



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

ECB Annual Report on supervisory activities

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Foreword by Christine Lagarde, President of the ECB



The financial crisis and the sovereign debt crisis showed how quickly and forcefully problems in the banking sector can spread across our monetary union and affect the economy and people. As part of the response, which aimed to ensure that banks are healthy and the banking system resilient, policymakers created European banking supervision, which is now in its sixth year.

In this short time, European banking supervision has developed from a start-up to a more mature institution, well established as a rigorous and consistent authority. Since 2014 risks have been reduced substantially: stocks of non-performing loans (NPLs) have declined by almost 50% and bank capital has increased significantly across the euro area. The handling of NPLs is a prime example of how a European approach has helped to address crisis legacies that affected many banks in different countries.

By making banks healthier, European banking supervision has also supported monetary policy. Stronger banks provide more lending to the economy, which helps strengthen monetary policy transmission. And by supporting productive risk-taking but countering excessive search for yield, European banking supervision helps contain risks to financial stability and enables the current monetary policy stance to deliver our price stability mandate.

Despite the significant supervisory efforts in recent years, there are still challenges ahead in 2020 that require stronger action by banks. Bank profitability remains low, which, if prolonged, may affect the resilience of the banking sector as a whole. Reducing excess capacity, reducing remaining NPL stocks and adapting business models and IT standards for the digital age are part of the answer.

The other part of the answer is to put in place the right institutional framework to foster a more efficient and integrated banking market. The foundation of the banking union, the single rulebook, remains fragmented along national lines. Moreover, in the absence of one of the pillars of the banking union, namely a European deposit insurance scheme, the integrity of the single banking market may continue to be called into question, thus hindering further cross-border integration.

In addition there are longer-run challenges, such as climate change, which are all-encompassing and no one can turn a blind eye to them. Climate change will affect all parts of the economy, including the banking system. So this is clearly an issue that we have to tackle in a joint effort – across borders, across institutions and across sectors.

Introductory interview with Andrea Enria, Chair of the Supervisory Board



You became Chair of the ECB's Supervisory Board at the beginning of 2019. What is your main takeaway after one year, and what is still on your to-do list?

My main takeaway is this: European banking supervision works. The idea of supervising banks at the European level is sensible and practical, and the pillars of our supervisory model are sound. But now, after five years, we are transitioning from the start-up phase to a more mature stage. Therefore, we need to finalise the large foundational projects and focus on stabilising our approach and our risk-based supervision. Along the way, we will strive to further simplify processes so as to reduce the burden for both supervisors and banks – which also means relying more on new technologies. And we will endeavour to enhance both the transparency and the predictability of our actions. We are still dealing with a banking sector that is struggling with low profitability and a banking union that is less integrated than it should be – helping to address these big items is also high on our to-do-list.

What is the aim of making European banking supervision more transparent, and how can it be achieved?

With the banking union, we have introduced a new model across the entire euro area. My impression is that banks and investors still find it difficult to fully understand this new model. This means that we supervisors need to bring greater clarity to what we do, why we do it and how we do it. This will also make us more predictable; after all, banking supervision should be a source of stability, not of surprises. Under the new institutional framework for crisis management, investors are first in line to absorb losses, instead of banks relying on government support. Therefore, investors need to be better informed about the position of banks with regard to the triggers for supervisory action. We took a first step towards enhancing transparency in January 2020: for the first time ever we published bank-by-bank information on the supervisory capital requirements resulting from our Supervisory Review and Evaluation Process, and provided further details on our supervisory methodology. This gave banks and investors a deeper insight into the supervisory assessment of European banks.

Turning to the banks, profitability is still high on the list of challenges. Do you see a light at the end of the tunnel?

I think we are still quite deep inside the tunnel, unfortunately. The low profitability of banks in the euro area is, without a doubt, a serious concern for me as a supervisor. Banks that are low in profits cannot generate capital internally and, because of their low market valuations, they might find it difficult to access equity markets when they need to. As a result, they become more vulnerable. It is obvious that this is not a great time for banks to earn money in the traditional way, but this difficult external environment is not going to change any time soon. So, banks need to accept and

adapt: they need to accept that the situation is as it is and that they may need to adapt their business models to keep them viable. The most competitive banks are those that are cost efficient, that are, as we say, strategically well steered and that are embracing some form of digital transformation. I'm afraid to say that other banks are moving quite slowly. Therefore, we will keep a close eye on their progress and will put pressure on those lagging behind.

Is cost-cutting part of the toolbox for banks? What can banks do to bring down their costs?

Becoming more cost efficient should be at the core of banks' self-help measures. Euro area banks still have high cost-to-income ratios: on average, they spend around 65 cent to earn a euro, much more than their international competitors. However, the key point is to avoid making savings in the wrong area. Cutting down on risk management, for example, is not an option. Likewise, investing in new technologies is still important, as it can help to reduce costs further down the road. Apart from that, there are some more radical ideas floating around. Banks could, for instance, pool services which are of a utility-like nature. This might help them to achieve economies of scale and thus reduce costs. Of course, the big lever to pull is fully fledged mergers. If done well and between the right banks, mergers can also help to bring down costs and refocus the business model.



So, do we need to see more consolidation, i.e. more mergers between banks?

Well, it seems obvious to me that the euro area banking sector needs to consolidate. Excess capacity is part of the profitability problem, so it needs to be removed. So yes, bank mergers, whether within or across borders, would be useful. National mergers can unlock greater efficiency gains thanks to overlapping distribution networks, for instance. Cross-border mergers, by contrast, can help diversify sources of revenues and, therefore, risks. As a result, banks and the whole financial system would become more resilient to shocks. I understand that, from an individual bank's perspective, low profitability and market valuations make it difficult to argue the case for mergers. But, from the system-wide perspective, it is unlikely that the reasons for

the low profitability and market valuations can be addressed without some form of consolidation within the sector.

Is there anything the ECB can do?

While I do see an economic rationale for consolidation, it is not my job to push for it or to rein it in. I can only address potential obstacles to mergers, especially if they fall within my remit. Some seem to think that the ECB tries to discourage mergers by requiring higher levels of capital from merged entities. This is a misconception which I have been trying to dispel for some time now. We will further clarify our policies on mergers later this year. For example, how do we treat goodwill? How do we look at capital adequacy in merging banks? These are the kind of questions we will be addressing to provide more clarity.

Is there any chance of further integration in Europe; will the banking union be finalised, for instance?

The banking market remains fragmented along national lines – even in the euro area. To a large extent, this is a legacy of the ring-fencing measures taken during the financial crisis. They have fuelled the fear that, when a shock hits a bank, capital and liquidity might flee a country and leave the local taxpayers with the bill. Here, we need to make further progress to complete the safety net within the banking union. Some progress has been made in setting up a backstop for the Single Resolution Fund, but the issues of liquidity in resolution and, in particular, the establishment of a European deposit insurance scheme remain very controversial. I hope that progress will be made soon, but I know how difficult these discussions are.

This begs the question: what else can we do? If the framework isn't going to change, can we do anything within it? One option might be to take concerns of host countries into account when setting the prudential requirements for entire banking groups: if a local risk does not diversify away or net out in consolidation, it could be captured in group requirements. Another option might be to make intragroup financial support agreements part of banks' recovery plans. If we want there to be integrated asset and liability management in good times, we need to make sure that it would also be in place in a crisis, via credible arrangements that can be enforced by the ECB.

So does the new European framework for crisis management help in this regard?

Having such a framework is clearly an improvement. But the new framework still has a few gaps at the European level. In fact, it is still a national framework to a large degree. And it is this fragmentation that makes it less effective and less efficient than it could be. The liquidation of banks, for instance, follows national approaches which still differ quite a lot. Likewise, the roles of deposit guarantee schemes and institutional protection schemes differ, as do policy stances towards bailing out banks with public money. This does not make for a level playing field; instead, it makes it more difficult for us supervisors to apply the tools we have. So we do need to move towards a more harmonised system. We could move a bit closer to the approach of

the United States, for instance, and establish an administrative liquidation tool at the European level.

Advancing towards a single European banking market will likely require granting host countries adequate safeguards that make them feel comfortable about lowering national barriers. Tackling those issues and improving crisis management might lower the perceived initial costs of pulling down some of the fences that still surround national banking sectors. In the meantime, we have a duty to explore all available avenues to encourage application of the current legislative framework in a way that is more supportive of group-wide asset and liability management within the banking union. For instance, we should find ways of exercising the latitude of discretion left to supervisors in some areas (e.g. waivers of liquidity requirements on a solo basis or intragroup exemptions to large exposures requirements) to support group-wide management of assets and liabilities within the banking union, which provides reassurance that, in a crisis, group support would be forthcoming.

Banks often claim that strong regulation is part of their profitability problem. Is this a valid claim from your point of view?

Regulatory reform was absolutely necessary given the weaknesses in the previous framework that were exposed by the financial crisis. So, when we discuss the costs of regulation, we also have to discuss the costs of a crisis. It is true that banks bear the one but not necessarily the other, and this was part of the original problem. In my view, we have reduced the likelihood of crises at a fair price. So yes, I do subscribe to regulatory reform, including the final package of Basel III. And I have repeatedly called for it to be implemented faithfully here in Europe.

That being said, I do acknowledge the burden banks are expected to carry when it comes to reporting requirements. The ECB has already made serious efforts to ease this burden, particularly for smaller and less complex banks. Yet, there are two issues still to resolve. The first is the number of authorities requesting data from banks. If the ECB, national supervisors, national central banks and macroprudential authorities were to coordinate better, the burden for banks could be reduced. The second is that there is not just regular reporting, banks are also subject to ad hoc data requests. Here we need to improve the way we plan, prioritise and communicate upcoming requests.

Apart from profitability, what other issues should banks address?

Governance issues are very often identified as an area of concern in our assessments. Best practice begins with remuneration schemes that are in line with the risk appetite of a bank, and goes all the way to supplying the board with accurate and timely risk data. And in the light of a few recent and prominent cases, anti-money laundering controls and procedures are still insufficient. To be clear: we expect all banks to have strong governance and effective risk management frameworks in place. Problems in these areas quickly spread elsewhere and can cause a lot of trouble. Operational risk is a good example. Here, the situation became worse in 2019, and most operational losses stem from conduct risk, which often links back to governance issues. Another source of operational risk is IT. As

banks become more digital, they become more exposed to cyber risks – or to generic IT risks stemming from outdated systems, for instance. This is something we take very seriously and we carry out a number of on-site inspections dedicated to IT.

Is climate change a concern for banks and bank supervisors?

Climate change is a concern for all of us, and, consequently, there are a number of far-reaching ideas floating around. Some argue, for instance, that regulation should feature a green supporting factor; in other words, capital requirements for green assets should be lower. From a supervisory point of view, our job is to ensure that banks are safe and sound. Therefore, whatever we do has to be based on risks, and these risks need to be carefully analysed before we jump to any policy conclusions.

So the key question is whether there are activities or assets that are more exposed to climate-related and environmental risks than others. Here, the EU taxonomy on sustainable activities currently under development is an important first step as it will allow banks to identify and report climate-related and environmental risks. This, in turn, will help to increase transparency. The second step would then be to cover any such risks that are reflected in the banks' risk management or in our Supervisory Review and Evaluation Process. Finally, these risks could also be part of supervisory stress tests. Work is ongoing in all of these areas, and much of it takes place at the European level or even at the global level. For instance, the ECB is a member of the Network for Greening the Financial System, which comprises more than 50 institutions from around the world.

1 Banking supervision in 2019

1.1 The euro area banking sector in 2019

1.1.1 General resilience of euro area banks

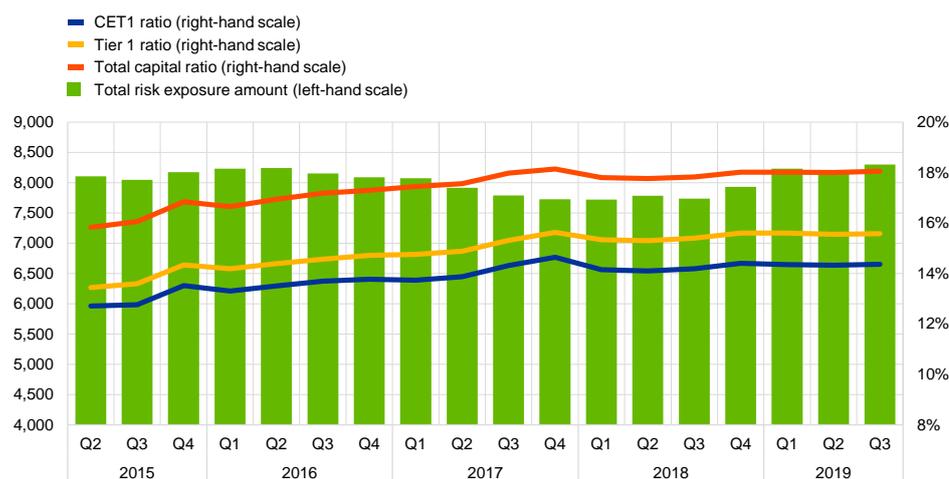
Over the most recent reporting periods, capital and leverage ratios have been stable at the aggregated level

Over the most recent reporting periods, capital ratios have been stable at the aggregated level (see [Chart 1](#)). The total capital ratio stood at 18.05% in the third quarter of 2019, slightly up from 17.83% one year earlier. Similar developments can be observed for the Common Equity Tier 1 (CET1) ratio and Tier 1 ratio, with minor fluctuations.

Chart 1

Total capital ratio of significant institutions (transitional definition)

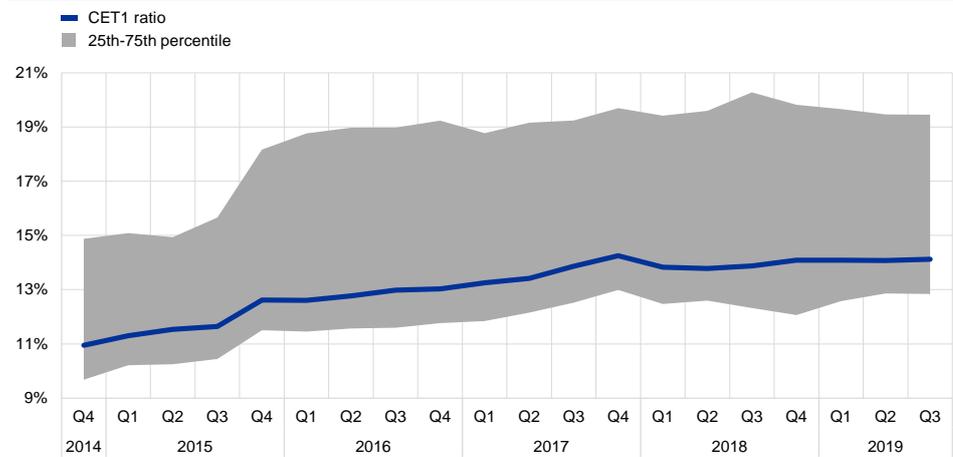
(left-hand scale: EUR billions; right-hand scale: percentages)



Source: ECB.

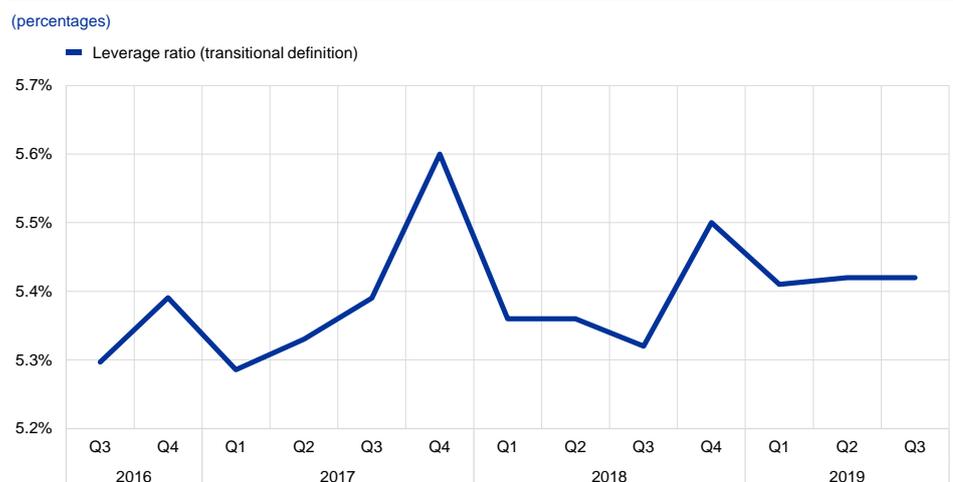
The weighted average fully-loaded CET1 ratio of significant institutions (SIs) remained stable between the fourth quarter of 2018 and the third quarter of 2019 at 14.1% (see [Chart 2](#)). The leverage ratio rose slightly over the first three quarters of 2019, standing at 5.42% in the third quarter, compared with 5.32% one year earlier (see [Chart 3](#)).

