

Written overview for the exchange of views of the Chair of the Supervisory Board of the ECB with the Eurogroup on 4 November 2024

Overview

The establishment of the banking union a decade ago, with the Single Supervisory Mechanism (SSM) as a key pillar, represents a strong and effective European response to the financial and sovereign debt crises. The SSM has been functioning well, enabling state-of-the-art, pan-European supervision that enhances the resilience of European banks while contributing to financial stability, and thereby growth, in Europe. Looking ahead, banks need to respond to a changing environment and ensure they are resilient against future risks. Supervision is being reformed to become more effective and efficient. Strong support from regulators is needed to improve the financial system's ability to deal with future crisis episodes by completing the banking union. Advancing the capital markets union will bring further benefits by enhancing integration and risk sharing.

The first decade of European banking supervision

Ten years ago exactly, on 4 November 2014, the Single Supervisory Mechanism (SSM) became operational after a year of intense preparations. Danièle Nouy, the first Chair of the Supervisory Board, said at the time: "We need the SSM to promote certainty in the banking sector and boost the confidence of European citizens and markets in the resilience of supervised banks."¹

The establishment of the SSM was a major institutional achievement for Europe. It marked the shift from national supervision to a single, European-level supervisor, along with a single rulebook. By unifying supervisory standards, the SSM has created a level playing field for banks across Europe. Close collaboration between national authorities and the ECB allows learning from best supervisory practices, while pooling resources and sharing knowledge. The SSM has a pan-European overview of banks, enabling comparisons and establishing benchmarks across banks all over Europe. This leads to better-informed supervisory decisions.

The resilience of European banks has strengthened over the past decade. This reflects stronger regulatory standards and improved supervision, more prudent capital and liquidity management, but

¹ Nouy, D. (2014), "[Marking the inauguration of the ECB's new supervisory responsibilities](#)", 20 November.

also the fact that fiscal and monetary policy have buffered recent shocks. The average CET1 ratio of significant banks, which is based on their risk-weighted assets, increased from 12.7% to 15.8% between mid-2015 and mid-2024. The leverage ratio, which is based on banks' total assets, also increased, albeit more modestly, from 5.3% in 2016 to 5.6% in 2023. Banks' liquidity buffers remained at comfortable levels also during the recent period of monetary policy tightening, and bank profitability has increased in the context of higher interest rates.

Non-performing loans (NPLs) have declined significantly. While cleaning up bank balance sheets took time, it ultimately formed a strong base for renewed growth dynamics in the countries that were particularly affected.² Overall, the NPL ratio of significant banks declined from over 7% in 2015 to less than 2% in 2023. Notably, corporate insolvencies and, by extension, NPLs even declined during the COVID-19 pandemic and the energy crisis, as fiscal support for firms and households mitigated the impact of these shocks. More recently, aggregate NPLs have increased slightly, reflecting heightened risks in vulnerable sectors such as the commercial real estate market.

Overall, the first decade of the SSM has shown the importance of the stability of individual banks for financial stability more broadly. Well-capitalised banks are the first line of defence against adverse shocks which can lead to financial crises with long-lasting economic, fiscal and social consequences. In the past, banking crises in Europe have been very costly with an average fall in GDP of around 7%.³ Financial stability, in turn, is a prerequisite for growth and innovation.⁴

There are no indications that European regulation and supervision have become too conservative to the point that they may be constraining lending or growth. On the contrary, well-capitalised banks are better equipped to provide funding to the real economy, including during economic downturns.⁵ They are better able to absorb losses, which reduces the risk of systemic banking crises which can lead to output losses and higher unemployment. Supervisory scrutiny reduces banks' incentives to take too much risk and improves financial stability, all while increasing market confidence, with positive effects on bank performance.⁶

² Ari, A., et al. (2019), "[The Dynamics of Non-Performing Loans during Banking Crises: A New Database](#)", *Working Paper Series*, No. 2019/272, IMF, and Balgova, M., et al. (2016), "[The economic impact of reducing nonperforming loans](#)", *Working Paper Series*, No. 193, EBRD.

