



ECB Banking Supervision: SSM Supervisory Priorities 2020

The supervisory priorities set out focus areas for supervision in 2020. They build on an assessment of the key challenges facing supervised banks in the current economic, regulatory and supervisory environment.

ECB Banking Supervision has identified sources of banking sector risk in cooperation with the national competent authorities, drawing on input from the Joint Supervisory Teams (JSTs), ECB microprudential and macroprudential analyses, as well as reports by international bodies. The key drivers of banking sector risks identified are: (i) economic, political and debt sustainability challenges in the euro area, (ii) business model sustainability, and (iii) cybercrime and IT deficiencies. Further significant risk drivers are: execution risk attached to banks' strategies for non-performing loans (NPLs); easing lending standards; repricing in financial markets; misconduct/money laundering/terrorism financing; Brexit; global outlook and geopolitical uncertainties; reaction to regulation; and climate-change related risks.¹

To ensure that banks address these key challenges effectively, ECB Banking Supervision has reviewed its supervisory priorities. Whereas restoring the health of balance sheets was crucial in the years after the inception of the Single Supervisory Mechanism (SSM), the supervisory focus has gradually shifted to encompass banks' future resilience and the sustainability of their business models. The supervisory priorities have therefore been realigned to the high level priority areas of

- continuing balance sheet repair,
- strengthening future resilience,
- other priorities.

The prioritised supervisory activities have been regrouped under these areas.

1

Continuing balance sheet repair

Follow-up on NPL guidance

Despite the progress made in reducing the stock of NPLs in the euro area, the current aggregate level of NPLs remains elevated by international comparison. ECB Banking Supervision will therefore continue its effort to address the stock of NPLs and prevent the build-up of new NPLs in the future. It will keep engaging with



Supervisory action in 2020
Follow-up on bank-specific
supervisory expectations

¹ <https://www.bankingsupervision.europa.eu/ecb/pub/ra/html/ssm.ra2020~a9164196cc.en.html>

affected institutions to follow up on bank-specific supervisory expectations within a harmonised framework. The aim is to maintain progress in reducing legacy risks and achieve consistent coverage of the stock and flow of NPLs over the medium-term.

Follow-up on internal ratings-based models



Supervisory action in 2020

- Follow-up on TRIM findings
- Interaction with banks on the EBA's IRB repair programme

Work will continue on ensuring the adequacy of internal models used by banks in calculating their regulatory capital requirements. Following the on-site investigations held during the targeted review of internal models (TRIM), the focus will be on the remediation of the detected shortcomings. In addition, for credit risk models, significant supervisory activities will be required of the institutions to address the requirements of the European Banking Authority's IRB repair programme².

Trading risk and asset valuations



Supervisory action in 2020

- On-site work on trading and market risk aspects

On-site missions with an enhanced focus on trading and market risk aspects will continue. In particular, inspections will be carried out at banks which are exposed to complex instruments marked at fair value. Deep dives and focused analyses may be performed in order to tailor the scope of on-site missions to relevant risk areas.

2

Strengthening future resilience

ECB Banking Supervision will conduct a number of supervisory activities aimed at strengthening banks' resilience, the most prominent of which are highlighted below.

Credit underwriting criteria and exposure quality (e.g. real estate, leveraged finance)



Supervisory action in 2020

- Assessment of credit underwriting criteria
- On-site work on real estate exposures and leverage finance

ECB Banking Supervision will continue to assess the quality of banks' underwriting criteria. On the basis of the comprehensive data collection that aimed to identify pockets of risks, ECB Banking Supervision will conduct a follow-up analysis with a view to acquiring a deeper understanding of banks' loan origination practices and processes. Depending on the findings, bank-specific actions may be considered. In addition, the quality of specific asset class exposures will be examined through dedicated on-site inspections in areas such as commercial real estate, residential real estate and leveraged finance.