Chart 2
CET1 ratio of SIs



Source: ECB.

Chart 3
Leverage ratio of SIs

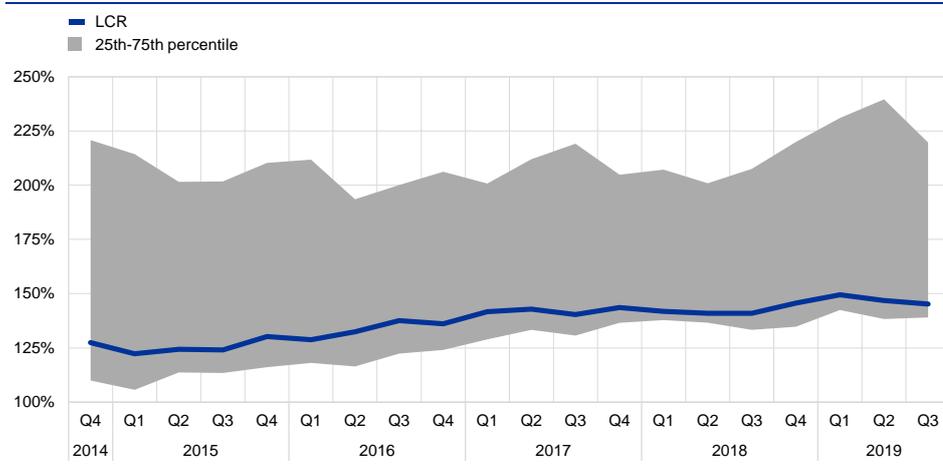


Source: ECB.

The liquidity coverage ratio for the aggregated group of SIs continued its upward trend

The liquidity coverage ratio (LCR) for the aggregated group of SIs continued its recent upward trend, standing at 145.16% in the third quarter of 2019 – a 4.23 percentage point increase on the same period in the previous year (see **Chart 4**).

Chart 4
LCR of SIs



Source: ECB.

ECB Banking Supervision conducted its sensitivity analysis of liquidity risk – stress test 2019

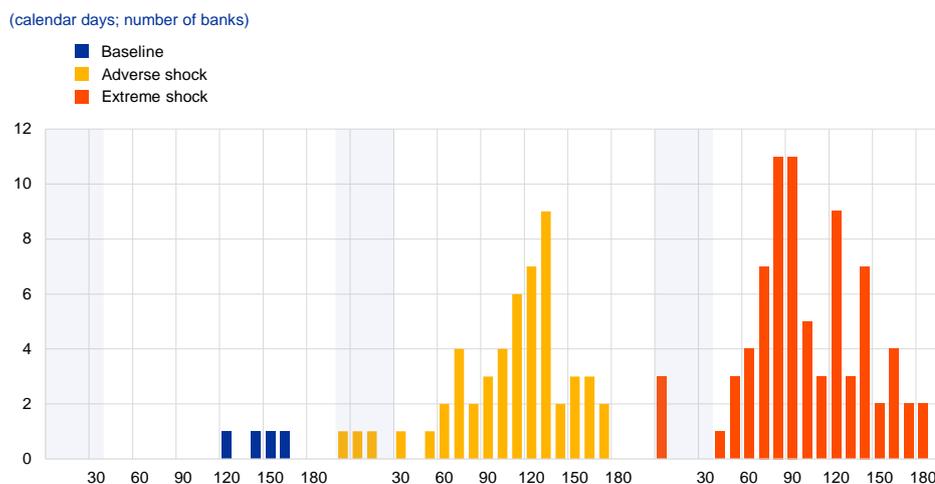
In 2019 ECB Banking Supervision conducted an in-depth assessment of banks' short-term liquidity risk as its annual supervisory stress test. The **sensitivity analysis of liquidity risk – stress test 2019** assessed the ability of SIs to withstand an idiosyncratic liquidity shock. Banks' resilience to an adverse and an extreme shock was assessed by means of hypothetical stress factors calibrated on the basis of recent crisis episodes, without any reference to monetary policy decisions.

The ECB found that banks had comfortable liquidity positions overall

Most of the 103 banks that took part in the exercise reported **ample liquidity buffers and relatively long survival periods** (see **Chart 5**). The median reported survival period was around six months in the adverse shock scenario and around four months in the extreme shock scenario (see **Chart 6**). Long survival periods under stress give banks more time to deploy their contingency funding plans.

Chart 5

Distribution of banks with a survival period of less than six months for each scenario

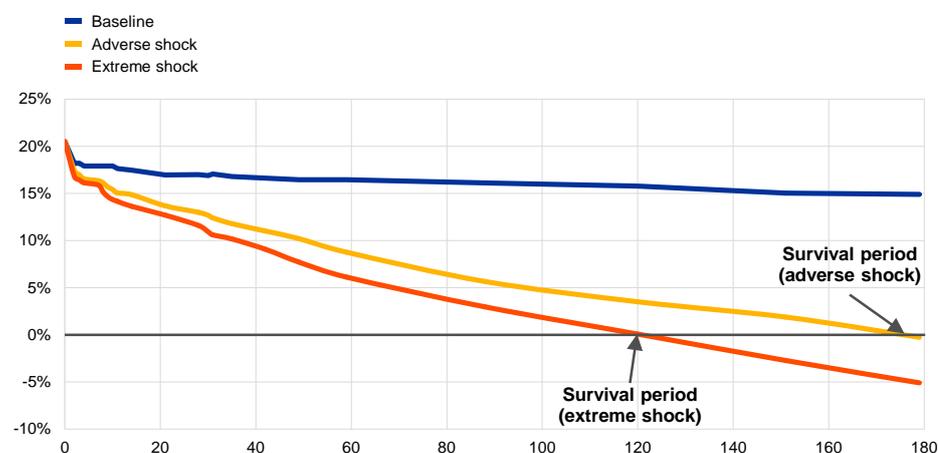


Source: ECB.

Notes: The survival period is defined as the period up to the first day on which cumulated net liquidity outflows exceed the available counterbalancing capacity. The longer the survival period, the better the bank's prospects of surviving a liquidity shock.

Chart 6 Median net liquidity position

(calendar days; median net liquidity position as a percentage of total assets)



Source: ECB.

Notes: The net liquidity position refers to the algebraic sum of cumulated net outflows and available counterbalancing capacity. The survival period is the period up to the first day on which the net liquidity position turns negative.

There are a number of issues, however, that require further attention

The overall liquidity position of SIs remained comfortable throughout 2019, but there are a number of issues that nonetheless deserve further supervisory scrutiny: (i) a few banks reported low liquidity positions in some foreign currencies (e.g. the US dollar); (ii) certain banks provide net liquidity to group entities outside the euro area, which exposes them to ring-fencing risk; (iii) several banks use optimisation strategies which improve their compliance with liquidity ratios, but provide only time-limited liquidity support; (iv) collateral management practices, including the ability to quickly mobilise unencumbered liquidity reserves, could be improved in many cases; and (v) banks may underestimate the negative impact on liquidity of a credit rating downgrade. The exercise also helped to uncover data quality issues related to liquidity reporting, which will help to improve the quality of supervisory information in the future.

The results served as input to the annual assessment of banks' liquidity and will be followed up on by supervisors

The results of the exercise fed into the assessment of banks' liquidity adequacy and risk governance. However, they did not directly affect supervisory capital requirements. Supervisors have taken the appropriate quantitative and qualitative liquidity measures to address the issues raised by the stress test. Supervisors discussed the conclusions with each bank as part of the annual Supervisory Review and Evaluation Process (SREP) and will follow up on specific findings as needed.

LSIs also enjoyed comfortable liquidity and capital positions in 2019

Less significant institutions (LSIs) were also shown to enjoy comfortable liquidity and capital positions in 2019, with an average LCR of over 200% in the second quarter and an average CET1 ratio of around 17%. However, some issues were identified that deserve close monitoring, such as significant maturity mismatches and the reliance on liquidity groups to pool available buffers across members.

The quality of bank assets further improved in the course of 2019

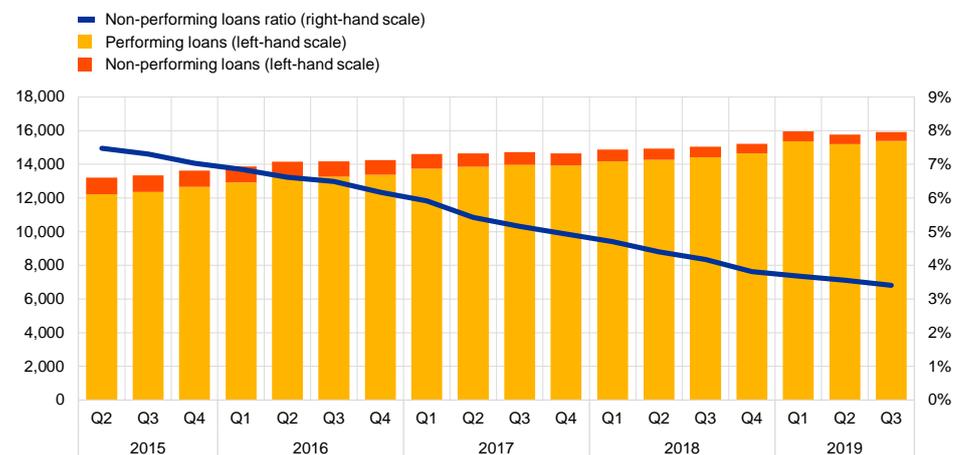
Finally, the quality of banks' assets improved, with the overall non-performing loans ratio (NPL ratio) steadily decreasing from 4.17% in the third quarter of 2018 to 3.41% in the third quarter of 2019 (see **Chart 7** and Section 1.2.2). The dispersion of the

NPL ratio across banks also decreased significantly over the same period, as shown in **Chart 8**.

Chart 7

Asset quality: non-performing loans and advances of SIs

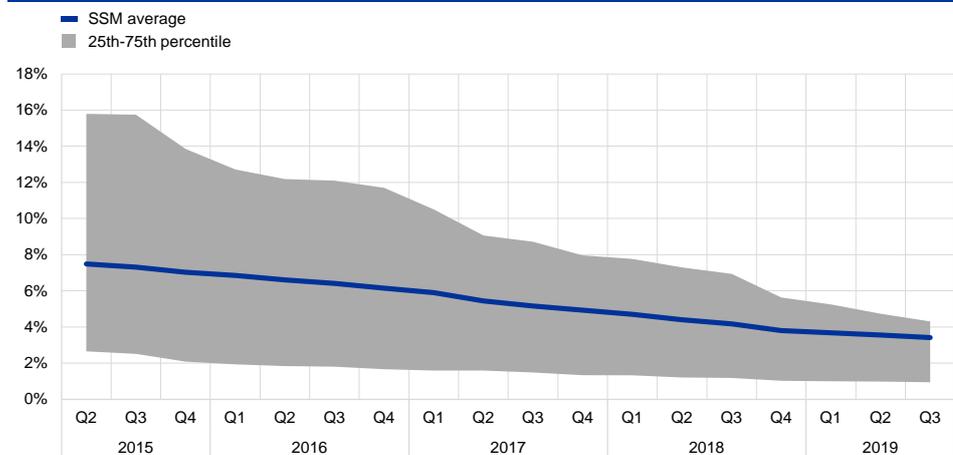
(left-hand scale: EUR billions; right-hand scale: percentages)



Source: ECB.

Chart 8

Distribution of SIs' NPL ratios



Source: ECB.

1.1.2 General performance of euro area banks

Profitability of SIs decreased by the second quarter of 2019, while cost-to-income ratios remained relatively high

In 2019 the profitability of euro area SIs remained subdued, with the aggregate annualised return on equity standing at 5.8% in the third quarter of 2019, down slightly from 6.2% in the fourth quarter of 2018 (see **Chart 9**).¹ On aggregate, the

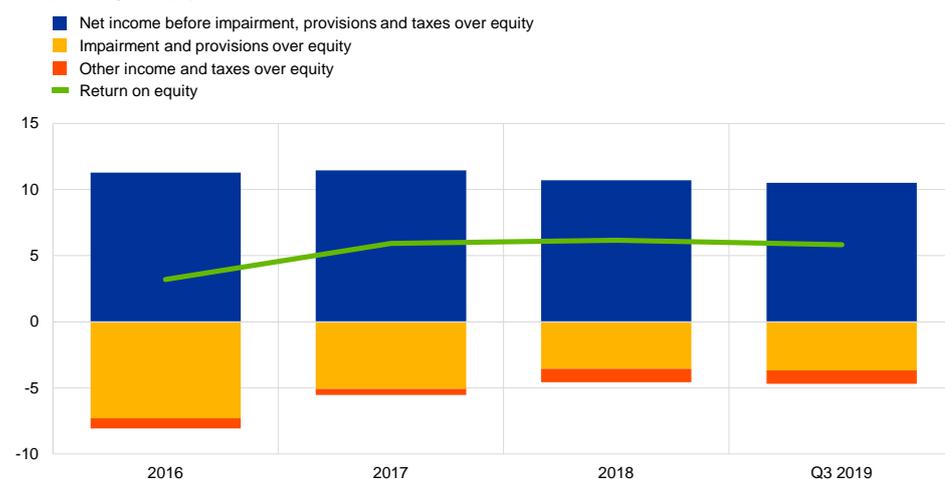
¹ For a discussion on SIs' performance in 2018, see "Profitability numbers are looking up, but not enough", *SSM Supervision Newsletter*, ECB, August 2019, and for a forward-looking analysis, see "Profitability: banks expect to remain under pressure", *SSM Supervision Newsletter*, ECB, November 2019.

return on equity of euro area SIs was lower than that of US banks and, in many cases, it was also below their self-reported cost of equity. This is also reflected in the low valuations of most publicly listed SIs, which had price-to-book ratios of well below one, making it hard for them to tap equity markets without significantly diluting existing shareholders.

Chart 9

SIs' return on equity broken down by income source

(as a percentage of equity)



Source: ECB supervisory banking statistics.
 Note: The data for the third quarter are annualised.

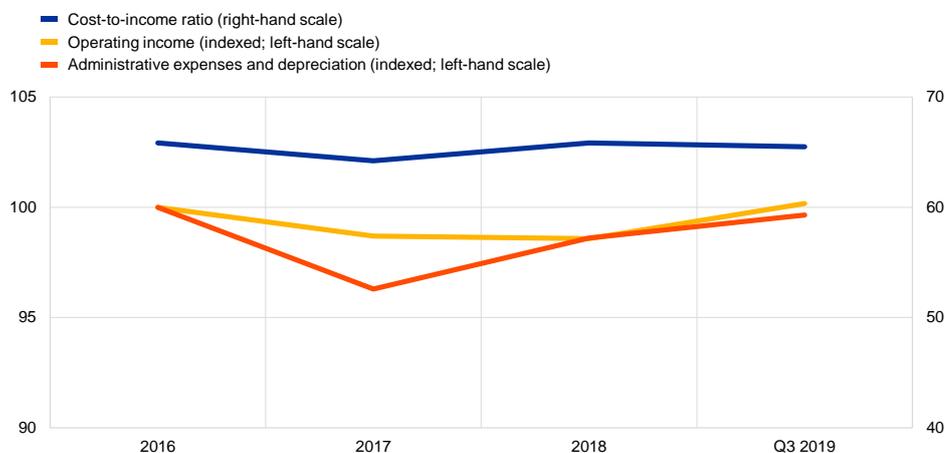
Amid ongoing concerns about rigid cost structures, net income before impairment, provisions and taxes decreased relative to equity, but was broadly flat in absolute terms. In addition, increases in trading income were offset by negative net or other operating income.

SIs' cost-to-income ratios remained relatively high (see [Chart 10](#)), reflecting not only cost inefficiencies, but also restructuring expenses and costs related to investments in digitalisation. In the medium term, digitalisation can improve cost efficiency and enable banks to offer new products and services. It is also important for the sustainability of business models, but it entails upfront costs and the benefits are only realised over time.

Chart 10

SIs' cost-to-income ratios and indexed components

(percentages)



Source: ECB supervisory banking statistics.

Impairment and provision flows rose sharply year on year in the first three quarters of 2019, ending the downward trend of recent years that resulted in the low levels observed in 2018, and putting further pressure on profitability. The increase was across the board, including in countries with low stocks of non-performing loans (NPLs), owing mainly to loan loss provisions for new NPLs and impairments to banks' non-financial assets associated with their restructuring programmes.

