



ECB Banking Supervision: SSM priorities 2016

The supervisory priorities for 2016 of the Single Supervisory Mechanism (SSM) set out focus areas for supervision in 2016. They build on an assessment of the key risks faced by banks under ECB supervision and take into account relevant developments in the economic, regulatory and supervisory environment.

The key risks SSM banks are confronted with have been identified in cooperation with the national competent authorities, leveraging on the input from the Joint Supervisory Teams, ECB macroprudential and microprudential analyses as well as reports by external bodies. Among the key risks identified, business model and profitability risk is ranked the highest, followed by other key risks, the importance of which varies across SSM countries: credit risk and heightened levels of non-performing loans; reversal of the search for yield; conduct and governance risk; sovereign risk; geopolitical risk and growing vulnerabilities in emerging economies; IT and cybercrime risk; and banks' ability to meet upcoming regulatory capital requirements.



To ensure that banks address these key risks effectively, the SSM has adopted five high-level priorities to guide its supervision throughout 2016. These are (i) business model and profitability risk, (ii) credit risk, (iii) capital adequacy, (iv) risk governance and data quality, and (v) liquidity. For each of these priorities, a number of supervisory initiatives will be carried out. In some cases, their full implementation spans more than one year.

The aforementioned risks, as well as the supervisory priorities, should not be seen as an exhaustive list. Differing supervisory activities may be required at bank level, taking into account credit institutions' specific risk profiles. Nonetheless, the priorities are an essential tool to coordinate 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 model and profitability risk

The key risk that stands out relates to banks' business models and profitability. Both are being challenged by the high level of asset impairments and the protracted period of low interest rates. In 2016, building on previous work around banks'



Supervisory action:
Thematic review of
banks' profitability drivers

business models and on profitability analyses, the SSM is launching a thematic review of banks' profitability drivers at firm level and across business models. The analysis of profitability drivers will facilitate the identification of banks with structurally low profitability. In this context, an area of supervisory focus will be examining whether profitability is achieved through, among other things, a weakening of credit standards, greater reliance on short-term funding, or an increase in risk exposures not commensurate with the bank's stated risk appetite.



Supervisory action:
Task force on NPLs
Thematic review of IFRS 9

Credit risk

Elevated levels of non-performing loans (NPLs) deserve heightened supervisory attention. The deterioration in the credit quality of loans to corporates and/or households as well as in credit standards is a source of concern in a number of SSM countries, particularly in ones hit hard by the crisis. A task force on NPLs is reviewing the situation of institutions with high levels of NPLs and will propose follow-up actions. In addition, exposure concentrations in areas such as real estate will be subject to greater supervisory scrutiny. Another credit-related topic is the implementation of "IFRS 9 – Financial Instruments" (International Financial Reporting Standards). A thematic review will assess the potential impact of IFRS 9 on banks' provisioning practices and how banks are preparing for its introduction.



Supervisory action:
Review of quality & consistency
of banks' ICAAP
Review of banks'
internal models

Capital adequacy

Capital adequacy remains a high priority for the SSM in 2016. Focal points are the quality and consistency of banks' Internal Capital Adequacy Assessment Processes (ICAAP), including banks' internal stress-testing capacities, and the conduct of supervisory stress tests such as the EU-wide stress test coordinated by the European Banking Authority. Further pivotal elements of supervision in 2016 are the follow-up on the quality and composition of banks' capital (also in relation to the ongoing efforts to harmonise options and national discretions) as well as the examination of banks' preparedness for new regulatory standards such as total loss-absorbing capacity (TLAC) and the minimum requirement for own funds and eligible liabilities (MREL), the application of which will result in minimum requirements for "bail-inable" capital instruments. In addition, a targeted review of banks' internal models will be carried out over several years.

Risk governance and data quality

Banks' risk governance will be assessed against the background of low profitability and resulting search-for-yield behaviour, paired with cheap and ample funding provided by central banks. Moreover, experience from the financial crisis has shown that banks' management boards did not always have at their disposal the risk information required to make sound business and risk management decisions. A



Supervisory action:

Clarify supervisory expectations to banks' boards

Thematic review of compliance with BCBS principles

priority for the SSM is to clearly articulate supervisory expectations vis-à-vis banks in that respect. Banks' boards are expected to require and receive adequate risk information, so that they can thoroughly judge whether business decisions entail risk levels that are in line with the bank's defined risk appetite standards and limits. Data quality and firm-wide risk aggregation capabilities are an essential precondition for sound, risk-based decision-making and therefore for proper risk governance. In this context, the SSM will carry out a thematic review of banks' compliance with the Basel Committee on Banking Supervision's principles for effective risk data aggregation and risk reporting. This review will also reinforce the follow-up actions to the SSM's 2015 thematic review of risk governance and risk appetite. Finally, ensuring data quality and security necessitates state-of-the-art IT infrastructure. Therefore, IT risks will form part of the analysis.

Liquidity



Supervisory action:

Dialogue on ILAAP

The 2015 Supervisory Review and Evaluation Process revealed that a number of banks do not yet fully meet supervisory expectations regarding the sound management of liquidity risks. The SSM will therefore focus on the reliability of banks' Internal Liquidity Adequacy Assessment Processes (ILAAP). Banks' progress in implementing and maintaining sound frameworks for managing liquidity and funding risk, both in a going concern situation and under stressed circumstances, will be scrutinised.

Countries participating in the Single Supervisory Mechanism

- Single Supervisory Mechanism
- European Union