² The IRB repair programme refers to a regulatory review of the internal ratings-based (IRB) approach resulting in a number of regulatory technical standards and guidelines on IRB assessment methodology, definition of default, risk parameter estimation and treatment of defaulted assets, and credit risk mitigation.

Capital and liquidity management, ICAAP and ILAAP and further integration into SREP



Supervisory action in 2020

- Improvement of banks' ICAAPs and ILAAPs
- On-site missions on ICAAPs

Internal capital and liquidity adequacy assessment processes (ICAAPs and ILAAPs) are key risk management instruments for credit institutions. ECB Banking Supervision will continue to work towards improving banks' ICAAPs and ILAAPs by promoting a common understanding of the ECB's expectations for them. Moreover, banks' ICAAPs will be the focus of dedicated on-site inspections. Work will also proceed on improving transparency around the risk drivers of the Pillar II capital requirements.

Business model sustainability



Supervisory action in 2020

- Assessment of banks' business models and profitability within SREP
- Focus on digitalisation

Euro area banks' profitability remains under pressure from the economic environment, low interest rates, legacy issues and competition from banks and non-banks. In addition, digitalisation poses significant challenges for banks, while at the same time providing opportunities for efficiency gains and new business. ECB Banking Supervision will therefore continue assessing banks' business models and profitability, also in the light of increasing digitalisation, complemented by horizontal analyses.

IT and cyber risk



Supervisory action in 2020

- On-site work on IT risk
- SSM cyber incident reporting

ECB Banking Supervision will continue to assess the IT and cyber risks facing banks by carrying out on-site inspections and monitoring these risks as part of the Supervisory Review and Evaluation Process (SREP). In addition, significant banks will report any significant cyber incidents to the ECB under the SSM cyber incident reporting process.

EU-wide (biennial) and/ or ECB stress test exercises



Supervisory action in 2020

- EBA EU-wide stress test and ECB stress test

The next supervisory stress tests for significant banks will be conducted in 2020. There will be two complementary exercises: a sample of large significant banks will participate in the EU-wide stress test coordinated by the European Banking Authority. In parallel, the ECB will conduct an additional stress test for the remaining significant banks not participating in the EU-wide stress test. The outcome of both exercises will feed into the SREP. The stress test also serves to encourage banks to enhance their own stress testing and risk management capabilities.



Supervisory action in 2020
Assessment of adherence to
governance expectations in specific
areas

Governance

One significant outcome of supervisory work in 2019 is that further improvements are still needed in banks' governance framework. Governance will therefore remain in the supervisory spotlight in 2020. Considering its cross-cutting nature, supervisors will focus on banks' adherence to governance expectations in the context of each of the above activities aimed at strengthening future resilience. Depending on the respective supervisory activity, supervisors will assess governance aspects from several perspectives, including board functioning and organisational framework, internal control functions, and data aggregation and quality, thereby complementing JSTs' ongoing assessment of governance as part of the SREP.

3

Other priorities



Supervisory action in 2020
Monitoring the implementation of
banks' Brexit plans

Follow-up on Brexit work

Brexit remains a high priority for ECB Banking Supervision. The ECB expects banks to prepare for all possible outcomes and finalise the implementation of contingency measures for a no-deal Brexit. Together with the national supervisors, the ECB will continue to monitor the implementation of banks' Brexit plans and their adherence to supervisory expectations. This includes banks' progress towards their target operating models in the euro area within the agreed timelines.

The above outline of risks and supervisory priorities should not be seen as exhaustive. Activities other than those explicitly highlighted here, such as those relating to IFRS 9 implementation, are being carried out on an ongoing basis. Moreover, differing supervisory activities, tailored to credit institutions' specific risk profiles, may be required at bank level. Nonetheless, the supervisory priorities are an essential tool for coordinating supervisory actions across banks in an appropriately harmonised, proportionate and effective way, thereby contributing to a level playing field and enhancing the supervisory impact.

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For specific terminology please refer to the [SSM glossary](#) (available in English only).

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