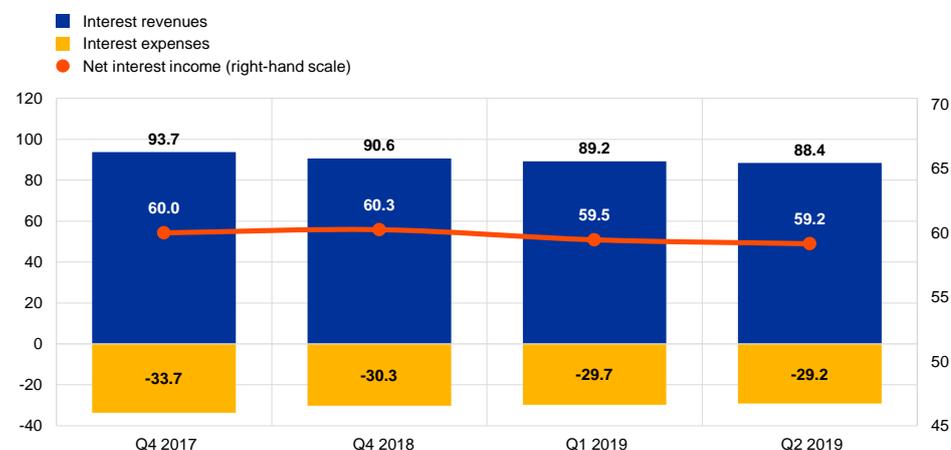
Like SIs, euro area LSIs also recorded a sustained low level of profitability. In particular, LSIs' dependence on interest income exposes them to the negative effects of a prolonged period of low interest rates, and their smaller size and predominantly regional focus reduce their ability to diversify their sources of income and reduce costs. The latest figures show an average return on equity for LSIs of just 5.1% in June 2019, which is only marginally better than the 4.7% recorded at the end of 2018.² On the assets side, interest revenues, which represent the largest income component for LSIs, continued to decline in 2019 (see [Chart 11](#)). However, net interest income decreased only slightly, owing to a simultaneous decrease in interest expenses. Finally, like for SIs, provision flows for LSIs also rose sharply, increasing by around 20% year on year in the first half of 2019. This notwithstanding, LSIs' cost of risk, measured as the ratio of financial impairments to total loans, remains relatively low at around 0.1% (which is less than one-third of that of SIs).

² An overview of LSIs' performance in 2018 is provided in the [Risk report on less significant institutions](#).

Chart 11

Evolution of LSIs' interest revenues, interest expenses and net interest income

(EUR billions)



Source: ECB supervisory banking statistics.

Notes: The chart is based on a changing sample of LSIs. Data for the first and second quarters of 2019 are annualised using a four-quarter trailing method.

LSIs continued their efforts to contain overall expenditures (see [Chart 12](#)). Nevertheless, their cost-to-income ratios remained relatively high at 72% in June 2019. This is fundamentally unchanged from the end of 2018 (73%) and still higher than those of SIs. With regard to asset quality, the large stocks of NPLs held by some LSIs remained a concern. Overall, progress on the clean-up of balance sheets slowed somewhat, with the gross NPL ratio standing around 2.71% in the second quarter of 2019, down 11 basis points from December 2018.

Chart 12

Overview of LSIs' costs

(left-hand scale: EUR billions; right-hand scale: percentages)



Source: ECB supervisory banking statistics.

Notes: The chart is based on a changing sample of LSIs. Data for the first and second quarters of 2019 are annualised using a four-quarter trailing method.

1.1.3 Main risks in the banking sector

Geopolitical uncertainties, NPLs and cybercrime and IT disruptions were identified as the key challenges for banks in 2019

In close cooperation with the national competent authorities, ECB Banking Supervision identifies each year the key risks for banks in the short and medium term (over a horizon of two to three years). These risks are then published as the Single Supervisory Mechanism (SSM) Risk Map. The 2018 exercise identified the following key risk drivers for the years 2019 and beyond: geopolitical uncertainties, the stock of NPLs and the potential build-up of future NPLs, as well as cybercrime and IT disruptions. Other risks identified were repricing in financial markets, the low interest rate environment and banks' reaction to regulation.

Geopolitical uncertainties were a major risk to the euro area economy

Geopolitical uncertainties were viewed as a major risk to global financial markets and the euro area economy. Escalating trade tensions and heightened geopolitical uncertainty had an adverse impact on global GDP growth, which remained subdued throughout 2019. Furthermore, Brexit continued to be an important source of uncertainty, requiring banks and supervisors to prepare for all possible scenarios. Together with greater political uncertainties in some euro area countries, these developments continued to weigh on the **euro area economic outlook**, which deteriorated in 2019.

The NPL ratio continued to fall in the euro area

Despite the continued decline in the euro area NPL ratio, the **high levels of NPLs** held by a large number of euro area banks remained a concern. With the implementation of their NPL reduction strategies, those banks made good progress in reducing their stocks of legacy NPLs. In the third quarter of 2019, the NPL ratio of SIs dropped to 3.41%, but remained above pre-crisis levels. Thus, further efforts are needed to ensure that NPL strategies are pursued, particularly as real GDP growth is expected to remain subdued in the near term.

Easing lending standards could lead to a build-up of future NPLs

Banks' constant search for yield could result in a **build-up of future NPLs**. The trend of easing lending standards seen in previous years weakened somewhat in 2019. That said, in two quarters of 2019 euro area banks still reported a slight easing of credit standards for loans to enterprises and loans to households for house purchase.³ Furthermore, SIs became even more active in the leveraged loan market, accepting record low levels of covenant protection.

IT and cybercrime-related risks are rising as a result of ongoing digitalisation

The trend towards digitalisation of financial services is potentially weakening banks' resilience to **cybercrime and IT disruptions**. Banks are relying more and more on digital processes and need to adopt additional technologies to become more efficient and meet changing customer preferences. However, a number of SIs are still working with legacy IT systems and need to overhaul their IT infrastructures, which might slow down this process and/or make it more costly. At the same time, there are additional risks stemming from cybercriminals with a strong collective malicious intent.

Substantial risk of repricing in financial markets persisted

There was still a substantial risk of a significant **repricing in financial markets** in 2019 amid the ongoing search for yield. Risk premia remained subdued throughout

³ For further information, see the [euro area bank lending survey](#).

Banks' profitability remained subdued

the year, despite the episodes of increased financial market volatility owing to escalating trade tensions. Although **public sector debt sustainability** improved in the euro area as a whole, debt levels remained elevated in several individual countries, leaving them vulnerable to the potential repricing of sovereign risk.

SIs continued to struggle with low profitability as the prospect of a **prolonged period of low interest rates** and intense competition weighed further on their ability to generate income. In 2019 over half of the SIs generated a return on equity below their estimated cost of equity. Despite the slight improvement in return on equity in 2018, they revised their profitability projections downwards, suggesting a drop in their forecasted return on equity for 2019 and 2020, and could revise them even further downwards if macroeconomic conditions in the euro area deteriorate.

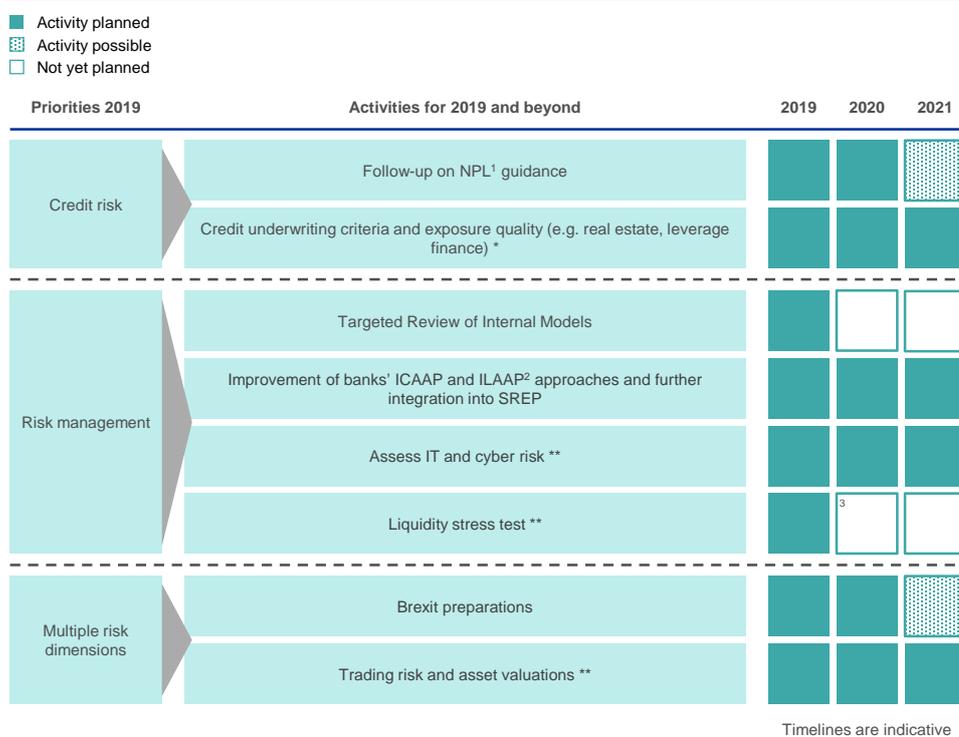
While there was some evolution of the risks in 2019, the key risk drivers described above remain highly relevant for the coming years (see Section 1.6 for the risk outlook for 2020 and beyond).

1.2 Supervisory priorities and projects in 2019

1.2.1 Overview of supervisory priorities for 2019

The supervisory priorities set out focus areas for ECB Banking Supervision for the year ahead. They are discussed and approved by the ECB's Supervisory Board and build on an assessment of the key risks faced by supervised banks (see Section 1.1) in the current economic, regulatory and supervisory environment. They also take into account thematic trends identified by the Joint Supervisory Teams (JSTs) in their day-to-day supervision and insights from on-site missions. The priorities are reviewed on an annual basis and are an essential tool for coordinating supervisory actions across banks in an appropriately harmonised, proportionate and efficient manner. Thus, they contribute to a level playing field and a stronger supervisory impact. The supervisory priorities for 2019 and related projects are presented in the remainder of this section (see also **Figure 1**).

Figure 1
Supervisory priorities 2019



Source: ECB.

* Amended activity

** New activity/focus area in 2019

1) Non-performing loans.

2) Internal capital and liquidity adequacy assessment processes.

3) Although a specific liquidity risk stress test is not yet planned, the EU-wide stress test exercise will be conducted in 2020 and will cover a variety of risks.

1.2.2 Work on NPLs

In 2019 the ECB decided to revise its supervisory expectations for prudential provisioning of new non-performing exposures (NPEs) specified in the “Addendum to the ECB Guidance to banks on non-performing loans” (hereinafter referred to as the “Addendum”). That decision was made in order to take account of the adoption of Regulation (EU) 2019/630⁴ that outlines the Pillar 1 treatment for NPEs. The new regulation entered into force on 26 April 2019 and complements existing prudential rules. The revision of the Addendum followed the ECB’s commitment to reconsider supervisory expectations for new NPEs once the new legislation on the Pillar 1 treatment of NPEs had been finalised.

Three main differences between the new Pillar 1 NPE treatment and the ECB’s Pillar 2 approach were identified.

[Key differences between Pillar 2 and Pillar 1 approach](#)

⁴ Regulation (EU) 2019/630 of the European Parliament and of the Council of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures (OJ L 111, 25.4.2019, p. 4).

- First, the Pillar 1 NPE treatment requires all banks to make a deduction from own funds where NPEs are not sufficiently covered by provisions or other adjustments in an automatic manner. This is a legally binding requirement, whereas the ECB's supervisory expectations for SIs' prudential provisioning under the Pillar 2 approach are not legally binding. In particular, the supervisory expectations are (i) a starting point for supervisory dialogue, (ii) dependent on a case-by-case assessment, and (iii) a supervisory measure that may be applied under the Pillar 2 framework in the SREP cycle.
- Second, the Pillar 1 NPE treatment and the supervisory approach to new and legacy NPLs under Pillar 2 have differed slightly in terms of the calendar calibration. In addition, there were also different paths to reach the adjustments in the case of the ECB's Pillar 2 approach and full implementation in the case of the Pillar 1 framework.
- Third, there is a significant difference in terms of scope. The Pillar 1 NPE treatment applies only to NPEs arising from new loans originated from 26 April 2019 onwards and not to either (i) the existing stock of NPEs or (ii) the full population of existing performing loans on the balance sheets of banks originated before 26 April 2019 which may turn into NPEs in the future. This meant that supervisors would need the tools at their disposal necessary for dealing with that potential risk – those tools are provided by the ECB's Pillar 2 approach.

Adjustments to the Pillar 2 approach for new NPEs related to the scope and calendar calibration

Having identified the main differences, the ECB decided to adjust its supervisory expectations for prudential provisioning for new NPEs. The aim was to simplify and harmonise the overall approach to NPEs. First, the scope of the ECB's supervisory expectations for new NPEs under the Pillar 2 approach, as communicated in the Addendum, would be limited to exposures not subject to Pillar 1 treatment in order to avoid an overlap, i.e. the same exposure being subject to both Pillar 1 and Pillar 2 measures. Thus, NPEs arising from loans originated from 26 April 2019 onwards would, in principle, be subject solely to Pillar 1. Second, the relevant time frames (i.e. vintage buckets/count) for NPEs arising from loans originated before 26 April 2019 would be changed from 2/7 years to 3/7/9 years, to align those time frames with those under the Pillar 1 framework.⁵ More precisely, NPEs subject to the Addendum are expected to follow the 3/7/9-year vintage count for unsecured/secured (other than by immovable property)/secured by immovable

⁵ Vintage buckets/count refers to the length of time an exposure has been classified as non-performing (i.e. its "vintage"). An NPE's vintage is defined as the number of days (converted into years) from the date on which an exposure was classified as non-performing to the relevant reporting or reference date. The 2/7 and 3/7/9 years refer to the vintage bucket for which full implementation (i.e. 100% coverage) is expected. More precisely, 100% coverage is expected after three years for unsecured NPEs, after seven years for NPEs secured by collateral other than immovable property and after nine years for NPEs secured by immovable property. There are also coverage expectations for lower vintage buckets. For further information see Table 3 in the [Communication on supervisory coverage expectations for NPEs](#).

property, with paths to reach the full implementation as under the Pillar 1 framework (i.e. 100% coverage).⁶

Supervisory expectations for the stock of NPEs remained unchanged

Supervisory expectations for the stock of NPEs (i.e. exposures classified as NPEs on 31 March 2018) remained unchanged, with the same starting point of 2/7 years vintage buckets for unsecured/secured NPEs, subject to supervisory coverage recommendations and phase-in paths as communicated in SREP letters.⁷ The first priority was to swiftly reduce the stock of NPEs in order to ensure that banks' balance sheets had been "cleaned" in case economic conditions became less favourable.

Specific circumstances that might render prudential provisioning expectations inappropriate would still be taken into account for both the NPE stock and new NPEs

All other aspects of the treatment of new NPEs under the Pillar 2 approach, as laid out in the Addendum, remained the same. Among other things, specific circumstances that could render the prudential provisioning expectations inappropriate for a specific portfolio/exposure would still be considered when assessing deviations from supervisory coverage expectations under the Pillar 2 approach, in the case of both new NPEs and the NPE stock.

Summary of the adjusted supervisory approach to provisioning for NPEs

To summarise, the scope of the ECB's supervisory expectations for new NPEs is limited to NPEs arising from loans originated before 26 April 2019, which are not subject to Pillar 1 NPE treatment⁸. NPEs arising from loans originated from 26 April 2019 onwards are subject to Pillar 1 NPE treatment, with the ECB paying close attention to the risks stemming from them. In addition, all new NPEs, regardless of the date of the exposure's origination, follow the same calendar calibration and breakdown of secured exposures. They are also treated in the same way as any part of the NPE that is guaranteed or insured by an official export credit agency, with a view to reducing the complexity of reporting for new NPEs (see [Figure 2](#)).

⁶ For parts of NPEs guaranteed or insured by an official export credit agency, the expected linear path to full implementation was removed, i.e. under the Pillar 1 NPE treatment, there is no coverage expectation until the 7-year vintage bucket and the coverage expectation of 100% is applicable to export credit exposures after more than 7 years of NPE status.

⁷ For more details, see Section 4 of the [Communication on supervisory coverage expectations for NPEs](#).

⁸ In line with the Pillar 1 NPE treatment, "where the terms and conditions of an exposure which was originated prior to 26 April 2019 are modified by the institution in a way that increases the institution's exposure to the obligor, the exposure shall be considered as having been originated on the date when the modification applies" (see Article 469a of Regulation (EU) No 2019/630).

