EUROPEAN CENTRAL BANK

BANKING SUPERVISION

ECB Banking Supervision: SSM supervisory priorities 2017

The supervisory priorities for 2017 set out focus areas for supervision in 2017. They build on an assessment of the key risks faced by supervised banks, taking into account the latest developments in the economic, regulatory and supervisory environment.

Sources of banking sector risk have been identified in cooperation with the national competent authorities, with input from the Joint Supervisory Teams (JSTs), ECB macroprudential and microprudential analyses, as well as reports by international bodies. The significant drivers of risk identified are: the ultra-low/negative interest rate environment, high levels of non-performing loans (NPLs) and lacklustre economic growth across euro area countries, EU geopolitical uncertainties, the reactions of banks and markets to new regulation, a potential reversal of risk premia in financial markets, the situation in emerging market economies, EU fiscal imbalances, cases of misconduct by banks, developments in real estate lending markets, cybercrime and IT disruptions, and non-bank competition. The two risk categories most impacted by these risk drivers are business model and profitability risk and credit risk.

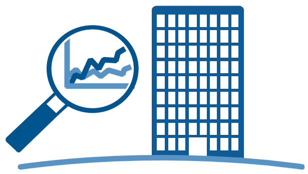
To enable banks to address these key risks effectively, European banking supervision has streamlined its supervisory priorities. For 2017 three priority areas will guide banking supervision:

1. business models and profitability drivers;
2. credit risk, with a focus on NPLs and concentrations;
3. risk management.

For each of the priorities, a number of supervisory initiatives will be carried out; in several cases, the full implementation of such initiatives may span more than one year.

The above risks, as well as the supervisory priorities, should not, however, be seen as an exhaustive list. Various activities not explicitly highlighted in this document are being carried out on an ongoing basis, for example activities related to cybercrime risks. Moreover, differing supervisory activities may be required at bank level, taking into account credit institutions' specific risk profiles. Nonetheless, the priorities are an essential tool for coordinating supervisory actions across banks in an appropriately harmonised, proportionate and efficient way, thereby contributing to a level playing field and a stronger supervisory impact.

Business models and profitability drivers



Supervisory action:

- **Thematic review of banks' business models and profitability drivers**

Business models and profitability drivers continue to be a priority area in 2017, especially in view of protracted ultra-low/negative interest rates. European banking supervision will therefore continue to drive forward its thematic review of banks' business models and profitability drivers. In the course of the review, JSTs will perform in-depth examinations throughout 2017. A further point of supervisory attention will be the possible repercussions of the UK's referendum on EU membership for supervised banks and their business models. In addition, European banking supervision will explore potential risks for banks' business models emanating from the emergence of "FinTech" and non-bank competition.

Credit risk, with a focus on NPLs and concentrations

Supervisory action:

- **Guidance and supervisory dialogue on NPLs**
- **Thematic review IFRS 9**

Credit risk remains a key supervisory priority in 2017. A number of institutions continue to exhibit a high stock of NPLs. Having published guidance on NPLs to banks, European banking supervision will – via its NPL task force – continue to support JSTs in follow-up actions and supervisory dialogues with respect to the NPL guidance and the assessment of banks' NPLs. In the light of the upcoming introduction of the accounting standard "IFRS 9 Financial Instruments", the thematic review of the potential impact of IFRS 9 on banks and their degree of preparation will be intensified. To investigate excessive concentrations of credit risk in certain asset classes, such as shipping loans, European banking supervision intends to use a new approach combining both on-site and off-site elements.

Risk management

Supervisory action:

- **Thematic review of compliance with BCBS 239**
- **TRIM**
- **Thematic review of banks' outsourced activities**

In this area, elements from the 2016 priorities of risk governance, capital adequacy and liquidity have been combined with new aspects in which improvements are deemed to be necessary. The following initiatives will receive special attention:

Compliance with the Basel Committee on Banking Supervision's principles for effective risk data aggregation and risk reporting

In times of low interest rates, ample and inexpensive central bank funding, low bank profitability and the resulting search-for-yield behaviour, it is crucial for banks to exercise prudent risk management. High data quality is an essential precondition for accurate risk information and, hence, sound risk management and control and ultimately adequate capital requirements. European banking supervision will therefore finalise its ongoing thematic review of banks' compliance with the Basel Committee's principles for effective risk data aggregation and risk reporting (BCBS 239), and JSTs will follow up with institutions, as appropriate.

Targeted review of internal models (TRIM)

To assess and confirm the adequacy and appropriateness of approved Pillar 1 internal models and, therefore, enhance the credibility of banks' risk management, European banking supervision will roll out its multi-year targeted review of internal models. On-site inspections will be launched in connection with this review.

ICAAP and ILAAP

ICAAP and ILAAP processes are of fundamental importance for institutions in managing capital and liquidity adequacy. European banking supervision reviews institutions' ICAAPs and ILAAPs as part of the Supervisory Review and Evaluation Process (SREP), verifying that banks have implemented adequate processes to assess and maintain their capital and liquidity adequacy. European banking supervision is committed to promoting the continuous improvement of banks' ICAAPs and ILAAPs.

Outsourcing

As the range of activities that banks may wish to outsource grows, new risks connected with outsourcing are emerging. European banking supervision will therefore initiate a thematic review to take stock of banks' outsourced activities and scrutinise how they are managing the associated risks (including IT risks).