³ The average output loss is approximately 8.5%, independent of the choice of cut-off date for the loss calculation (end of acute phase versus recovery phase), and the median output loss amounts to between 6% and 7% across all methods. The median output loss associated with banking crises is 7% (Lo Duca, M. et al. (2017/updated 2021), "[A new database for financial crises in European countries](#)", *Occasional Paper Series*, No 194, ECB). Moreover, crises are typically associated with lower medium-term growth (Reinhart, C. and Reinhart, V. (2015), "Financial Crises, Development, and Growth: A Long-term Perspective", *The World Bank Economic Review*, Vol. 29, Supplement, pp. S53-S76), while extreme global financial crises occurring with a 1% probability every five years lead to losses of between 2.95% and 4.54% of world GDP (Kapp, D. and Vega, M. (2014), "Real output costs of financial crises: A loss distribution approach", *Cuadernos de Economía*, Vol. 37, No 103, pp. 13-28).

⁴ See, for example, Agénor, P.-R. et al. (2018), "[The effects of prudential regulation, financial development and financial openness on economic growth](#)", *Working Papers*, No 752, Bank for International Settlements.

⁵ Budnik, K. et al. (2021), "[Macroeconomic impact of Basel III finalisation on the euro area](#)", *Macroprudential Bulletin*, No 14, ECB. See also Siciliani, P. et al. (2023), "[Paper 2: The links between prudential regulation, competitiveness and growth](#)", Bank of England Prudential Regulation Authority, 11 September. On the usability of buffers for bank lending, see Couaillier, C. et al. (2021), "[Bank capital buffers and lending in the euro area during the pandemic](#)", *Financial Stability Review*, November; and Couaillier, C. et al. (2022), "[Caution: do not cross! Capital buffers and lending in Covid-19 times](#)", *Working Paper Series*, No 2644, ECB.

⁶ Avgeri, I., Dendramis, Y. and Louri, H. (2021), "The Single Supervisory Mechanism and its implications for the profitability of European banks", *Journal of International Financial Markets, Institutions and Money*, Vol. 74, September

It is not for supervisors to promote the competitiveness of specific markets or business models. Good supervision ensures that banks remain safe and well-capitalized, that they can manage risks and have sustainable business models. It is individual banks that are competing with each other in different markets. Banks that are well-capitalised benefit from having a good reputation and are seen as trustworthy by investors and depositors.⁷

Supervisory priorities as banks need to adapt to a changing risk environment

The environment in which banks operate has changed significantly. Major shocks, including the COVID-19 pandemic, the Russian invasion of Ukraine and the energy crisis, have affected the macroeconomic environment and triggered structural changes. Geopolitical risks remain heightened. Climate change and the associated energy transition, as well as digitalisation, require deep economic transformations and materially affect the risks banks are facing. Banks need to adapt and strengthen their resilience – both financially and operationally.

The supervisory priorities of the SSM for 2024-26 reflect the changing environment in which banks operate.

First, cyberattacks on banks have become more frequent and severe. The number of significant incident reports at banks under European supervision nearly doubled between 2022 and 2023.⁸ That is why the SSM has conducted a cyber resilience stress test this year. While banks generally have response and recovery frameworks in place, improvements are needed with regard to business continuity, communication and recovery plans, assessments of dependencies on critical third-party ICT service providers, and estimating losses from cyberattacks.⁹

Second, banks need to respond to heightened geopolitical risks through their risk management and governance. The SSM has developed a framework to identify channels through which geopolitical risks affect banks.¹⁰ Geopolitical risks are difficult to predict and often not priced in by markets, but they can affect many risk areas. Traditional risk models do not capture the uncertainty around adverse geopolitical events, so banks need to be sufficiently resilient to withstand unexpected shocks. Several supervisory initiatives address geopolitical risks, including guidance on governance and risk

⁷ Berger, A. and Bouwman, C. (2013), “How does capital affect bank performance during financial crises?”, *Journal of Financial Economics*, Vol. 109, No 1, pp. 146-176. The impact of stress test results on market behaviour shows how banks’ capital resilience reinforces investor confidence. See Durrani, A. et al. (2022), “[Does the disclosure of stress test results affect market behaviour?](#)”, *Macprudential Bulletin*, No 17, ECB; and Georgescu, O.-M. et al. (2017), “[Do stress tests matter? Evidence from the 2014 and 2016 stress tests](#)”, *Working Paper Series*, No 2054, ECB.

⁸ Our latest cyber incident report will be published on the ECB’s banking supervision website in the near future.

⁹ ECB (2024), “[ECB concludes cyber resilience stress test](#)”, *press release*, 26 July.