Figure 2

Overview of supervisory and regulatory approaches to provisioning for NPEs

NPE classified on or after 1 April 2018	Exposure origination date on or after 26 April 2019	Pillar 1 – Backstop 3/7/9 calendar Progressive path to 100% CRR	Pillar 2 measures NPE reduction strategies, reporting, etc.	*Special treatment of export credit agency as under Pillar 1 for Pillar 2 scope under Addendum
	Exposure origination date before 26 April 2019	Pillar 2 – Addendum* 3/7/9 calendar Progressive path to 100% Addendum exemptions		
NPE classified before 1 April 2018		Pillar 2 - Stock of NPEs (ECB press release) 2/7 calendar No progressive path Addendum exceptions		

Source: ECB.

Aspects relating to the guidelines on NPEs published by the European Banking Authority

The ECB notified the EBA of its intention to comply with the EBA Guidelines on NPEs

The supervisory approach to NPEs was further strengthened at the end of 2018 when the European Banking Authority (EBA) published two sets of guidelines on NPEs: (i) Guidelines of 31 October 2018 on management of non-performing and forborne exposures (EBA/GL/2018/06), and (ii) Guidelines of 17 December 2018 on disclosure of non-performing and forborne exposures (EBA/GL/2018/10). The ECB notified the EBA of its intention to comply with the aforementioned EBA Guidelines.⁹

Work on the NPL stock: progress and assessment of banks' NPL reduction strategies

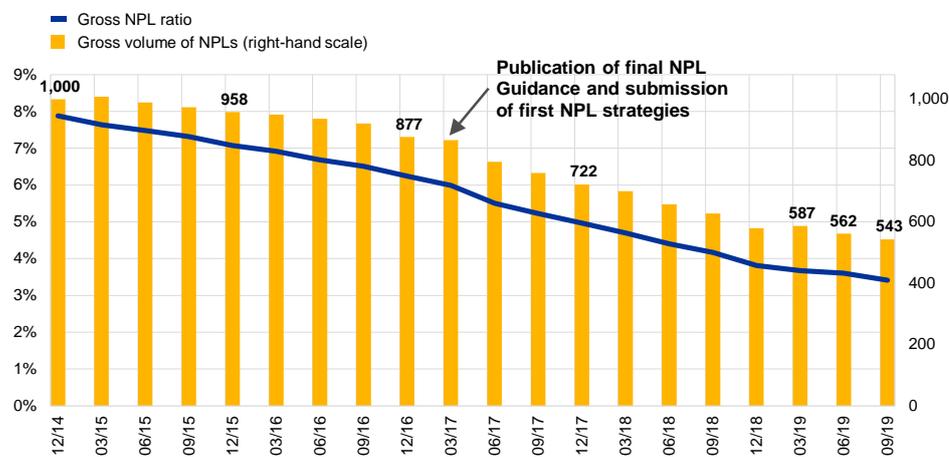
Stock of NPLs held by SIs has decreased by more than 40% since December 2014

At the start of European banking supervision, the volume of NPLs held by SIs stood at around €1 trillion (an NPL ratio of 8%). By the end of September 2019, this had been reduced to €543 billion (an NPL ratio 3.41%), i.e. the stock of NPLs had shrunk by around 46% from December 2014 (see [Chart 13](#)). The decline in the NPL stock accelerated in 2017, particularly in countries with high NPL ratios. This coincided with the publication of the ECB's [Guidance to banks on non-performing loans](#) (hereinafter referred to as the "NPL Guidance") in March 2017, which sets out ECB Banking Supervision's expectations on NPL management. [Chart 13](#) shows the evolution of the NPL stock for all SIs.

⁹ For more details, see Section 2 of the [Communication on supervisory coverage expectations for NPEs](#).

Chart 13
Evolution of SIs' NPLs

(left-hand scale: percentages; right-hand scale: EUR billions)



Source: ECB.

SIs with high NPL ratios submitted NPL strategies for the first time in 2017 and have updated them twice since

The NPL Guidance sets out the expectations for how banks should manage their NPL stocks.¹⁰ As a follow-up to that Guidance, the ECB asked SIs with higher levels of NPLs (hereinafter referred to as “high NPL banks”) to submit their NPL and foreclosed asset reduction strategies and to define their portfolio-level reduction targets over the medium term. In 2017 those SIs communicated their NPL reduction strategies to the ECB for the first time and have updated them twice since.

2019 NPL strategies envisaged a 50% reduction in the NPL stock over a three-year horizon

The NPL strategies submitted in 2019 envisaged a gross reduction in the NPL stock of roughly 50% from the end of 2018 to the end of 2021. **Charts 14 and 15** show the stocks of non-performing assets (NPAs) at the end of 2018 for a sample of 32 high NPL banks, together with their own projected reduction in the volume over the period from the end of 2019 to the end of 2021.

High NPL banks exceeded their NPL reduction targets in 2018

In 2018 high NPL banks performed well overall and, in many cases, even exceeded their targets for reducing their NPL stocks. The tools used to reduce NPL stocks varied across both institutions and countries. Notably, they included loan repayments (borrowers repaying contractually agreed amounts) and cures, sales (including portfolio sales, securitisations and reclassification under International Financial Reporting Standard (IFRS) 9 as held for sale) and write-offs.

In the first half of 2019, banks achieved an 8% reduction in NPL stocks, which constituted 42% of the annual plan for 2019, compared with 51% in the second quarter of 2018. While NPL outflows and inflows from performing exposures are generally on track, other inflows are above target. The outflows are driven mainly by loan repayments and cures, write-offs and sales (including portfolio sales, securitisations and reclassification under IFRS 9 as held for sale).

¹⁰ It is important to note that the terms “non-performing exposure” (NPE) and “non-performing loan” (NPL) are used interchangeably in this document. The reason for this is explained in footnote 1 of the [Communication on supervisory coverage expectations for NPEs](#).

Banks are frontloading planned reduction efforts

Most of the banks are actively frontloading their reduction efforts. According to the NPL reduction strategies submitted for the period 2019-21, around 50% of the three-year reduction is projected to take place in the first year for most of the countries. More than 75% of the reduction over the three-year period is likely to be driven by outflows from non-performing portfolios, loan repayments, sales and write-offs.

Banks are targeting older NPE vintages more aggressively

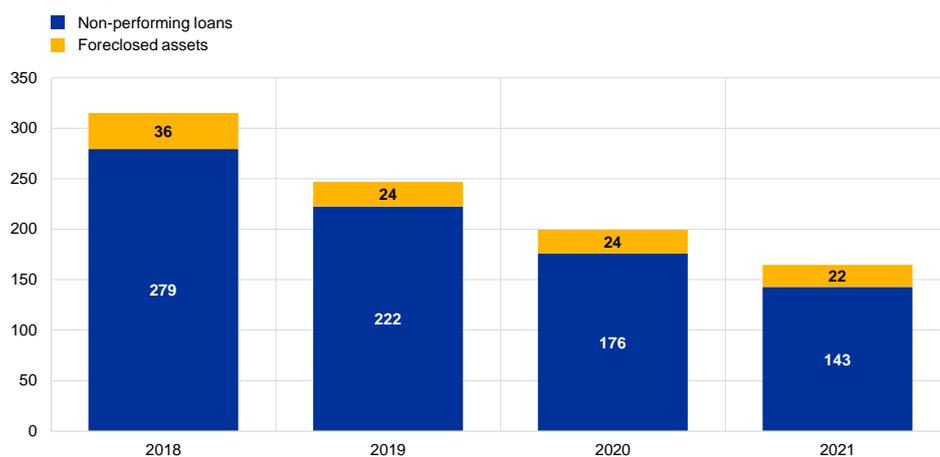
It is also positive that banks are targeting older vintages of NPLs more aggressively in their reduction plans. As can be seen from **Chart 16**, exposures classified as non-performing for more than five years are projected to be reduced at a substantially faster pace than that of exposures that have been non-performing for less than five years.

Overall, NPL stocks remain high in the euro area. ECB Banking Supervision will therefore continue its efforts to address the stock of NPLs and prevent the build-up of new NPLs.

Chart 14

NPA reduction strategies: planned evolution of NPAs

(EUR billions; years)

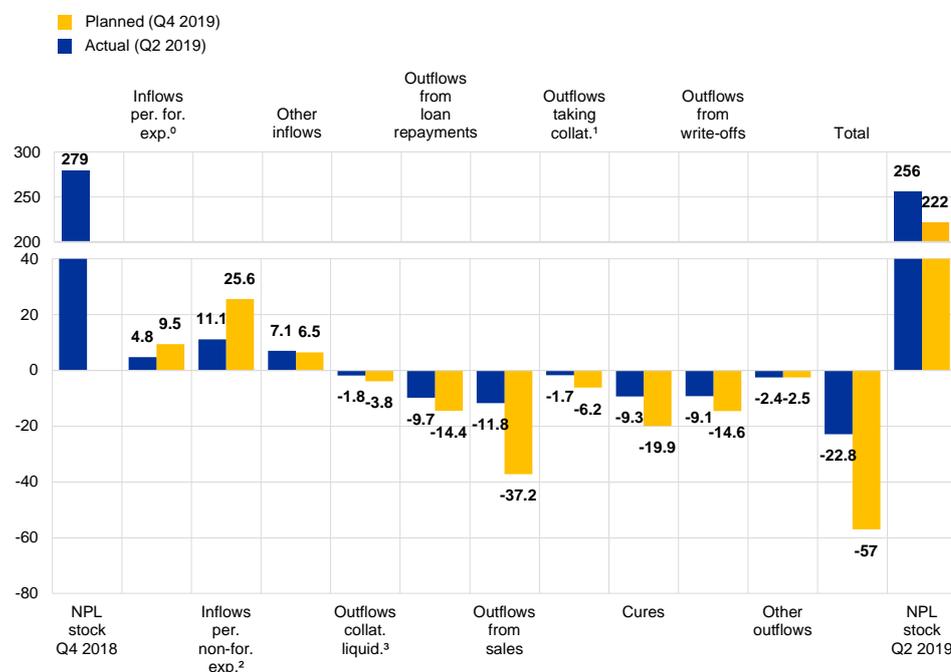


Source: ECB.

Chart 15

Planned NPL reduction for the full year 2019 against actual reduction in the first half of the year

(EUR billions)



Source: ECB.

0) Inflows from performing forborne exposures.

1) Outflows from taking collateral.

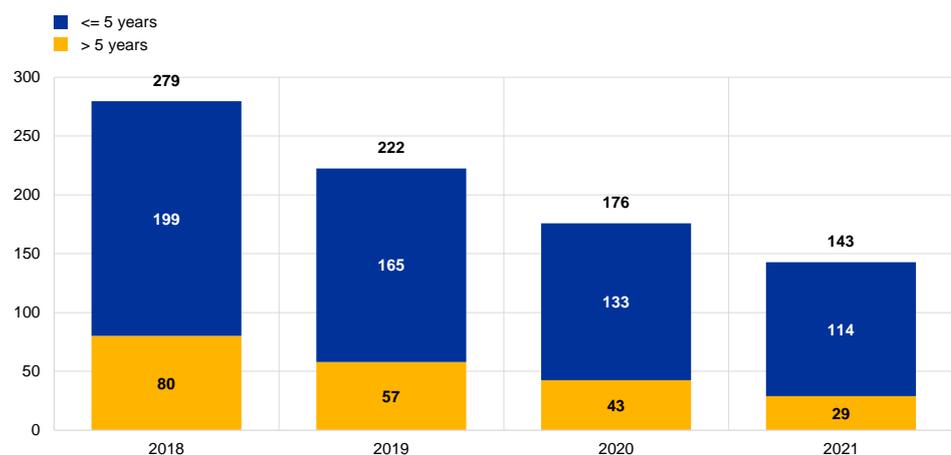
2) Inflows from performing non-forborne exposures.

3) Outflows from collateral liquidation.

Chart 16

NPA reduction strategies: planned future reduction of NPLs by vintage bucket

(EUR billions)



Source: ECB.

Box 1

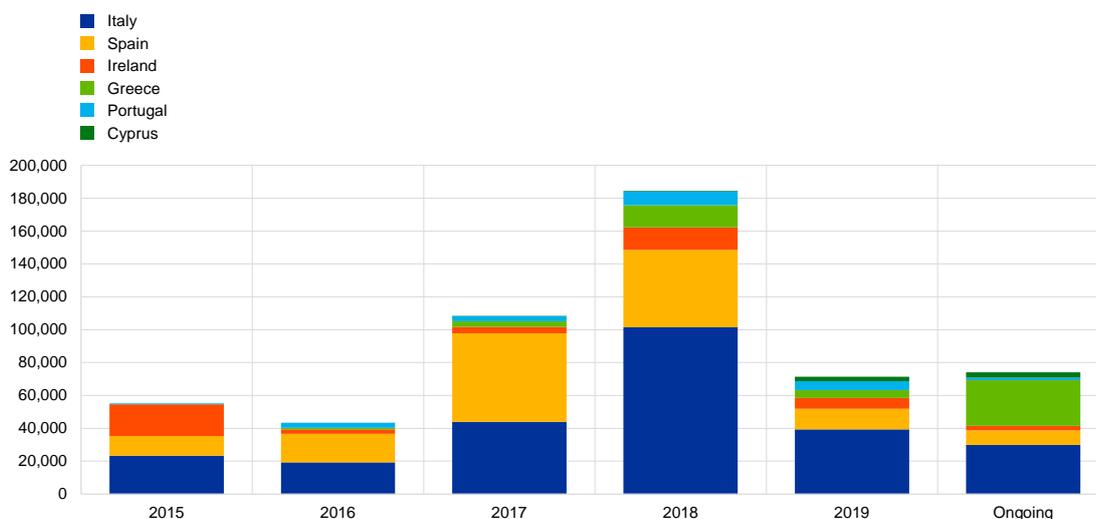
Impact of non-performing loan disposals on the stock market

This box investigates empirically how the stock market responded to announcements by SSM significant institutions (SIs) and less significant institutions (LSIs) regarding their balance sheet clean-up during the period 2015-19. The aim is to assess whether sales¹¹ of non-performing loans (NPLs) generated a positive “wealth effect” for SIs and LSIs in the most active countries (namely Italy, Spain, Ireland, Greece, Portugal and Cyprus). The total volume of sales of NPLs and foreclosed assets by SIs and LSIs in those countries reached over €184 billion in 2018, compared with €108 billion in 2017. Latterly during the period under review, activity was driven, in particular, by the Italian and Spanish markets, and there was also a significant increase in activity in Greece, Portugal and Cyprus, where the annual volume of disposals more than doubled in 2018 compared with 2017 (see the **chart**). Even though activity in terms of sale volumes slowed in 2019 compared with 2017 and 2018, €74 billion of sales are still ongoing and are expected to be closed by the end of 2020. Moreover, the size of the “unlikely to pay” asset segment is increasing. In 2019 around one-third of total disposals made by Italian credit institutions went into this segment.

Chart

Sales of NPLs and foreclosed assets – by SSM SIs and LSIs in the sample countries during the period 2015-19 plus ongoing

(EUR millions; gross book values)



Sources: Bank announcements, Credit Village, Debtwire, Deloitte, KPMG and ECB calculations.

Notes: The cut-off date for data is 31 December 2019. “Ongoing” means sales to be finalised by the end of 2020. The chart includes outright NPL sales, NPL securitisations leading to deconsolidation and foreclosed asset sales. It shows disposals by SSM SIs and LSIs in the selected countries. Sales by asset management companies are excluded. The 2017 figures for Spain include Santander’s sale of the majority stake in its €30 billion real estate asset portfolio to Blackstone. The 2018 figures for Italy include Monte dei Paschi di Siena’s bad loan securitisation of around €24.1 billion, which was completed in May 2018, and the €18 billion Veneto Banca/Popolare di Vicenza portfolio transfer to SGA S.p.A finalised in 2018 after the banks’ liquidation in 2017. UniCredit’s disposal of €17.7 billion (project Fino) is included in the 2017 figures for Italy.

¹¹ The analysis covers outright NPL sales, NPL securitisations leading to deconsolidation and foreclosed asset sales.

The finance literature has long studied the impact of balance sheet clean-ups on banks' share prices and the wealth effect for sellers.¹² Using the event study methodology¹³, the ECB has complemented previous empirical studies on the same subject, analysing the effect of 135 announcements of NPL disposals made by SIs and LSIs¹⁴ as of 2015. The results reveal that the announcements of NPL disposals had a positive and significant impact on the share price of those credit institutions that had made substantial progress in NPL deleveraging during the period under review (see the **table**).

