.8%	359	31.7%	1.2%	n / a
LV	9,884	359	3.6%	99	27.7%	2.6%	42.0%
MT	12,428	576	4.6%	205	35.6%	3.0%	n / a
NL	1,700,714	43,576	2.6%	15,719	36.1%	1.6%	58.5%
PT	182,529	36,140	19.8%	15,399	42.6%	11.4%	61.4%
SI	14,519	2,439	16.8%	1,625	66.6%	5.6%	60.0%
SK	31,206	1,434	4.6%	775	54.1%	2.1%	n / a
TOTAL	13,540,317	899,085	6.6%	408,999	45.5%	3.6%	64.2%

Source: ECB.

Notes: All country-level ratios are computed as weighted averages.

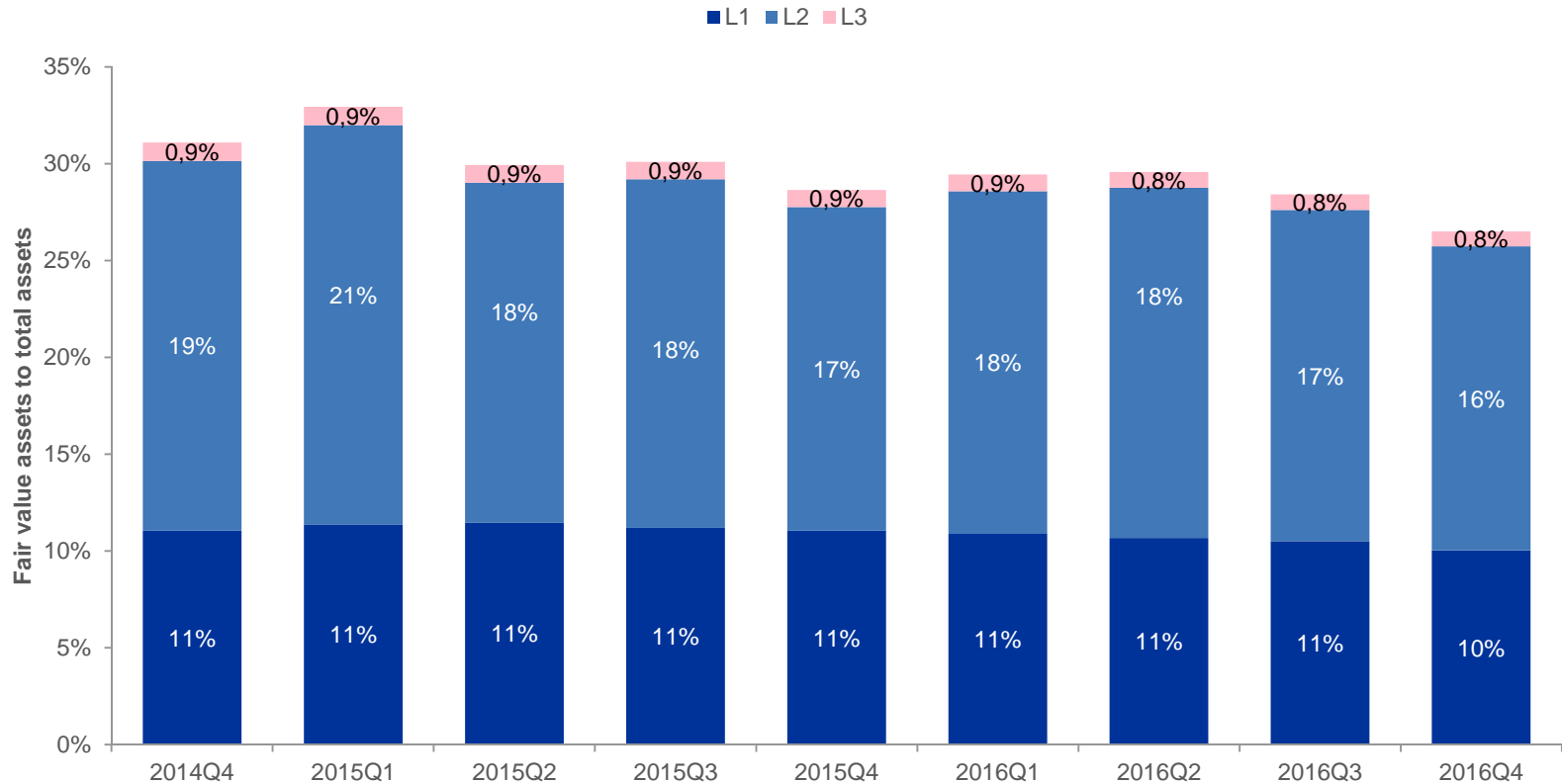
Loan data refer to a sample of 115 significant institutions.

Cost-to-income data refer to a constant sample of 101 IFRS-reporting significant institutions.

