



ECB Banking Supervision: SSM supervisory priorities 2018

The supervisory priorities set out focus areas for supervision in 2018. Taking into account the relevant developments in the economic, regulatory and supervisory environment, the supervisory priorities build on an assessment of the key challenges faced by supervised banks.

Sources of banking sector risk have been identified in cooperation with the national competent authorities and take into account 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: the protracted low interest rate environment, large stocks of non-performing loans (NPLs), geopolitical uncertainties, structural economic challenges in the euro area (including fiscal imbalances and debt sustainability concerns), the growth outlook in emerging market economies, banks' reactions to new regulatory initiatives, developments in residential and commercial real estate markets, repricing of risk in financial markets, cybercrime and IT disruptions, cases of misconduct, non-bank competition, the potential failure of a central counterparty and a rigid business environment.

To ensure that banks address these key challenges effectively, ECB Banking Supervision has reviewed its supervisory priorities. The risk situation outlined above warrants a continuation of the high-level priority areas from 2017, albeit with amendments. In 2018 four priority areas will guide banking supervision:

1. business models and profitability drivers;
2. credit risk;
3. risk management;
4. activities comprising multiple risk dimensions.

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



- ✓ Analysis of banks' profitability
- ✓ Sensitivity analysis of IRRBB

Supervisory action in 2018

- Follow-up on sensitivity analysis of IRRBB

Business models

Banks' business models and profitability drivers remain a priority for ECB Banking Supervision in 2018. Activities will focus on examining the evolution of banks' profitability in the current environment and on assessing interest rate risk implications for banks. For these purposes, ECB Banking Supervision will take into account the results of the recent horizontal analysis of banks' profitability drivers. Moreover, the findings of the sensitivity analysis of interest rate risk in the banking

book (IRRBB) will help supervisors to follow up on the impact on banks of potential changes in the interest rate level.

Credit risk



✓ NPL guidance issued

Supervisory action in 2018

- Examination of banks' NPL strategies
- Scrutiny of timeliness of NPL provisioning and write-offs

Non-performing loans

Credit risk continues to be an important supervisory priority for 2018. NPL stocks remain large at a number of institutions and this ultimately may have a negative impact on bank lending to the economy. High levels of NPLs affect capital and funding, reduce profitability, and consequently inhibit the supply of credit to households and companies. Working out NPLs is therefore important for both bank viability and macroeconomic performance. Hence, subsequent to the publication of the NPL guidance, the supervisory dialogue with banks will continue with a strong focus on examining NPL strategies and improving the timeliness of NPL provisioning and write-offs. In addition, the NPL task force will continue to support JSTs in follow-up actions and their supervisory dialogues with respect to banks' non-performing exposures.



✓ On-/off-site approach to investigating exposure concentrations

Supervisory action in 2018

- Investigation of real estate exposures
- Analysis of collateral management and valuation practices

Exposure concentrations & collateral management and valuation

The concentration of banks' exposures in specific asset classes continues to merit supervisory attention. In that regard, the supervisory approach combining off-site and on-site elements that has been effectively adopted in the context of shipping portfolios is envisaged to be rolled out over time to other asset classes such as real estate. Furthermore, supervisory attention will focus on banks' collateral management and valuation practices.

Risk management

This priority area combines elements that are of continuing importance with respect to banks' risk management. Numerous activities will be carried out as part of day-to-day supervision, including the monitoring of complex financial instruments like level 2 and level 3 assets. The following initiatives will receive special attention:



- ✓ First version of the “Guide for the TRIM” issued

Supervisory action in 2018

- Analysis and dialogue with banks
- Public consultation on the “ECB guide to internal models”

Targeted review of internal models (TRIM)

The TRIM project will continue in 2018 and 2019 with the overarching aim of enhancing the credibility and confirming the adequacy of banks’ approved Pillar I internal models. The “Guide for the TRIM”, a first version of which was made available in 2017, covers the way in which the SSM intends to implement the most relevant regulatory requirements related to internal models and laid the foundation for the execution phase of the project. Activities in 2018 will align closely with the progress made in 2017, with on-site inspections at banks continuing for credit, market and counterparty credit risk. As the results of those on-site inspections become available, the ECB will continue conducting horizontal analyses, which will also inform the supervisory follow-up and the revision of the guide. The outcome of this revision, the “ECB guide to internal models”, will be issued for public consultation. Different parts of the guide will be consulted separately as they become available.



