EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Written overview for the exchange of views of the Chair of the Supervisory Board of the ECB with the Eurogroup on 12 May 2025

Recent financial market developments are a clear reminder of how important a resilient and well-capitalised banking system is for the real economy. The announcements of new tariffs have led to a significant market adjustment, which shows how quickly the environment in which banks operate can change.

But a resilient banking system is not an end in itself – it is the foundation of a strong and competitive real economy and thereby promotes growth. Financial crises, as we have repeatedly seen over time, drag down the real economy and have long-lasting adverse effects.

The European approach to regulation and supervision ensures the stability of the European banking sector. European banks have weathered the storms of recent stress episodes, thanks to both their own resilience and the policy measures that were taken to support the real economy.

The resilience of European banks

The European banking sector's strong capital and liquidity positions allows it to take the risks necessary to provide services to the real economy. The ECB Annual Report on supervisory activities 2024 provides information on the resilience of the sector.[1] In terms of financial resilience, European banks are much better capitalised than they were before the global financial crisis. The aggregate Tier 1 ratio of significant banks more than doubled from around 8% in 2007 to just over 17% at the end of 2024.[2] The leverage ratio increased over the past decade, from just above 5% in 2016 to 5.9% in 2024. European banks' liquidity positions have remained comfortable, even during the recent monetary policy tightening. Profitability has increased, partly on account of higher interest rates.

But resilience goes beyond financial indicators, as it requires strong operational safeguards. The number of significant cyber incidents reported by banks has doubled since 2022, and the severity of attacks has increased. This highlights the need for state-of-the-art IT infrastructure and risk management systems. A cyber resilience stress test conducted in 2024 helped banks to assess and enhance their preparedness to respond to a successful cyberattack.[3] Moreover, many banks outsource critical services, and their ability to manage risks depends on the reliability of these outsourcing

[1] ECB (2025), *ECB Annual Report on supervisory activities 2024*, 27 March.

[2] The aggregate Tier 1 ratio is defined as banks' core capital, comprising Common Equity Tier 1 (CET1) capital and Additional Tier 1 capital, as a percentage of the total risk exposure amount. Information on the CET1 ratio is only available for the period since the start of European banking supervision. The CET1 ratio stood at 15.9% at the end of 2024, up from 10.9% in 2014.

[3] ECB (2024), "ECB concludes cyber resilience stress test", *press release*, 26 July.

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

arrangements. The Digital Operational Resilience Act (DORA), which came into effect in 2025, helps to ensure that outsourcing does not expose banks to undue risks.

Heightened geopolitical risks

As regards the risk landscape, heightened geopolitical tensions can have adverse effects on the banking sector. Banks' resilience to immediate macro-financial threats and severe geopolitical shocks is thus a key priority for European banking supervision. Geopolitical risk is not a new risk category, but it affects banks through all existing risk categories. Let me give you three examples.

First, geopolitical conflicts can expose vulnerabilities related to cyber risk and outsourcing concentration risks. This is why we conduct targeted reviews of supervised banks' cyber resilience and outsourcing arrangements. A new register of information and communication technology (ICT) third-party providers and a single reporting framework for ICT-related incidents are two key sources of information introduced under DORA.

Second, shifts in investor sentiment in response to geopolitical events expose banks to risks. A sudden repricing of risks can have adverse implications for banks' asset portfolios and the stability of market funding. We therefore monitor the impact of market developments on European banks. Although market adjustments in early April were not targeted at the European financial sector, valuations of European banks' stocks have displayed higher volatility. The funding costs of significant banks under ECB supervision have generally widened and have become more volatile for most debt instruments. That said, funding costs remain well below their historical peaks. We also monitor potential spillovers from non-bank financial intermediaries to banks, for example through margin calls. So far, despite the high level of market volatility, counterparty credit risk has remained largely contained.

Third, escalating trade tensions could increase credit risk and expose banks to losses. Elevated tariff-related risks have not yet had a significant impact on banks' balance sheets. The non-performing loan ratio stood at around 1.9% at the end of 2024, significantly lower than a decade earlier.[4] Initial signs of a deterioration in asset quality with regard to lending to small and medium-sized enterprises and commercial real estate have not spread across credit portfolios. It will, however, take time for the full impact of higher tariffs and heightened uncertainty to be reflected in banks' balance sheets. Increased costs and lower volumes of trade adversely affect the real economy, spreading via banks' credit exposures to the sectors and countries affected. Banks therefore need to remain vigilant and consider how adverse scenarios could affect asset quality.[5]

[4] The non-performing loan ratio includes cash balances at central banks and other demand deposits (computed for significant banks). The non-performing loan ratio excluding cash balances at central banks and other demand deposits stood at 2.3%.
[5] ECB (2025), "ECB to stress test 96 euro area banks in 2025", *press release*, 20 January.

Structural challenges

As banks respond to geopolitical risks, they must not lose sight of longer-term, structural challenges related to digitalisation and climate change. Both are also priorities for European banking supervision.