Market risk; breakdown by accounting categories

Fair-valued assets represent around 30% of total assets
(fairly distributed across countries)

Share of Level 1-3 assets relative to total assets



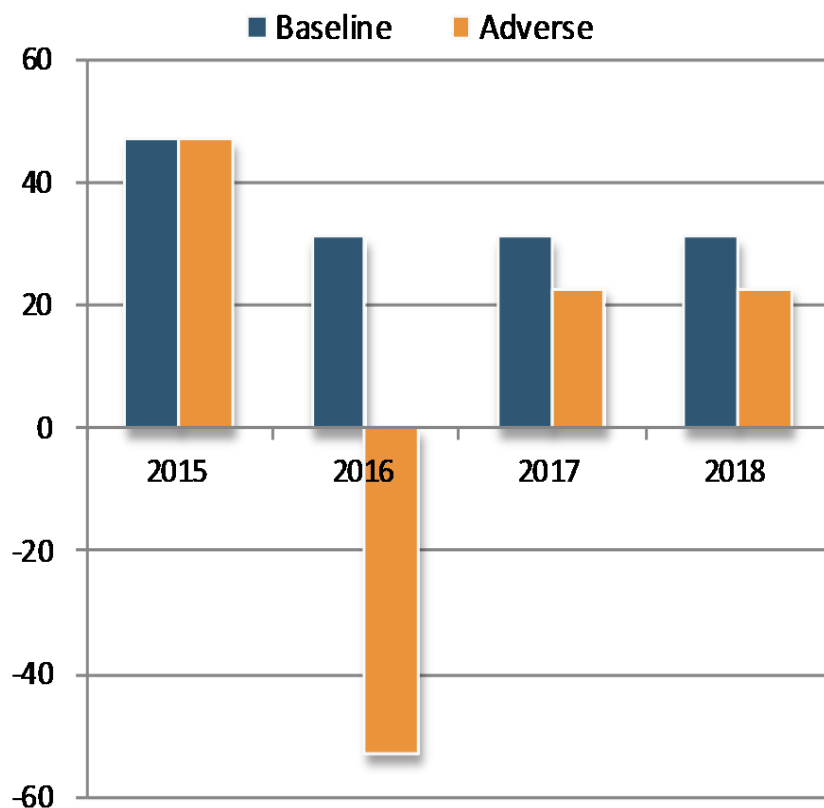
Source: ECB staff calculations, FINREP.

Notes: constant sample of 100 significant institutions. Subsidiaries that are significant institutions are excluded to avoid double counting.

Stress test impact: credit risk vs. market risk

2016 ST – Market risk P&L impact

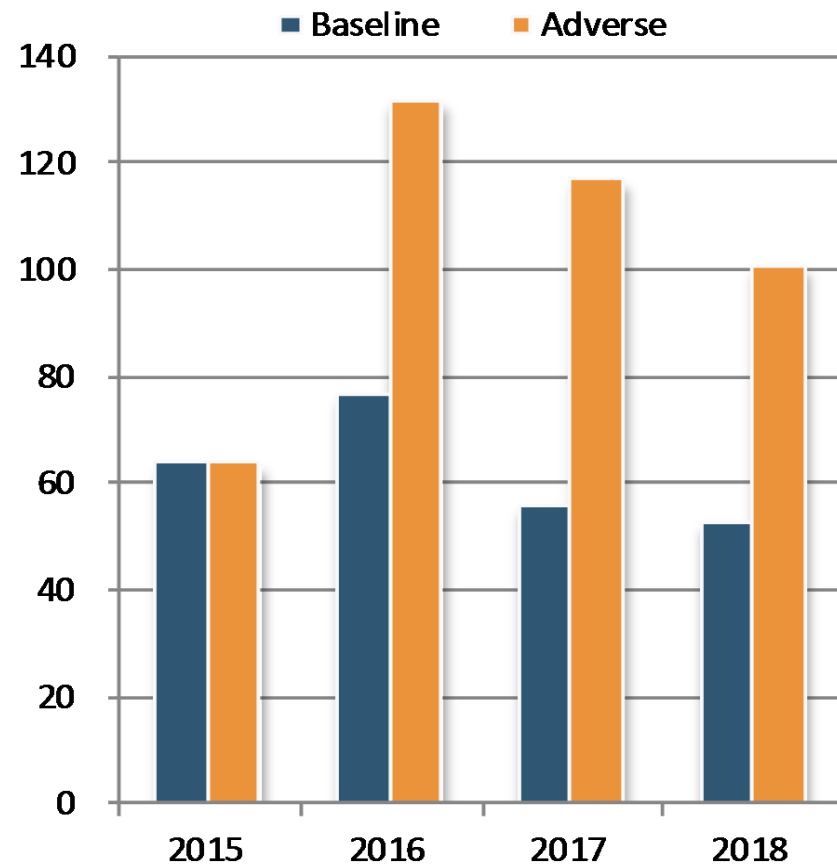
(EUR bn)



Source: EBA 2016 stress test

2016 ST – Credit losses

(EUR bn)



- **Profitability challenge**
 - *thematic review of banks' business models*
 - *cost structures*
 - *dialogue, benchmarking (no direct legal powers)*
- **Normalization of interest rate cycle**
 - *2017 stress test on IRR on banking book*
- **Credit risk**
 - *ECB NPL guidance and follow-op action plans*
- **Market risk**
 - *Targeted Review of Internal Models (TRIM)*
 - *individual deep-dives and on-site inspections*

Conclusion

- **ECB supervision set-up was a success**
- **Progress still ongoing, much work to be done**
- **NPLs are a major challenge for the system**
- **All risks are carefully monitored through SREP, TRIM and regular supervision**
- **Major challenges in the background:**
 - ✓ *weak profitability, heavy cost structures*
 - ✓ *legal framework needs improvement*
 - ✓ *overbanking, technological challenges*