Table

Event study results

Sample	Type of NPL disposal (large = above median, small = below median)	Number of events covered	Selected event window	Cumulative average abnormal returns (CAAR value)	t-test value	Boehmer, Musumeci and Poulsen (1991)
Total sample (SIs and LSIs in Italy, Spain, Ireland, Portugal, Greece and Cyprus)	Large	102	(0;2)	0.023	3.179***	3.336***
		102	(-2;0)	0.007	1.326	1.944*
	Small	33	(0;2)	0.005	0.581	-0.421
		33	(-2;0)	0.003	0.426	-0.363
Italy	Large	57	(0;2)	0.017	2.804***	2.195**
		57	(-2;0)	0.002	0.282	0.952
	Large (of which GACS)	13	(0;2)	0.065	3.975***	4.639***
		13	(-2;0)	0.015	1.128	1.753*
	Small	24	(0;2)	0.003	0.236	-0.952
		24	(-2;0)	0.004	0.546	-0.693
Spain	Large	21	(0;2)	0.032	1.184	1.543
		21	(-2;0)	0.002	0.435	0.520
Ireland	Large	11	(0;2)	0.031	2.357**	2.222**
		11	(-2;0)	0.004	0.376	1.085
Greece	Large	16	(0;2)	0.020	1.178	0.868
		16	(-2;0)	0.023	1.103	1.080

¹² See La Torre, M., Vento, G., Chiappini, H. and Lia, G., "NPL sales and market reactions: who is left empty-handed?", *Bancaria*, No 3, March 2019, and Gasbarro et al. "The Response of Bank Share Prices to Securitization Announcements", *Quarterly Journal of Business and Economics*, Vol. 44, No 1, January 2005, pp. 89-105. La Torre, M. et al. observe that NPL sales had a positive impact on Italian sellers during the period 2015-17. Their study also shows that the market does not react negatively to the loss of value deriving from the gap between the sale price and the net book value of NPLs. Gasbarro et al. show that very positive wealth effects were generated by the announcements of securitisations by a sample of US banks with high bond ratings, high financial leverage, low non-interest expenses and a high issue frequency.

¹³ The event study methodology is based on the model published by Fama et al. in 1969 (see Fama E.F., Fisher L., Jensen M.C. and Roll R., "The Adjustment of Stock Prices to New Information", *International Economic Review*, Vol. 10, No 1, 1969, pp. 1-21). First, the "events" were identified. Second, the abnormal returns were calculated by deducting the expected normal returns had there been no NPL disposal announcement from the actual returns of the banks' stocks. Third, the cumulative abnormal return (CAR) was computed by adding up the individual abnormal returns in order to measure the total impact of a disposal over a specific period of time termed the "event window". Finally, the cumulative average abnormal returns (CAARs) were computed. They represent the mean values of all the events in the sample, i.e. the average stock market responses (as a percentage) to the press releases. In order to verify the statistical significance of the CAARs, two statistical parametric tests were used: (i) the parametric cross-sectional t-test, and (ii) the test introduced by Boehmer, Musumeci and Poulsen in 1991, the latter being robust to the variance induced by the event (see Boehmer, E., Musumeci, J and Poulsen, A.B., "Event-study methodology under conditions of event-induced variance", *Journal of Financial Economics*, Vol. 30, No 2, 1991, pp. 253-272).

¹⁴ The total sample includes 135 events related to press releases on NPL disposals published during the period 2015-19 by 31 SSM SIs and LSIs listed on a stock exchange.

Sources: ECB and Bloomberg (for actual returns).

Notes: The "event" is the press release published by the listed SIs and LSIs regarding NPL disposals, including both direct NPL sales on the market and NPL securitisations leading to deconsolidation, and disposals of foreclosed assets. Press releases containing overlapping and confounding events were disregarded (e.g. a disposal communicated in the context of the publication of quarterly financial results, announcements of a capital increase, business strategies, mergers, etc.). "Large disposals" means disposals of non-performing assets with a gross book value of over €320 million, i.e. the median of all disposals by SSM SIs and LSIs during the period 2015-19 (also taking into account the transactions excluded from this analysis). Our sample of announcements in Spain, Ireland and Greece include disclosures of disposals of assets with an above-average gross book value. Abnormal returns were calculated by deducting the expected normal returns had there been no NPL disposal announcement from the actual returns of the stocks. The expected normal returns were estimated using the "market model", which is based on the actual returns of a reference market and the correlation of the bank's stock with the reference market. For this analysis, the reference markets were the FTSE Italia Bank index for Italian banks, the IBEX 35 index for Spanish banks, the Athens Stock Exchange General Index for Greek banks, the FTSE Ireland Index for Irish banks, the FTSE Portugal Index for Portuguese banks and the Cyprus Stock Exchange General Index for Cypriot banks. Natural logarithm returns were used. The estimation period was 120 trading days. After calculating the abnormal returns, the cumulative abnormal return (CAR) was computed by adding up individual abnormal returns in order to measure the total impact of an event over a particular period of time ("event window"). Two event windows were considered in this analysis, namely -2;0 and 0;2, where 0 is the day of the event or the first trading day after the announcement if the announcement was made after the markets had closed or if the event falls on a non-trading day (e.g. a weekend day). The cumulative average abnormal returns (CAARs) are the mean values of all the events in the sample (total or at the country level), i.e. the average stock market responses (as a percentage) to the press releases. The parametric cross-sectional t-test and the test of Boehmer, Musumeci and Poulsen (1991) were used to verify the statistical significance of the CAARs. ***, **, * refers to a significance level of 1%, 5% and 10% respectively of the cross-sectional t-test and the test of Boehmer, Musumeci and Poulsen (1991).

The analysis also shows that the maturity of the domestic NPL markets and the characteristics of the domestic legal frameworks affect stock prices differently across jurisdictions. For example, credit institutions in Italy announcing large NPL disposals¹⁵ exhibit, on average, significant and positive stock market responses in the two days following the press release. In particular, there is a strong positive wealth effect for Italian banks using the GACS scheme¹⁶. This suggests that a carefully designed scheme to incentivise the transfer of NPL risks off credit institutions' balance sheets would generally have a positive effect on the selling bank. Similarly, credit institutions in Ireland experienced a positive market response following the announcements, potentially owing to the favourable impact on capital ratios that was disclosed in most of the Irish press releases on NPL disposals.¹⁷ By contrast, no statistically significant impacts were observed for credit institutions in Greece, where the secondary markets contributing to the reduction of NPLs started to grow in 2017. However, risk transfer via the "Hercules" securitisation scheme, which, together with other external and internal strategic tools, aims to reduce the volume of NPLs to sustainable levels¹⁸, may result in a positive wealth effect in the future. With regard to Spain, the response to banks' announcements during the period 2015-19 was not statistically significant. This might be attributable to the maturity of the Spanish NPL market and the relatively low NPL ratio of Spanish credit institutions.¹⁹ Portuguese and Cypriot credit institutions were considered in the analysis as part of the total sample, but there are no country-level results for Portugal and Cyprus owing to the limited number of available listed banks and announcements.

¹⁵ Large disposals means disposals of NPAs with a gross book value of over €320 million, i.e. the median of all SSM SIs and LSIs disposals during the period 2015-19.

¹⁶ The Guarantee on securitisation of bank non-performing loans (*Garanzia Cartolarizzazione Sofferenze* – GACS) scheme is a state guarantee that secures the payment obligations of Italian securitisation vehicles (SPVs) in relation to senior tranches of asset-backed notes issued by the SPVs (in the context of securitisation transactions of NPLs).

¹⁷ 70% of the press releases on NPL disposals published by Irish credit institutions in the event study sample mentioned a favourable impact on capital ratios. This is the highest percentage among the countries in the sample.

¹⁸ See Opinion of the European Central Bank of 6 December 2019 on a guarantee scheme for securitisations of loans originated by credit institutions (CON/2019/42) and the Greek law 4649/2019 (Government Gazette A 2016 of 16 December 2019).

¹⁹ According to ECB internal data and the ECB's supervisory banking statistics, when considering SSM SIs only, between the fourth quarter of 2014 and the second quarter of 2019 the NPL ratio decreased from 17.1% to 8.0% for Italian SIs, from 23.9% to 4.1% for Irish SIs, from 8.0% to 3.5% for Spanish SIs, from 39.68% to 39.24% for Greek SIs, from 50.8% to 18.6% for Cypriot SIs, and from 17.15% to 10.59% for Portuguese SIs.

1.2.3 Work on credit underwriting criteria

Inadequate practices for originating loans greatly contributed, among other things, to the high NPL ratios in some participating Member States. The aim of the supervisory efforts to reduce NPLs is to clean up banks' balance sheets and thus restore trust in the banking sector. However, given the increased likelihood of a turn in the economic cycle, it is important to understand the risks that banks are currently loading onto their balance sheets, as they might cause problems in the future. Therefore, the focus is now shifting to the underwriting standards that banks apply when granting loans. The goal is to take proactive measures to limit an excessive build-up of future NPLs, and this was part of the [supervisory priorities for 2019](#) (see Section 1.2).

The first step in achieving this goal was to assess risks and trends in the way banks grant credit, and thereby steer supervisory efforts towards pockets of risk. To this end, the ECB thoroughly assessed relevant data that the supervisors already had at their disposal. However, there was a need to collect additional harmonised data to allow for a sound and structured assessment of the quality of banks' underwriting criteria with a focus on new lending. ECB Banking Supervision therefore launched a data collection exercise in 2019.

The main goals of this exercise were to (i) clarify whether banks' credit underwriting standards had deteriorated over time, and (ii) identify patterns and uncover specificities in certain loan segments, different business models and across countries. Moreover, it was intended to help determine whether certain key risk indicators were readily available in banks' IT systems and ascertain the level of automation in compiling and reporting those data.

The exercise was designed in cooperation with the industry. This ensured that the definitions of key risk indicators included in the credit underwriting templates (e.g. loan-to-value ratios) were aligned with the most common banking practices. The resulting template covered key risk indicators for lending and risk parameters for loans to the non-financial private sector. To encourage the consistency of the data across credit institutions, the process was supported by an elaborate FAQ process and followed by a comprehensive quality assurance check.

The interpretation of the data collected needed to take into account the underlying environment for granting credit, as it differs from country to country. Thus, to complement the data analysis, there were dedicated country meetings, which were attended by both the JSTs and the national competent authorities (NCAs). The objective of those meetings was to jointly evaluate the "bottom-up" findings of the JSTs together with horizontal observations. This meant that country and bank-specific circumstances could be taken into account, while ensuring a harmonised assessment. The outcomes of those meetings formed the basis for defining the scope of the follow-up analysis that will take place in 2020.

Once completed, the results from the data analysis will benefit all stakeholders. The ECB and the NCAs will have gained valuable insights into banking practices in the context of loan granting and related to risk-based pricing. The results will also shed light on developments in business segments, such as the market for housing loans

or lending to small and medium-sized enterprises, and reveal which data banks use to steer risks stemming from their loan portfolios. The value added for banks will be in the detailed individual feedback on their results benchmarked to peers. The aggregate results from the analysis will also be published. This work may result in bank-specific actions that will be further discussed in the next phase of the credit underwriting criteria project in 2020. Finally, the timing of the project is conducive to reinforcing the EBA's work on loan origination, in which the ECB is actively involved.

1.2.4 Targeted Review of Internal Models

The Targeted Review of Internal Models (TRIM) aims to assess the adequacy and appropriateness of banks' internal models, thus reducing unwarranted variability in risk-weighted assets (RWA). TRIM contributes to a level playing field, as it fosters consistent supervisory practices that focus on the correct and consistent implementation of regulatory requirements for internal models.

Following analytical preparatory work performed in 2016, the on-site part of TRIM started in 2017 and was completed in 2019. During that period 200 on-site investigations across 65 SIs were performed, focusing on internal models for credit, market and counterparty credit risk.

The investigations followed a common methodological framework based on a common understanding of European regulations on internal models between the ECB and the NCAs. This common understanding is reflected in the ECB guide to internal models, which provides transparency on how the ECB understands the applicable regulatory requirements for internal models and how it applies them in a consistent manner when assessing whether banks meet those requirements. The publication of the [revised version of the guide](#) in 2019 marked an important milestone for TRIM and followed an extensive feedback process, including a request for comments from the industry on the first version of the document in 2017 and two public consultations on updated versions of the different chapters of the guide in the course of 2018. Going forward, the ECB guide to internal models will remain a key reference document for the ECB's approach to supervising internal models beyond the scope of TRIM. The guide will be amended and updated over time as needed.

Throughout TRIM, various analyses have been conducted (and are still being conducted) to assess and compare the outcomes of investigations across institutions. The interim outcome of these analyses has already been published for the benefit of both the inspected institutions and the general public. In fact, an overview of the most material or common deficiencies identified across TRIM investigations was published first in 2018 and further updated and expanded in April and [November 2019](#). These horizontal analyses, alongside other layers of quality assurance,²⁰ are important to ensure the consistency of the supervisory

The on-site part of TRIM was completed in 2019

A revised version of the ECB's guide to internal models was published in 2019

²⁰ For more details on the different layers of quality assurance included in TRIM, see "[TRIM: reviewing internal models](#)", *SSM Supervision Newsletter*, ECB, November 2018.

assessments across investigations. Their disclosure supports banks by presenting a broader context in which to view the TRIM-related decisions that they receive.

The supervisory decisions resulting from TRIM on-site investigations are another key output of the project. In fact, the legally binding obligations included in the decisions help to ensure that banks remedy the shortcomings identified as part of TRIM; this enforces the necessary improvements to internal models. So far, approximately 110 such decisions have been issued in their final form (i.e. after encompassing the feedback provided by the institutions as part of the hearing period), addressed to around 55 out of the 65 institutions participating in TRIM. On average, each of these TRIM decisions contained about 20 binding obligations, accompanied, where appropriate, by additional measures.²¹ Through such a detailed follow-up, TRIM contributes to reducing unwarranted variability of RWA in banks' internal models by ensuring compliance with regulatory requirements. In terms of credit risk, for instance, banks notably showed deficiencies in calculating realised losses on their exposures and in the use of long-run average default rates for the calibration of the probability of default parameters. In terms of market risk, shortcomings related mainly to the methodology banks use to measure value at risk (VaR), stressed VaR, regulatory back-testing of VaR, the scope of the internal model approach and the incremental risk charge methodology.

Overall, TRIM has required substantial supervisory resources. To avoid disrupting banks' normal model maintenance, material model changes and initial model approvals have also continued to be assessed on-site, in addition to TRIM investigations and sometimes in combination with them. In the course of 2019, on top of the 49 on-site investigations launched as part of TRIM, 117 investigations on internal models were launched at SIs (of which 52 were performed on-site)²². Altogether, a total of 141 supervisory decisions on internal model investigations²³ (including for TRIM) were issued in 2019.

TRIM will be completed in the second half of 2020

The TRIM project will be completed in the second half of 2020, but the regular supervisory review of material model changes, as well as requests for initial model approvals, are expected to continue at an intense pace in 2020-21. Supervised entities will have to adjust their models in response to (i) the findings of TRIM, and (ii) the requirements set out by the EBA in a series of new regulatory technical standards and guidelines issued as part of the regulatory review of the internal ratings-based approach. Together with banks, ECB Banking Supervision expects to realise synergies by combining, to the extent possible, the implementation and the assessment of changes to internal models that stem from the two initiatives and affect the same rating systems.

²¹ More information on the supervisory decisions issued as a follow-up to TRIM on-site investigations will be provided as part of the communication related to the finalisation of the project.

²² Excluding cancellations of on-site investigations.

²³ Excluding follow-up decisions on ancillary provisions.

1.2.5 IT and cyber risk

Throughout 2019 ECB Banking Supervision continued to address IT and cyber risk as a supervisory priority. From a general point of view, IT and cyber risk should be part of banks' overall risk governance and management framework, and there should be a broad awareness of it among all staff members. After all, the impact of IT and cyber risk could be firm-wide. Therefore, all staff members should contribute to the mitigation of this risk – across business areas and hierarchies.

Given the high level of interconnectedness in the financial sector, cyber incidents could propagate rapidly throughout it. To enable supervisors to better identify and monitor trends in cyber incidents in the banking sector, a cyber incident reporting process was introduced in 2017. All SIs are required to report significant cyber incidents²⁴ as soon as they are detected. The SSM's cyber incident database provides greater transparency and also enables the ECB to react quickly if a major incident affects one or more SIs. Compared with 2018, the number of cyber incidents reported in 2019 rose by around 30%.

Frequent on-site inspections also allow ECB Banking Supervision to assess the banks' individual IT and cyber risk management capabilities, while “campaign” inspections (which focus on the same topic in several banks on a comparable scale) provide horizontal insights. The 2019 focus on IT continuity management revealed the need for improvements, particularly in relation to testing major disaster responses. These findings will be followed up on as part of ongoing supervision. The upcoming 2020 campaign on IT risk will further assess banks' cyber risk management.