The increasing digitalisation of finance can provide new opportunities, particularly if combined with renewed political impetus to promote the Single Market. But banks are also being exposed to increased competition, which may lead to higher risks. Crypto-asset companies and other providers of financial services are often less well-regulated than banks but are increasingly venturing into banks' traditional market segments. This is putting pressure on banks' business models, highlighting the need for them to ramp up their investment in IT infrastructure and risk monitoring. We will continue to monitor banks' digitalisation strategies and how they are addressing the associated risks.

Banks have made progress in addressing climate and nature-related risks. But to be able to comply with supervisory expectations in this area, it is crucial that they have access to reliable information about the relevant risks. While we welcome the European Commission's aim of reducing administrative costs with its "omnibus" simplification package on sustainable finance, the amount of relevant information banks need for their risk management should be retained.

These examples show that we need to maintain a strong supervisory and regulatory framework that ensures banks remain resilient and allows them to continue providing their services to the real economy. The post-crisis reforms have served us well here. Banks are better capitalised. Microprudential and macroprudential capital requirements are set in a way that addresses the relevant risks. Capital buffers that can be released if loan losses materialise have been increased, thereby protecting banks' ability to lend in periods of stress. And a new resolution framework enables us to better deal with episodes of financial stress without spending taxpayers' money.

Enhancing efficiency and effectiveness

At the same time, we are open to improving the current framework without weakening it. In Europe, the interaction between common rules and national specificities may lead to undue complexity. We therefore support any simplification initiative that does not compromise financial stability.

In our own supervisory procedures we are implementing a comprehensive reform package to further increase the efficiency and effectiveness of our work. These reforms have tangible benefits for banks, including faster supervisory decisions, better coordination of different supervisory activities, improved communication and better use of digital tools. They make supervision more targeted and risk-based. And they span across all our activities, including onsite inspections.

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Of course, we remain focused on relevant risks and ensuring that supervisory findings are remediated swiftly. Effective remediation benefits financial stability. It is in the interest of each and every bank as it strengthens business model in the face of the current challenging environment.

Turning to reporting requirements, there is room for better coordination and data sharing to ensure that data are only collected once. We thus welcome the political agreement reached by co-legislators on better data sharing in financial services.[6] Several initiatives are underway and promise concrete progress: the Integrated Reporting Framework (IReF), which will eliminate overlaps in banks' statistical and prudential reporting, the Banks' Integrated Reporting Dictionary (BIRD), and the Joint Bank Reporting Committee that has been established by the ECB and the European Banking Authority (EBA), with strong involvement from the banking industry.

As regards regulation, we need to avoid a race to the bottom. Pressure to lower standards in order to maintain the competitiveness of European banks is mounting. However, lower standards would weaken banks, not strengthen them. Well-capitalised and well-supervised banks are in fact more competitive. With the implementation of the Basel framework, capital requirements will be better aligned with relevant risks. Europe is showing its commitment to adhere to international standards. Implementing the "last mile" of the Basel III framework does not put undue pressure on banks. Transition periods are relatively long, allowing banks to adjust their balance sheets. For some banks, capital requirements will actually decline.[7]

Strengthening the Single Market and the banking union

Looking ahead, we must turn international challenges into opportunities and strengthen the Single Market. Rather than a lower regulatory bar, European banks need a fully functioning pan-European market. The savings and investment union can allow banks to scale up by investing in technological infrastructure across lending, payments and other financial services. Harmonising rules that are relevant for banks – going beyond prudential rules – can be a powerful tool to simplify regulation and promote integration. This is particularly true in terms of developing capital market finance as a crucial complement to bank lending for financing innovation.

Closing the remaining gaps in the crisis management framework is key to making the system more resilient. The credibility of the resolution framework can be increased by bringing more banks under its umbrella while ensuring that sufficient funds – provided by the banking industry – are available for resolution. This is the intention of the European Commission's proposal, which we fully support. Credible resolution has direct benefits – setting the right incentives for banks, reducing the probability

[6] 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).
[7] See the Basel III monitoring report published on 4 October 2024 by the European Banking Authority (EBA) based on December 2023 data, which assesses the impact that the EU implementation of the Basel III framework will have on EU banks at the full implementation date, i.e. 2033. The results of the EBA report are broadly aligned with ECB internal estimates.

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of financial stress and making it less likely that taxpayers' money would have to be used to bail out banks. Similarly, a European deposit insurance scheme would help weaken the bank-sovereign nexus, enhance risk-sharing and ensure that savers throughout Europe have the same level of protection.

The European banking sector is at an important crossroads. After a decade of relative financial stability, banks are operating in a challenging environment. Geopolitical risks are increasing. Competitive pressures and the digitalisation of financial services require banks to invest in making their business models future-proof. European banking supervision is playing its part in ensuring that European banks are resilient – financially and operationally – and able to support the real economy in times of stress.

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