¹⁰ Buch, C. (2024), “[Global rifts and financial shifts: supervising banks in an era of geopolitical instability](#)”, keynote speech at the eighth European Systemic Risk Board (ESRB) annual conference on “New Frontiers in Macroprudential Policy”, 26 September.

management of banks, work on cyber resilience and third party outsourcing, as well as guidance for banks' capital planning.

Third, banks need to further improve their management of climate-related and environmental risks. In 2020, the ECB published a guide setting out its supervisory expectations for how banks should manage these risks, in line with the Capital Requirements Directive. By the end of 2024, banks are expected to adequately assess the materiality of climate and nature-related risks, and they must include these risks in their internal governance, strategy and risk management. Most banks have made progress. But those that do not remediate shortcomings by a certain date can incur a periodic penalty payment for every day that they fail to do so. This is one of the areas where the ECB has started to use the more severe supervisory tools available in the legislation to make sure that banks are remedying deficiencies.

Ultimately, the viability of a bank depends on its financial and operational resilience. The currently good levels of profitability provide an opportunity to strengthen capital buffers and invest into the long-term sustainability of business models, in particular in terms of IT and cyber resilience.

In an environment characterized by a high degree of uncertainties, the strength of banks' governance and risk management has a key impact on resilience. Past banking crises have shown that adverse external shocks can expose fault lines in these areas. Therefore, the ECB developed a guide on governance and risk culture, which was recently issued for consultation and will be published in early 2025.¹¹ The draft guide clarifies supervisory expectations regarding management bodies and committees, the roles and responsibilities of internal control functions, risk appetite frameworks, and remuneration practices.

The changing environment has concrete implications for the way in which supervision is carried out in Europe. In its first ten years, the SSM has established a strong basis for rule-based and harmonised supervision. But over this past decade, supervisory procedures and methodologies have also become relatively complex.

Therefore, in May 2024, the Supervisory Board decided on a package of reforms to make European supervision more efficient, effective and intrusive.¹² Supervision will now focus more on relevant risks, building on a risk tolerance framework and a multi-year supervisory assessment that have been in place since 2023. Different supervisory activities will be coordinated more stringently, which will improve the communication with banks about supervisory findings and expectations. If banks fail to sufficiently remediate open findings, supervisory measures will be escalated faster. Stabilising existing methodologies and making better use of IT systems and analytics will help to make European supervision more efficient. These reforms will be phased in gradually and become fully effective in 2026.

The SSM is fully committed to reducing unnecessary complexity, provided it does not come at the expense of resilience. Simplification will be a guiding principle for new supervisory initiatives, and we

¹¹ ECB (2024), "[ECB consults on governance and risk culture](#)", *press release*, 24 July.

¹² Buch, C. (2024), "[Reforming the SREP: an important milestone towards more efficient and effective supervision in a new risk environment](#)", *The Supervision Blog*, ECB, 28 May.

are open to engaging with relevant stakeholders, including the industry. The ECB is also seeking to reduce and simplify the reporting burden on supervised entities. The Integrated Reporting Framework, which will integrate, standardise and minimise the burden and costs of the Eurosystem's statistical requirements for banks is a key project in this regard, which we fully support.¹³

Completing the banking union and promoting integration through a capital markets union

Maintaining a resilient financial sector that can support the real economy also in times of stress requires a further strengthening of European institutions. Europe operates under a unified regulatory framework for banks, which will be further enhanced with the upcoming finalisation of the Basel III framework. But the banking union remains incomplete. This weakens our ability to respond to future shocks. Europe must not wait for the next crisis to make decisive progress on the other two pillars of the banking union – gaps in bank resolution need to be closed, and a European deposit insurance scheme (EDIS) needs to be implemented.

Closing gaps in the resolution framework supports supervision and financial stability. It will make resolution more credible, thereby lowering the likelihood of banks failing and the associated costs if they do. An effective crisis management and deposit insurance framework (CMDI) would enable a better management of bank failures, including of mid-sized institutions. Making resolution work for a broader range of banks would minimise the probability that taxpayer money would cover losses. It would allow authorities to preserve economic value and protect financial stability. In this respect, the ECB shares the concerns expressed by the European Commission¹⁴ and the Single Resolution Board¹⁵ that the Council's position would not ensure adequate resolution funding in many cases and would thus not achieve the objectives agreed by the Eurogroup.¹⁶ The upcoming trilogues provide an opportunity to develop an effective framework for resolution that provides sufficient funding when needed to protect financial stability.