As part of the annual SREP, JSTs perform ongoing supervision of IT and cyber risk, following a common and standardised risk assessment methodology, which is based on EBA Guideline EBA/GL/2017/05²⁵ and supported by an IT risk questionnaire (bank's self-assessment). This is complemented by thematic reviews on IT risks and horizontal analysis. The self-assessments of IT risk and controls performed by the SIs provide valuable information. One of the relevant findings in 2019 was that, on average, the sector shifted to more prudent self-assessments. The self-assessment also revealed that those SIs that have IT experts as board members are more competent in several IT risk control categories and more aware of the risks.

At the same time, the self-assessment showed that the number of SIs depending on end-of-life-systems for their critical business processes is growing, and outsourcing expenses for IT are increasing. The focus on these topics will be stepped up in 2020.

In addition, ECB Banking Supervision liaises with numerous stakeholders both within and outside the EU to ensure a coordinated approach and knowledge-sharing on IT and cyber risk. It contributes, for instance, to international fora such as the EBA Task Force on IT risk supervision, the Basel Committee on Banking Supervision (BCBS)

²⁴ The ECB has defined thresholds to ensure that only relevant and significant cyber incidents are reported.

²⁵ [Guidelines on ICT Risk Assessment under the Supervisory Review and Evaluation Process \(SREP\)](#).

working group on operational resilience and the Financial Stability Board working group on cyber incident response and recovery.

1.2.6 Brexit

ECB Banking Supervision continued to monitor banks' implementation of their Brexit plans

In 2019 ECB Banking Supervision's work on Brexit focused on (i) the preparedness of banks and supervisors for a possible no-deal Brexit, and (ii) the implementation of banks' Brexit plans, as agreed between banks and supervisors.

Throughout the year ECB Banking Supervision monitored the preparedness of banks for a no-deal scenario, in which the United Kingdom would exit the EU with no transition period. In this context, the ECB clearly communicated to banks that they should continue preparing for all possible contingencies and asked them to implement effective mitigating measures where needed. Overall, banks' preparations for a no-deal exit progressed reasonably well.

Already in the run-up to the initial Brexit date at the end of March 2019, ECB Banking Supervision had completed the majority of authorisation procedures related to the setting-up of new – or the restructuring of existing – credit institutions in the euro area. Furthermore, it had wrapped up its assessment of the Brexit plans of SIs with operations in the United Kingdom and granted the approval of their third-country branches where required under national law. To this end, ECB Banking Supervision had entered into detailed discussions with banks in order to agree on the operation and business models of their UK branches in the future.

ECB Banking Supervision also monitored the implementation of banks' Brexit plans to ensure that affected banks adhered to the commitments they had made, including the implementation timelines they had agreed with their supervisors. Horizontal monitoring exercises were complemented by bank-specific follow-ups and corresponding supervisory actions where necessary.

For the banks that became significant as a result of activities being relocated to the euro area because of Brexit, new JSTs were set up and the ECB assumed the direct supervision of those entities. For some of those banks, the obligatory comprehensive assessment was launched in the second half of 2019.

The ECB continued to communicate its supervisory expectations through updates to the [FAQs](#) on the ECB's banking supervision website, several articles in the Supervision Newsletter and via bilateral discussions with the supervised entities.

Looking ahead

In 2020 the ECB will continue to monitor how banks are implementing their Brexit plans, based on the commitments and timelines that were agreed in order to achieve their target operating models. While banks made some progress in 2019, they still need to do more to meet the ECB's supervisory expectations in various areas, such as internal governance, business origination and access to financial market

infrastructures, booking models, intragroup arrangements, and IT infrastructure and reporting.

Comprehensive assessments for other institutions that were newly classified as significant owing to their Brexit-related activities will also be launched.

The ECB will continue to monitor the political negotiations between the EU and the United Kingdom, and assess the implications from a supervisory perspective.

1.2.7 Trading risk and asset valuations

A set of coordinated off-site and on-site initiatives were launched in 2019

In 2019 ECB Banking Supervision launched a series of coordinated off-site and on-site initiatives in the field of market risk. This includes risks stemming from trading activities and the valuation of financial instruments that are accounted for at fair value. The aim of those initiatives was to:

- ensure compliance with existing regulations;
- increase supervisory knowledge about the composition of such financial assets and liabilities;
- monitor the areas more exposed to valuation risk;
- assess the frameworks used by institutions to calculate fair value and prudent additional valuation adjustments.

Throughout 2019 granular data on the regulatory trading book was collected for 13 large SIs covering 87% of the level 2 and level 3 positions²⁶ in the trading books of the banks directly supervised by the ECB.²⁷ The availability of information at desk and product level made it possible to drill down on the composition of a significant subset of level 2 and level 3 assets and liabilities. This will facilitate the definition of the scope of the on-site investigations to be launched as part of the on-site campaign on valuation risk.

Level 3 assets and liabilities are concentrated in a few large banks, while level 2 assets and liabilities consist largely of swaps and repos

In terms of asset levelling, the majority of the trading book positions (around 87%) included in the sample are classified as level 2, while level 3 positions account for only around 2% and are concentrated in a few banks (around 82% in three banks). Looking at the composition by product, a large part of level 2 assets and liabilities are swaps and repos, mostly with maturities of less than ten years.

²⁶ Level 1, 2 and 3 positions are distinguished based on the inputs used to determine their fair value (IFRS 13). Positions traded in active markets are classified as level 1 as quoted prices (unadjusted) can be used to value them. Level 2 positions are priced using directly or indirectly observable inputs other than the quoted prices used for level 1 positions. Level 3 positions are priced using unobservable inputs (i.e. not available or not sufficiently reliable market data). Thus, these positions need to be valued using the best information available about the assumptions market participants would use when pricing such positions.

²⁷ The level 2 and level 3 positions held in the trading books of the 13 SIs included in the sample represent around 61% of the total level 2 and level 3 positions held in the trading books and banking books of all SIs.

Banks' practices for defining observability, asset levelling, day one profit and fair value measurement vary considerably

With regard to the on-site initiatives, a campaign²⁸ on valuation risk was launched in 2019 and will continue in 2020 and 2021. Preliminary results from the campaign highlight that banks' practices are very diverse and that there is a lot of potential for banks to diverge from one another given the amount of discretion they have in defining observability, asset levelling, day one profit and fair value measurement when applying the accounting framework. This level of divergence presents a challenge when assessing valuation risk. The on-site initiative aims to promote a level playing field for prudential purposes and to harmonise the application of the methodology for conducting on-site inspections at banks.

In terms of the implementation of the [EBA's Regulatory Technical Standards on prudent valuation](#), the 2019 on-site investigations revealed that institutions' prudent valuation frameworks were not up to the standards expected by the ECB, while highlighting that institutions face data challenges in achieving the required level of certainty in the prudent valuation. The EBA Q&A process has helped to provide greater clarity in applying the prudent valuation framework.

1.2.8 Work on supervisory methodologies

Capital and liquidity are key to ensuring the resilience of banks

Financial shocks to the banking sector are often caused or amplified by the fact that the amount and quality of the capital and liquidity held by banks are inadequate. Against this backdrop, two core processes, the internal capital adequacy assessment process (ICAAP) and the internal liquidity adequacy assessment process (ILAAP), are key to strengthening the resilience of banks.

Both the ICAAP and the ILAAP aim to ensure that institutions measure and manage their capital and liquidity risk in a structured way, using institution-specific approaches. They allow banks to identify, assess and thus effectively manage and cover capital and liquidity risk at all times.

In line with their key role in managing banks' capital and liquidity adequacy, the ICAAP and the ILAAP warrant particular attention from supervisors. As part of the SREP, the quality and the results of the ICAAP and the ILAAP are taken into account when determining capital, liquidity and qualitative measures. Good ICAAPs and ILAAPs reduce uncertainty for both institutions and supervisors in terms of an institution's actual risk exposures. This helps institutions to maintain adequate capital and liquidity, and thus to remain viable.

ECB Banking Supervision published guides on the ICAAP and ILAAP

In November 2018 ECB Banking Supervision published guides on institutions' [ICAAPs](#) and [ILAAPs](#) and started to apply them in January 2019. The guides are not intended to provide complete guidance on all aspects relevant to sound ICAAPs and ILAAPs. Instead, they follow a principle-based approach with a focus on selected key aspects.

²⁸ Further information on the on-site initiatives is provided in Section 1.3.2.

Each institution is responsible for implementing ICAAPs and ILAAPs tailored to its individual circumstances

ECB Banking Supervision thus stresses that, in the first place, ICAAPs and ILAAPs are internal processes that should be tailored to each institution. Each institution is therefore responsible for implementing ICAAPs and ILAAPs that are tailored and proportionate to its individual circumstances. Sound, effective, comprehensive and forward-looking ICAAPs and ILAAPs are key tools for ensuring the resilience of banks. Hence, banks are encouraged to use the guides to close any gaps and remedy shortcomings in their capital and liquidity management as soon as possible.

Over the course of 2019 ECB Banking Supervision's horizontal functions, together with the JSTs, engaged with banks to discuss how they planned to enhance their ICAAPs and ILAAPs in line with the new guides.

More than half of all ICAAPs and more than one-third of all ILAAPs had severe shortcomings

In its 2019 SREP assessments, ECB Banking Supervision concluded that there were still severe shortcomings in more than half of all ICAAPs and more than one-third of all ILAAPs used by SIs. They did not provide a solid basis for the prudent management of capital and liquidity and thus institutions would need to improve them (further). The conclusions drawn from these case-by-case assessments are having a growing impact on the SREP and the relevant individual supervisory measures. In other words, sound ICAAPs and ILAAPs reflect positively on a bank's SREP.

The ICAAP and ILAAP will play an even bigger role in the SREP

In the future, the ICAAP and ILAAP will play an even bigger role in the SREP, which will incentivise banks to keep improving their internal processes. Among other things, both the qualitative and quantitative aspects of the ICAAP will play an enhanced role in determining supervisory capital add-ons on a risk-by-risk basis.

Box 2

Supervisory technology

The ECB has established a Supervisory Technology (SupTech) Hub to explore the potential of artificial intelligence (AI) and other pioneering technologies in the context of banking supervision.

Innovation and SupTech

Technology is changing the financial industry. Moreover, supervisors around the globe are taking measures to implement innovative technologies to modernise infrastructures and ensure effective and efficient supervision. In 2019 the ECB established a SupTech Hub as a way of introducing innovative tools into its supervisory processes.

AI and data analytics

The ECB has launched various AI projects. One major area of AI is machine learning, which gives computers the ability to learn from data and to make predictions. For example, the ECB is developing a tool that can predict the outcome of the European Banking Authority's stress tests based on the data collected in line with the [Implementing Technical Standards on Supervisory Reporting](#).

Another area of AI is natural language processing (NLP), which can help supervisors analyse unstructured data. Computers using NLP can understand and assess information provided in text form. For example, the ECB is devising a tool that can be used to extract structured information

from unstructured data sources, such as financial reports, which at the moment can only be retrieved manually.

The ECB is also working on advanced data analytics tools, which enable supervisors to draw deeper insights from data and make more informed, data-driven decisions. To take one example, network analysis is being used to gain a better understanding of interconnections in ownership stakes in supervised entities.

Portal for authorisations

The high volume of authorisation procedures (see also Section 2.1.2) creates a heavy workload not only for supervisors, but also for banks. In cooperation with the national competent authorities, the ECB is therefore developing an online portal with a view to managing the process more efficiently, starting with fit and proper assessments.

The objectives of the portal are to improve the exchange of information on the procedures and to reduce bureaucracy by automating aspects of the authorisation process. The portal should also better support banks in submitting complete and accurate applications and, in turn, increase the efficiency and timeliness of the assessments. Finally, it should also harmonise the authorisation process across the SSM participating countries, while taking into account relevant national law specificities. The goal is that, in the future, it will become a comprehensive banking supervision portal, covering a variety of supervisory processes under the remit of the ECB.

Spreading knowledge and enhancing skills

Spreading knowledge and engaging all relevant stakeholders is essential to ensure the adoption of SupTech. Acting as a knowledge hub, the SupTech team has started to organise events and training courses to equip banking supervision colleagues with technical know-how and skills that they need to be able to innovate.

Collaboration

In order to exchange technological expertise and practices, the ECB has reached out to the national competent authorities currently introducing digital tools into their supervisory processes, peer authorities (e.g. the Monetary Authority of Singapore, the UK Prudential Regulation Authority, the Federal Reserve Bank), academic institutions (e.g. the Technical University of Darmstadt and the applied AI initiative of the Technical University of Munich) and a number of start-up companies.

1.3 Direct supervision of significant institutions

1.3.1 Off-site supervision

ECB Banking Supervision strives to supervise SIs in a proportionate and risk-based manner that is both demanding and consistent. To that end, it defines a set of core ongoing supervisory activities for each year. These activities draw on the existing regulatory requirements, the [SSM Supervisory Manual](#) and the [SSM supervisory](#)

priorities, and are included in the ongoing supervisory examination programme (SEP) for each SI.

In addition to these centrally defined core activities, other supervisory activities that are tailored to banks' specificities can be included in the SEP. This allows them to address rapidly changing risks at the level of the individual institution or at the level of the entire system.

The off-site SEP activities include (i) risk-related activities (e.g. the SREP, stress testing), (ii) other activities related to organisational, administrative or legal requirements (e.g. the annual assessment of significance), and (iii) additional activities planned by JSTs to further tailor the ongoing SEP to the specificities of the supervised group or entity (e.g. analyses of the bank's business model or governance structure). While the first two sets of activities are defined centrally, the third is bank-specific and defined by the respective JST.

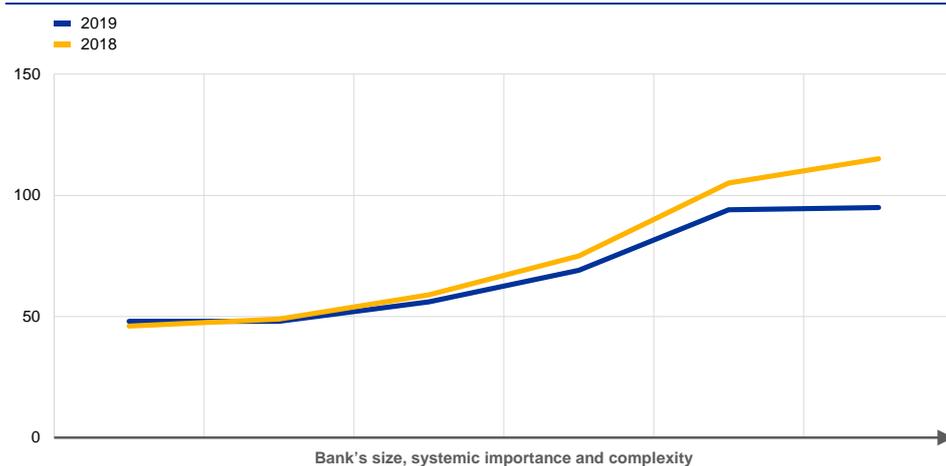
Being proportionate

Supervisory activities in 2019 followed the principle of proportionality, tailoring the intensity of supervision to the systemic importance and risk profile of the supervised bank

The SEP follows the principle of proportionality, i.e. the intensity of the supervision depends on the size, systemic importance and complexity of each institution. Following guidance from the internal SSM Simplification Group in 2019, the average number of centrally defined supervisory activities per SI was reduced slightly from the previous year (see [Chart 17](#)), which meant that the JSTs had more leeway to address institution-specific risks.

Chart 17

Average number of tasks per SI in 2018 and 2019



Source: ECB.

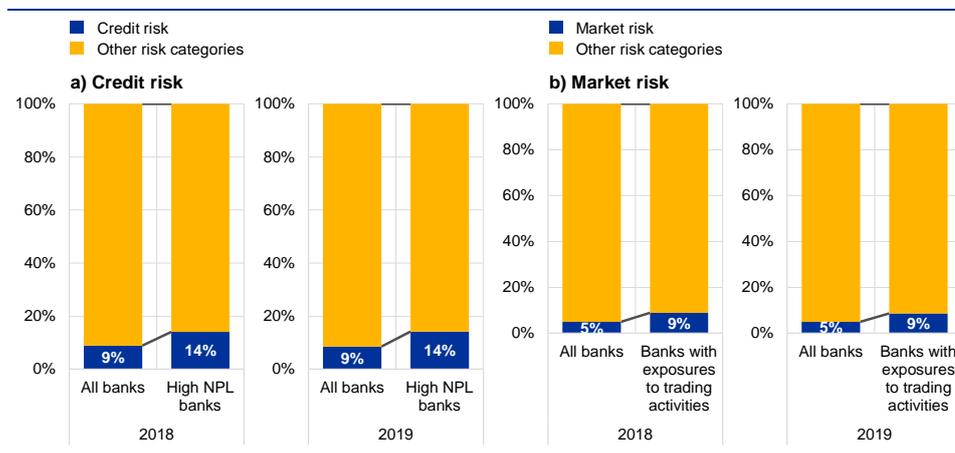
Taking a risk-based approach

The SEP takes a risk-based approach, focusing on the most relevant risk categories for each SI. For example, the percentage of tasks related to credit risk is greater for

high NPL banks than for the average bank, and the percentage of tasks relating to market risk is higher for banks with large exposures to market and trading activities than for the average bank. (see [Chart 18](#)).

