8th ECB Banking Supervision Market Contact Group (BSMCG) meeting

Friday, 14 February 2025, physical meeting

MEETING SUMMARY

Claudia Buch, Chair of the Supervisory Board, opened the eighth meeting of the BSMCG and outlined the agenda. Furthermore, Ms Buch recalled that the exchanges of views with market participants are an essential component of the market intelligence activities conducted by ECB Banking Supervision to support its assessment of the main risks and vulnerabilities of the banking sector.

1. European banking sector outlook

BSMCG members noted that the European banking sector was performing well and broadly characterised by a positive profitability outlook. Banks' profitability has seen a large upward shift in 2024 and is expected to fall only modestly with expected decreasing rates. Asset quality remains also robust and is expected to weaken only slightly from historical low levels. During the discussion, participants focused on several key issues impacting the outlook of the banking sector, mainly related to the economic outlook, interest rate dynamics, geopolitical instability, challenges posed by non-bank financial intermediaries and the role of consolidation.

The high uncertainty around the evolution of the interest rates has been highlighted as an important risk driver for banks' cost of equity in the near term. There was a consensus that that market valuations, as observed at the time of the meeting, were reflecting a scenario of progressive interest rate decline expected to land in the vicinity of the neutral rate. High uncertainties stemming from the current geopolitical context, especially threats from further global trade fragmentation and impact of new tariffs, may challenge the European economic growth outlook and inflation dynamics, leading to mounting pressures on some economic sectors and regions. While not new, geopolitical risks were acknowledged as becoming increasingly global and systemic, impacting global growth, business operations and security, leading to financial and operational resilience challenges for banks. Against this background, participants emphasized the importance for banks to leverage more on disclosures and communication in order to enhance market confidence, e.g. by providing more information to investors regarding banks' assumptions underlying their financial and capital plans, monetary policy transmission to business (e.g. deposit betas) and sensitivity analyses of their performance under different interest rate scenarios.

Some members pointed out that growing trends in securitisation and private credit markets were progressively shifting risks outside traditional banking, with implications for investors' strategies and regulatory oversight. While most of the members regarded these developments as overall positive for financial stability, some highlighted potential issues stemming from assets and liabilities mismatches or the involvement of smaller banks with less expertise in these areas. The linkages between banking and non-bank financial intermediaries remain unclear, pointing towards the importance for banks to improve transparency and disclosures to investors.

The discussion also touched upon the challenges of M&As given recent developments, particularly in protecting minority shareholders and navigating regulatory approvals in some countries. There was a consensus on the need for stronger and more profitable banks in Europe, with M&As being susceptible to support, thanks to increasing efficiency gains and economies of scale needed for IT investments to ensure sustainability in the medium/longer term.

2. Regulatory scenarios and the impact on European banks

The discussion focused on an emerging global deregulation trend, in particular market participants' views on potential regulatory and supervisory adjustments. The US implementation of the Basel 3 finalisation package was a major topic among members, with discussions emphasising concerns as regards the timeline and the features of an upcoming US transposition with potential implications for other jurisdictions' adherence to international standards. A significant reduction in capital requirements, especially for Global Systemically Important Banks, or changes in compensation rules could impact European banks' competitiveness.

The discussion also covered concerns stemming from a withdrawal or weakening of global commitments to implement policies aiming at addressing challenges from climate change. Some participants stressed that despite this trend, immediate impacts of physical risks are expected to remain high on the radar given their increasing frequency and materiality. Some participants also stressed an expected deregulation trend in the digital asset space in an attempt to foster innovation. In this context, challenges associated with crypto assets were discussed, emphasizing the need for regulatory clarity, investors' protection and a better understanding of the implications for banks' funding structures.

The meeting underscored the potential benefits of advancing the European Capital Markets Union or Savings and Investment Union (SIU), noting its potential to drive significant economic growth, alongside the finalisation of the European Banking Union. The SIU was regarded as a needed development for Europe to foster investments in defence, energy autonomy and the transition to a net-zero economy. Finally, the importance of transparency and efficiency in supervisory reporting was emphasised, with a focus on balancing effective oversight with the costs associated with reporting requirements.

3. Concluding remarks

Ms Buch concluded the meeting by thanking the members for their contributions and active participation in the discussions. She also recalled that the annual review of the BSMCG memberships was expected to take place in the coming months. The next meeting is planned to take place in early September 2025.