Without European deposit insurance as its third pillar, the banking union will remain vulnerable. A common insurance scheme would reduce the vulnerability of national deposit insurance systems to large shocks and weaken the link between banks and sovereigns. Citizens and firms that hold deposits in domestic and non-domestic banks would be equally covered. In an integrated market, the provision of cross-border services should not depend on the strength of the deposit insurance system. EDIS is a key complement to European supervision, which ensures that banks are covered by the same

¹³ For other examples of efforts that the ECB is contributing to with a view to enhancing supervisory data sharing and reducing reporting requirements, see the [Opinion of The European Central Bank of 21 June 2024 on the proposal for a regulation of the European Parliament and of the Council as regards certain reporting requirements in the fields of financial services and investment support \(CON/2024/21\)](#).

¹⁴ McGuinness, M. (2024), "[Speech at Bruegel event, 'Europe's banking union at 10: unfinished yet transformative'](#)", 25 June.

¹⁵ Laboureix, D. (2024), "[CMDI will enhance the EU crisis management framework if its tools are effective](#)", *VIEWES, The EUROFI Magazine*, 12 September.

¹⁶ See the [Eurogroup statement on the future of the Banking Union of 16 June 2022](#).

European Central Bank

Directorate General Communications

Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany

Tel.: +49 69 1344 7455, email: media@ecb.europa.eu, website: www.bankingsupervision.europa.eu

supervisory standards. The significant decline in legacy assets in the form of non-performing loans during the past decade is another key pre-condition for EDIS that is now met. It should also be noted that banks' contributions to the European deposit insurance fund would be risk-based, promoting banks' resilience and ensuring appropriate incentives.

The credibility of resolution would be further enhanced by setting up a framework for liquidity in resolution. A resolved bank should primarily rely on market funding for liquidity. Yet, during resolution, a public liquidity backstop can be critical to maintain confidence in the resolution process, as demonstrated by recent stress episodes in other jurisdictions.¹⁷ A resolved and adequately capitalized bank may not have sufficient eligible collateral to obtain liquidity through standard monetary policy operations. From a supervisory perspective, it is important that such a bank does not remain at risk of a liquidity-driven failure. However, the current arrangements within the euro area lack an effective public sector backstop mechanism to provide temporary liquidity funding, contrary to what is suggested by international standards.¹⁸ We would thus welcome if Member States were to resume discussions on setting up a European-level public backstop, to ensure liquidity is provided to banks subject to resolution in a timely and efficient manner.

Finally, making progress on the capital markets union project would benefit the integration of banking markets. Currently, differences in national rules and legislation that affect banks' activities pose significant obstacles to further integration. In a more unified, pan-European financial market, banks would be able to better capitalise on the advantages of the Single Market by providing their services across borders. Many aspects of the capital markets union proposal would serve to further align the conditions under which banks in Europe operate, including more harmonised insolvency legislation. Generally, more developed capital markets can complement bank lending and support risk sharing.

European banking supervision serves European citizens by keeping banks safe and sound, and by contributing to financial stability. A stable banking system is indeed a key foundation for economic growth. As a complement to European banking supervision, a sound macroprudential framework is also essential to ensure financial stability, and its forthcoming review offers an opportunity to strengthen, simplify and refine the framework further. By contrast, relaxing regulation and supervision to promote growth or competitiveness would weaken resilience, ultimately doing more harm than good.

¹⁷ See, for example, Hill, T. (2024), "[Reflections on Bank Regulatory and Resolution Issues](#)", remarks at the American Enterprise Institute, 24 July, as regards the cases of Silicon Valley Bank, Signature Bank and First Republic Bank; and Swiss National Bank (2023), "[Swiss National Bank provides substantial liquidity assistance to support UBS takeover of Credit Suisse](#)", *press release*, 19 March as regards the Crédit Suisse case. In both cases, the Federal Reserve and the Swiss National Bank are not expected to incur losses from the liquidity support they provided to banks placed under receivership or sold to an acquirer prior to their failure.

¹⁸ Financial Stability Board (2016), "[Guiding principles on the temporary funding needed to support the orderly resolution of a global systemically important bank \("G-SIB"\)](#)".

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