Chart 18

SEP activities in 2018 and 2019: focus on credit risk and market risk



Source: ECB.

Note: Only planned activities related to risk categories were considered.

Highlights of off-site supervision in 2019

In the context of the ongoing 2019 SEP, three centrally driven activities are of particular significance: (i) the SREP assessment, (ii) the liquidity stress test, and (iii) the assessment of banks' credit underwriting criteria.

The SREP is the key supervisory tool for summarising all the information collected on an individual institution in a given year to produce the annual risk assessment for that institution. That assessment forms the basis of the supervisory dialogue with the institution on appropriate supervisory measures before they are decided on by the ECB. In 2019 the assessment of institutions' ICAAPs and ILAAPs against the backdrop of the new [ECB guides](#) and the [results of the liquidity stress test](#) (LiST) served, among other things, as important input for the SREP.

The LiST examined banks' resilience in terms of liquidity. The bottom-up exercise covered 103 SIs and was based on banks' liquidity information as at the end of 2018. The results were published on 7 October 2019.²⁹

Another activity that required considerable JST involvement was a structured assessment of the quality of banks' underwriting criteria. This exercise involved 94 SIs that were subject to a qualitative and quantitative data collection exercise that focused mainly on standard lending practices. Based on a quantitative horizontal

²⁹ For further details on the liquidity stress test, see Section 1.1.1.

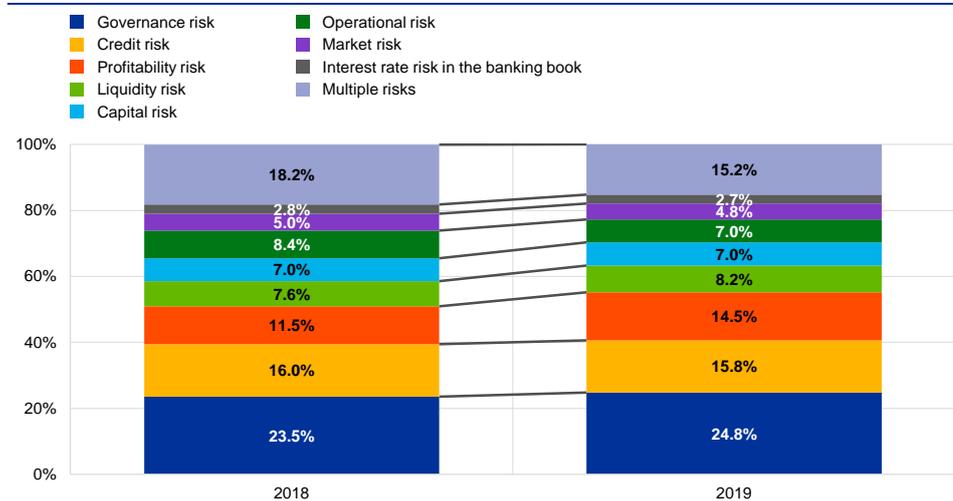
analysis of the data collected, feedback will be provided to banks and follow-up actions will be devised³⁰.

Deep dives

As part of ongoing supervision, JSTs have discretion to address institution-specific risks. They do so, for instance, by setting the scope of deep dives, i.e. analyses of idiosyncratic issues, which are part of the SEPs. In 2019 they performed a larger number of deep dives than in 2018, possibly owing to the smaller number of centrally driven tasks. The risk areas subject to deep dives broadly reflected the supervisory priorities for 2019 (see **Chart 19**).

Chart 19

Deep dives and analyses by risk category in 2018 and 2019



Source: ECB.

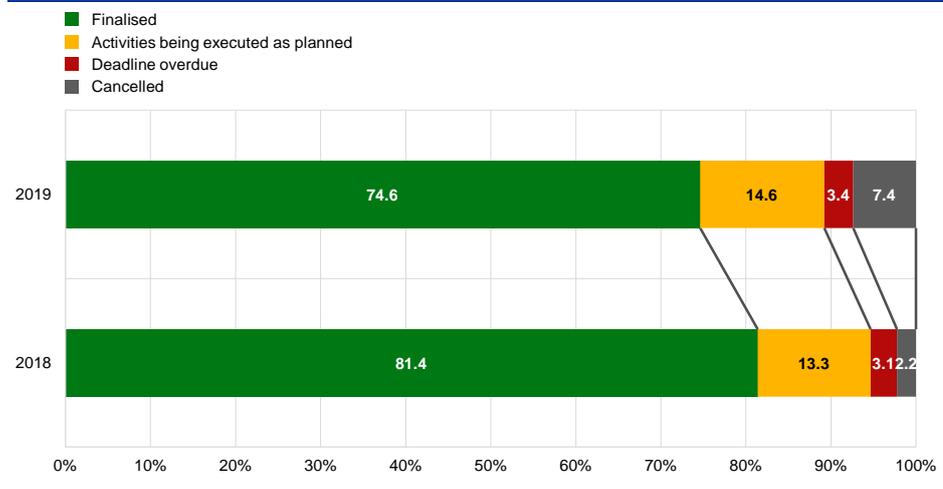
Status of SEP activities

The 2019 SEPs were successfully executed, with a 90% implementation rate

The 2019 SEPs were successfully executed. At the end of the year, 90% of all activities had followed the initial plan. Of those, 75% had been completed, while 15% were still being executed as planned. Another 3% of activities will be completed in 2020 with some delay. 7% of activities were cancelled, mainly owing to changes in bank structures, but also because some SIs became LSIs and were thus no longer directly supervised by the ECB (see **Chart 20**). All key activities were performed according to plan, covering the main risks for the banking sector. Overall, the low percentages of delays and cancellations underline the suitability and stability of the ongoing SEPs, as well as the JSTs' ability to carry out activities according to plan.

³⁰ For further details, see Section 1.2.3.

Chart 20
Completion rate in 2019



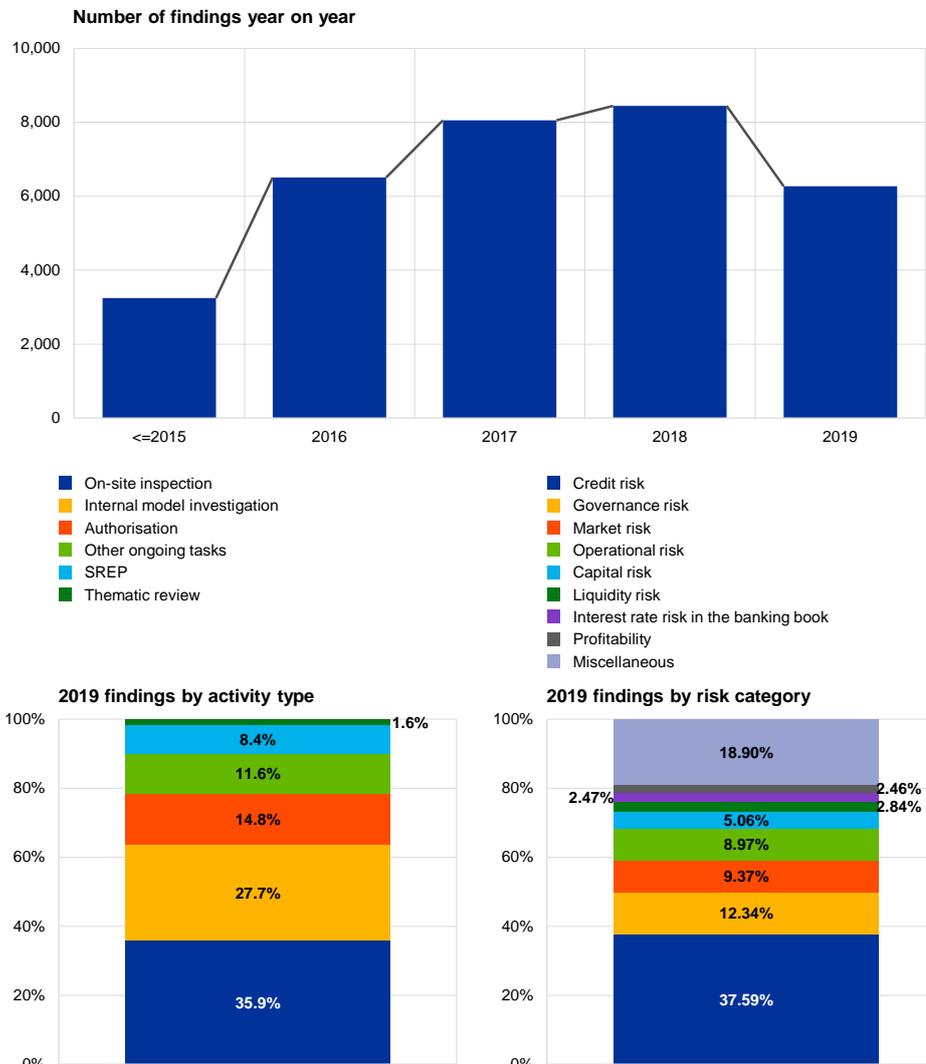
Source: ECB.

Supervisory findings

“Supervisory findings” are one of the main outcomes of the regular supervisory activities and reflect shortcomings that need to be remedied by banks. The JSTs are responsible for monitoring how banks follow up on these findings. In 2019 the overall number of registered findings fell by comparison with previous years.³¹ The majority of the findings originated from on-site inspections, internal model investigations and activities related to authorisations (see [Chart 21](#)).

³¹ There were two main reasons for this decrease: (i) there were no thematic reviews completed in 2019, thus cutting out one source of findings; and (ii) findings from internal model investigations are now included at a later stage of the process, which resulted in a one-off reduction in the number of findings in 2019.

Chart 21
Supervisory findings



Source: ECB.
Note: 34 findings from previous JSTs are excluded.

The SREP 2019

The SREP is an annual exercise in which supervisors examine banks' risks and subsequently determine individual capital requirements and guidance for each bank, in addition to legally required minimum capital.

For the 2019 SREP, the ECB published, for the first time, aggregate data by business model and bank-by-bank information on Pillar 2 requirements.³² This is in

³² More information on the results and methodology of the 2019 SREP can be found on the [ECB's banking supervision website](#).

line with the goal of providing more transparency to banks, investors and the general public.

In 2019 the SREP requirements and guidance (excluding systemic buffers and the countercyclical buffer) for CET1 capital remained unchanged from 2018, at 10.6%. This confirmed a stabilisation in the supervisory assessment of banks' capital needs. Almost all banks had adequate levels of capital, in excess of all requirements, including the systemic buffers and the countercyclical buffer.

In addition to capital requirements and guidance, qualitative measures are often required as an outcome of the SREP. In the 2019 SREP 91 banks received qualitative measures, only slightly more than in 2018. The distribution of the qualitative measures shows that supervisory concerns are particularly focused on the area of internal governance: almost a third of all remedial actions to be taken by banks relate to their governance. Indeed, the SREP scores for internal governance worsened across all business models, continuing a trend seen in previous years.

At the same time, the scores for operational risk also deteriorated, which reflects the fact that IT and cyber risks have increased for a number of banks. Thus, in 2020 ECB Banking Supervision is maintaining a heightened focus on such risks by carrying out on-site inspections dedicated to IT. In addition, the harmonised cyber incident reporting framework will provide greater insights into cyber security breaches – clearly an area that banks need to work on.

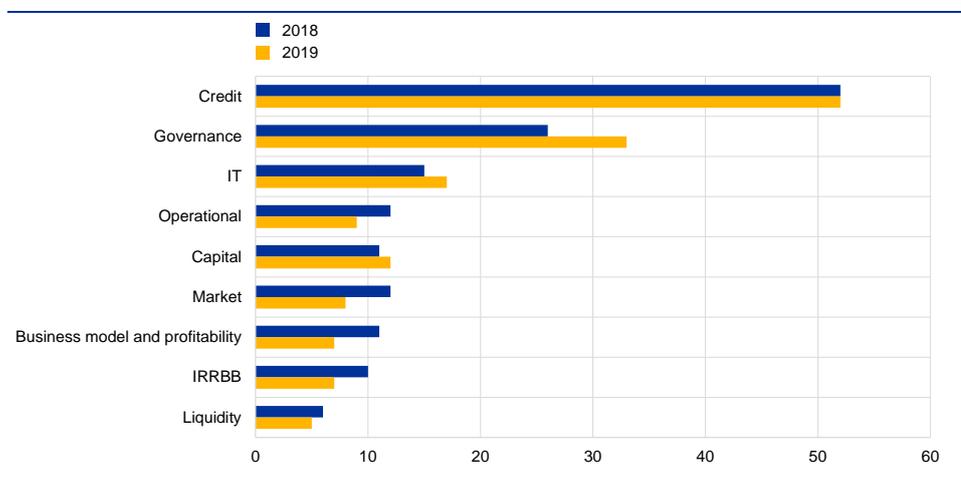
1.3.2 On-site supervision

151 OSIs were launched in 2019

As part of the on-site SEP, a total of 151 on-site inspections (OSIs) were launched in 2019, compared with 156 in 2018. The planning of the OSIs was based on the supervisory priorities for 2019 (see [Chart 22](#)). The OSI programme remained flexible so that it could be updated regularly throughout the year to deal with urgent situations and unexpected events.

Chart 22

OSIs in 2018 and 2019, broken down by risk type



Source: ECB.

On-site supervision planning forms part of the ongoing supervision. Although the OSI programme is driven by the [SSM supervisory priorities](#), it is also tailored to the specificities of each supervised entity in a proportionate and risk-based manner. OSIs draw on the ongoing supervisory work done by the JSTs. They are a complementary, intrusive and focused supervisory tool based on close cooperation with the JSTs, but at the same time ensure an additional, independent view.

One of the strengths of European banking supervision is the ability to perform horizontal analyses and benchmark banks from across the euro area. Leveraging this ability, the concept of campaigns of OSIs was further expanded in 2019. A campaign clusters together several OSIs examining the same topic, thereby providing a framework for inspection teams to coordinate, continuously collaborate, align objectives and capitalise on synergies. During the year, the campaign approach to OSIs was applied in three different fields, in line with the supervisory priorities: (i) commercial and residential real estate, (ii) leverage finance and prudent market valuation, and (iii) IT risk business continuity.

1.3.2.1 Key findings from OSIs

The following analysis provides an overview of the most critical findings from 113 OSIs undertaken in 2018 and 2019, for which the final reports were published between the fourth quarter of 2018 and the third quarter of 2019.

Credit risk

More than half of the credit risk inspections targeted the quality of assets and were conducted by reviewing credit files. This revealed additional provisioning needs of more than €5 billion and reclassifications from performing to non-performing status amounting to around €4.4 billion. The remaining inspections focused on the qualitative aspects of the credit risk management process. In more detail, the most critical findings were:

- **Inappropriate classification of debtors:** shortcomings in defining and/or identifying defaulted or non-performing exposures, as well as deficiencies in the processes for identifying forbearance and detecting early warning indicators.
- **Underestimation of expected credit losses:** overvaluation of collateral and cure rates, inappropriate cash flow estimates and shortcomings in collateral haircuts and provisioning parameters.
- **Weak monitoring processes:** shortcomings in identifying early signs of credit deterioration and inadequate rating systems.
- **Weak credit-granting processes:** insufficient debtor risk assessments, inadequate price-setting mechanisms and inappropriate exception approval processes.

Governance risk

The most severe findings on governance risk were in the following areas:

- **Corporate structure and organisation:** weak institution-wide risk culture, insufficient human resources, deficiencies in internal control frameworks and incomprehensive organisational guidelines.
- **Internal control functions (including compliance, risk management and internal audit):** severe deficiencies in the status, resources and scope of activity of all internal control functions.
- **Risk data aggregation and risk reporting:** incomprehensive risk management reporting, weaknesses in data architecture and IT infrastructure.

IT risk

The majority of high-severity findings revealed deficiencies in:

- **IT security management:** inadequate measures for the timely detection and mitigation of IT security incidents, and improper management of access rights for privileged user accounts.
- **IT risk management:** insufficient assessment of the residual risks.
- **IT operations management:** lack of comprehensive and accurate asset inventories.