- ✓ Draft guidance on ICAAP and ILAAP issued

Supervisory action in 2018

- Improvement of banks’ ICAAP and ILAAP
- Public consultation on revised guidance

ICAAP and ILAAP

The ICAAP and the ILAAP are of fundamental importance for institutions in managing capital and liquidity adequacy. To promote the improvement of institutions’ ICAAPs and ILAAPs, the ECB follows a multi-year plan. Based on an intensive dialogue with banks on draft guidance published in 2017 and taking into account further input, ECB Banking Supervision has refined and enriched its supervisory guidance on ICAAP and ILAAP and will finalise it in 2018, after a public consultation to be launched early in the year. In addition, work aiming at improving the transparency around the risk-by-risk composition of the Pillar II requirements will also be performed.



- ✓ Analysis of banks’ preparedness for IFRS9

Supervisory action in 2018

- Follow-up monitoring of banks’ IFRS9 implementation
- Scrutiny of banks’ preparedness for other regulatory changes

Preparedness for IFRS 9 and other regulatory changes

With a number of regulatory changes affecting banks, in 2018 ECB Banking Supervision will follow up with banks on their preparedness for, and implementation of, the relevant changes. An important change is the introduction of IFRS 9, where the interim results of a thematic review have shown that there is still room for improvement with regard to banks’ preparation for and implementation of IFRS 9. In this regard, JSTs will continue monitoring and follow-up activities with banks. Further regulatory changes in relation to which banks’ preparedness will be monitored include the net stable funding ratio (NSFR), the leverage ratio, and the minimum requirements for own funds and eligible liabilities (MREL).

Multiple risk dimensions

Supervisory activities planned for 2018 to address multiple risk dimensions include stress testing as well as the ongoing preparations for Brexit.



✓ Brexit policy stances developed

Supervisory action in 2018

- Continuing dialogue with banks on their Brexit preparations

Brexit preparations

Brexit will continue to be high on the supervisory agenda for 2018. The focus of activities will shift from preparatory work to the practical implementation of policy stances developed. The ECB – together with the NCAs – will continue to assess banks' plans to relocate activities from the United Kingdom to the euro area, including applications for the granting of banking licences. Special attention will be paid to compliance with the agreed policy stances, especially to avoid the establishment of empty shell institutions in SSM countries. The United Kingdom's withdrawal from the European Union also impacts a number of significant institutions headquartered in the euro area. JSTs will continue to actively engage with significant institutions that will be affected by Brexit and closely monitor the further development and implementation of banks' contingency plans.



Supervisory action in 2018

- EBA EU-wide stress test and ECB stress test

Stress testing

The next supervisory stress tests for significant institutions will be conducted in 2018. There will be two complementary exercises: a sample of large significant institutions will participate in the EU-wide stress test coordinated by the European Banking Authority; the ECB will conduct an additional stress test for the remaining significant institutions not participating in the EU-wide stress test. The stress test exercises will feed into the Supervisory Review and Evaluation Process (SREP), strengthen banks' own stress-testing and risk-management capabilities, and provide a quantitative assessment of banks' risk profiles across various risk categories.

The above-mentioned risks, as well as the supervisory priorities, should not be seen as an exhaustive list. Various activities not explicitly highlighted in this document are being carried out on an ongoing basis, for example in relation to IT and cybercrime risks. Moreover, differing supervisory activities may be required at bank level, taking into account credit institutions' specific risk profiles. Nonetheless, the supervisory 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.