Capital risk

The main findings on **regulatory capital (Pillar 1)** related to deficiencies in the assignment of the correct risk weights to exposures, leading to an underestimation of RWA, particularly in terms of credit risk as a result of the incorrect allocation of exposure classes and determination of collateral value. Other major weaknesses identified related to the absence of suitable control frameworks for the process for calculating capital requirements.

The most severe findings identified in **ICAAP** inspections related to deficiencies in the quantification of risks (mainly credit risk and interest rate risk in the banking book (IRRBB)), underdeveloped stress-testing frameworks (failure to address all material risks with sufficiently severe but plausible events) and material deficiencies in the integration of the ICAAP into the management framework.

Market risk

The most severe findings related to the **measurement and management of valuation risk** (deficiencies in the methodologies for allocating financial instruments

to the fair value hierarchy, inadequate day one profit recognition practices, incomplete fair value measurement frameworks, and severe weaknesses in the implementation of the [EBA's Regulatory Technical Standards on prudent valuation](#)).

IRRBB

The most critical findings on IRRBB related mainly to the **measurement and management of risk**, i.e. inadequacy of the quantification methods, use of inadequate assumptions and parameters, lack of solid grounds for the modelling of non-maturing deposits, absence of regular validation of IRRBB models and weaknesses in group steering.

Liquidity risk

The majority of high-severity findings related to **risk measurement and monitoring** (misclassification of deposits, wrong assumptions in the LCR calculation methodology), **compliance with reporting requirements** (lack of review and errors in the LCR calculation) and **stress testing** (the institutions' specificities are not taken into account in stress-testing scenarios).

Business models and profitability

The most critical findings related to **financial projections analysis** (overly optimistic financial forecasts and scenarios) and **profitability analysis** (insufficient analysis of key profitability drivers and business lines, deficiencies in the pricing tools in terms of including all costs and risks).

Operational risk

The most critical findings related to the **identification of operational risk** (incomplete coverage and definition of significant operational risk) and **its measurement** (deficiencies in the operational risk data collection process, inadequate risk prevention and remediation actions when dealing with operational risk events).

1.4 Indirect supervision of LSIs

For the supervision of LSIs, the SSM Regulation³³ entrusts the ECB with an oversight function and confers the direct supervision of these institutions on the

³³ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

NCAAs. In 2019 several important milestones were reached in developing and maintaining the operational framework for the NCAAs' supervision, and the ECB's indirect supervision, of LSIs.

1.4.1 Oversight of LSI supervision

In 2019 the ECB prepared a risk report on LSIs, which was published in January 2020

As part of its oversight activities in 2019, the ECB prepared a [risk report on LSIs](#), which was published in January 2020. This report provides the results of an annual assessment of the state of the LSI sector, which was undertaken in cooperation with the NCAAs. It combines a comprehensive quantitative analysis of the LSIs' current risk profile with more forward-looking considerations regarding their main risks and vulnerabilities.

In addition, the ECB continued to develop several analytical tools that have been made available to LSI supervisors at NCAAs. These tools display aggregated risk indicators in each jurisdiction of European banking supervision, together with the corresponding system-wide benchmarks. They also facilitate a better detection of outliers within each jurisdiction.

The ECB also further refined its LSI early warning system, the purpose of which is to identify, in a forward-looking manner, those LSIs that are likely to face a deterioration in their financial situation, and provide input into the continuous dialogue with the NCAAs.

The ECB continued to focus on institutional protection schemes

Given the importance of hybrid³⁴ institutional protection schemes (IPSs) for the LSI sectors of some jurisdictions of European banking supervision, the ECB continued to monitor them in 2019. It also conducted a deep-dive analysis of one IPS and supported one NCA in its application for recognition of an IPS.

In addition, the ECB continued to cooperate actively with the NCAAs, conducting a series of visits and meetings throughout the year, both at the technical and the managerial level. Several staff exchanges between the ECB and the NCAAs were organised, with ECB staff joining the NCAAs for three to six-month periods and vice versa. All such initiatives contribute to a better functioning of the ECB's supervision.

Finally, the ECB organised several LSI supervisory intelligence workshops, which provide a platform for discussion with LSIs and other relevant market participants.

Fostering common high-quality standards for LSI supervision within European banking supervision

In 2019 the ECB continued its implementation of a series of initiatives to foster the consistent application of high-quality supervisory standards to LSIs.

³⁴ The term "hybrid" is used here to refer to both SIs and LSIs.

In 2019 the SREP methodology for LSIs was applied to high-priority LSIs

Following approval by the ECB's Supervisory Board in January 2018 of the SREP methodology for LSIs,³⁵ the ECB and NCAs worked on implementing the methodology in a staggered manner. In 2019 the LSI SREP methodology was applied to high-priority LSIs³⁶, and should be applied to all LSIs from 2020. To ensure a consistent application and to support the NCAs in rolling out the methodology, the ECB provided multiple training courses to NCA staff, for example. It also worked on improving the methodology to take better account of newly emerging risks.

Beyond the all-encompassing LSI SREP, the ECB made further progress in promoting a consistent supervision of the IT and cyber risks affecting LSIs. Its horizontal analysis identified best practices, which have been shared with NCA supervisors to encourage high-quality supervision.

The ECB completed a project on national accounting standards

The ECB also completed an important project related to national accounting standards (nGAAP). This involved developing a methodology for converting parts of nGAAP into IFRS and a tool for line supervisors. The tool will enhance internal analytical capabilities and make it easier to compare data from banks that apply different accounting standards.

Work on an SSM policy for the supervision of fintech institutions continued in 2019

Another key area of the supervisory focus is the development of an SSM policy for the supervision of fintech institutions (including both SIs and LSIs). Following the publication of the [Guide to assessments of fintech credit institution licence applications](#) in 2018, the ECB organised an industry dialogue in May 2019. The event focused on the use of credit scoring based on artificial intelligence and big data, as well as the use of cloud computing and robo-advisory services. In the same year, the ECB also revamped its SSM fintech hub, a single point of reference on the topic for all SSM supervisors, and organised training courses on the topic within the SSM supervisory community.

Finally, the ECB conducted a verification exercise in 2019 regarding NCAs' implementation of Guideline (EU) 2017/697³⁷ on the exercise of options and discretions for LSIs.

1.4.2 Other relevant topics for LSI supervision

Following the adoption of the revised Capital Requirements Regulation (CRR II)³⁸ and of the revised Capital Requirements Directive (CRD V)³⁹, the ECB and NCAs

³⁵ The LSI SREP methodology is based on the SREP guidelines developed by the EBA and builds on the ECB's approach to SIs and on existing national methodologies.

³⁶ Low-priority LSIs represent a very limited threat to financial stability and have manageable intrinsic riskiness, whereas medium-priority LSIs have either (i) high intrinsic riskiness with low or medium impact, (ii) low intrinsic riskiness but medium or high impact or (iii) medium riskiness and medium impact. High-priority LSIs are considered as medium or high risk with high or medium impact.

³⁷ Guideline (EU) 2017/697 of the European Central Bank of 4 April 2017 on the exercise of options and discretions available in Union law by national competent authorities in relation to less significant institutions (OJ L 101, 13.4.2017, p. 156).

worked in 2019 on applying the principle of proportionality when supervising LSIs. In particular, the ECB assessed the impact of the new classification of small and non-complex institutions. This work will continue in 2020 in close cooperation with the EBA.

Following the entry into application of the EBA [Guidelines on management of non-performing and forborne exposures](#), the ECB also started to assess NCAs' implementation of those guidelines for LSI supervision. This work will continue in 2020 and will also incorporate a horizontal benchmarking analysis of a sample of LSIs' NPL strategies by the ECB.

In 2019 the ECB launched an assessment of LSIs' credit underwriting standards

In 2019 the ECB launched an assessment of LSIs' credit underwriting criteria. This assessment was based on a survey, which was then supplemented by the collection of statistical data from national central banks and a selection of LSIs. This information will form the basis of a horizontal analysis and feed into follow-up work in 2020.

Finally, the ECB continued to support the convergence of LSI supervision standards across SSM participating Member States by providing NCAs with standardised technical IT tools. These tools are based on those used by the ECB and national supervisors for the supervision of SIs, tailored to the specificities of LSIs and the needs of NCA supervisors.

1.5 Macroprudential tasks of the ECB

With regard to macroprudential policy in the euro area, the ECB continued to engage actively with the national authorities in 2019, in accordance with the tasks conferred on it under Article 5 of the SSM Regulation. Within this defined frame of macroprudential policy, the ECB may apply (i) higher requirements for relevant capital buffers than those applied by the national authorities, and (ii) more stringent measures aimed at addressing systemic or macroprudential risks. The Macroprudential Forum serves as a platform for members of the Governing Council and Supervisory Board to bring together microprudential and macroprudential perspectives from across the SSM. Furthermore, the ECB was involved in the work conducted by the European Systemic Risk Board (ESRB), which is responsible for the macroprudential oversight of the financial system in the EU.

105 macroprudential notifications were received from national authorities in 2019

In 2019 the ECB received 105 macroprudential policy notifications from national authorities. Most of these notifications concerned quarterly decisions on setting countercyclical capital buffers and decisions on the identification and capital

³⁸ Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (OJ L 150, 7.6.2019, p. 1).

³⁹ Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (OJ L 150, 7.6.2019, p. 253).

treatment of global systemically important institutions (G-SIIs) and/or other systemically important institutions (O-SIIs). It also assessed notifications on other macroprudential measures, for example the systemic risk buffers, measures introduced under Article 458 of the Capital Requirements Regulation (CRR)⁴⁰ and the reciprocation of macroprudential measures taken in other Member States.

Following the methodology developed by the BCBS, the ECB and national authorities identified eight euro area G-SIIs⁴¹ that will be required to hold additional capital buffers ranging from 1.0% to 1.5% in 2021. The ECB also received notifications from national authorities on the capital buffer rates for 109 O-SIIs. These rates were in line with the floor methodology for setting the O-SII capital buffers, which the ECB has followed since 2016. The revision work on this methodology has now been completed and the revised methodology will be published in Issue 10 of the ECB Macroprudential Bulletin.

1.6 Looking ahead – risks and supervisory priorities for 2020

The identification and assessment of the risks faced by supervised entities are crucial for successfully conducting banking supervision and serve as a basis for the supervisory priorities that are set during the regular strategic planning process. In October 2019 ECB Banking Supervision, in close cooperation with national supervisors, published its updated SSM Risk Map for 2020 and beyond.

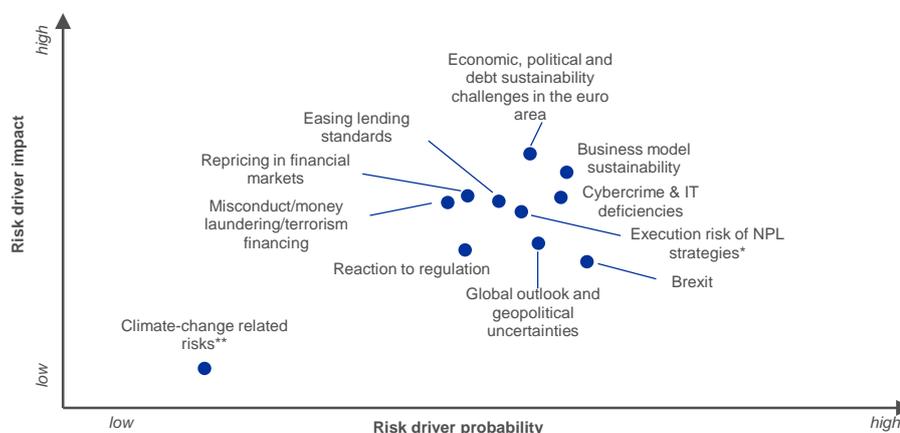
The three most prominent risk drivers expected to affect the euro area banking sector during the period 2020-22 are (i) economic, political and debt sustainability challenges in the euro area, (ii) business model sustainability, and (iii) cybercrime and IT deficiencies. Other risk drivers include execution risk attached to banks' NPL strategies, easing lending standards; repricing in financial markets, and misconduct, money laundering and terrorist financing (see [Chart 23](#)).

Risks related to the euro area economic environment have grown, together with concerns about sustainability of banks' business models

⁴⁰ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

⁴¹ The identified G-SIIs are BNP Paribas, Deutsche Bank, Groupe BPCE, Groupe Cr dit Agricole, ING Bank, Santander, Soci t  G n rale and UniCredit.

Chart 23
SSM Risk Map for 2020



Sources: ECB and national supervisory authorities.

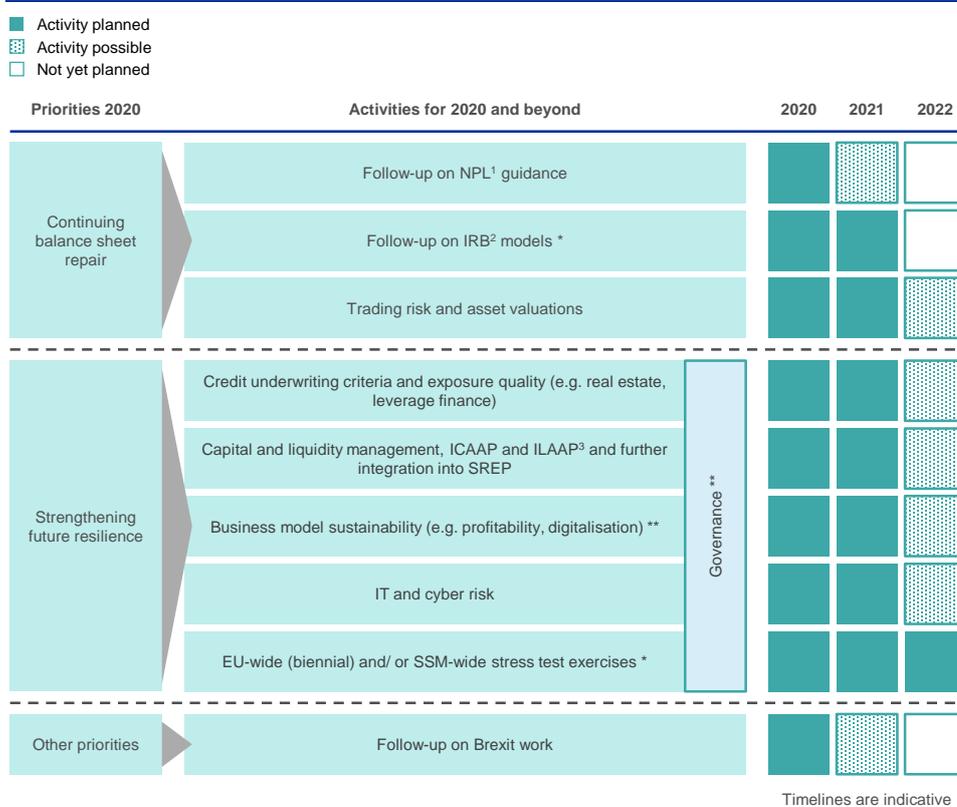
* The execution risk attached to banks' NPL strategies only applies to high NPL banks.

** Climate change-related risks are more relevant over the longer-term horizon (i.e. a horizon of more than three years).

Compared with the risk assessment for 2019, risks related to the euro area economic environment have increased amid a deteriorating global growth outlook, mainly on the back of rising trade protectionism, uncertainties surrounding Brexit and pronounced debt sustainability concerns in some countries. This, together with the prolonged period of low interest rates that is expected to continue, is adding to concerns about the subdued profitability of euro area banks and the sustainability of their business models. More intense scrutiny of money laundering cases is also driving up the risk of losses owing to misconduct.

To ensure that banks address these key challenges effectively, ECB Banking Supervision reviewed its supervisory priorities, which were subsequently published alongside the SSM Risk Map. In the early years of European banking supervision, restoring the health of banks' balance sheets was crucial, but the supervisory focus has gradually shifted. It now encompasses banks' future resilience and the sustainability of their business models. The supervisory priorities were therefore adjusted to include the high-level priority areas of (i) continuing balance sheet repair, (ii) strengthening future resilience, and (iii) following up on Brexit work (see **Figure 3**).

Figure 3
Supervisory priorities 2020



Source: ECB.
 * Amended activity.
 ** New activity/focus area in 2020.
 1) Non-performing loans.
 2) Internal ratings-based.
 3) Internal capital and liquidity adequacy assessment processes.

As in previous years, a three-step approach will be followed to ensure effective implementation: (i) planning the activities to be carried out by European banking supervision in 2020 on the basis of the supervisory priorities, (ii) ensuring that these activities are executed, and finally (iii) assessing the efficacy of the activities that have been executed, i.e. the extent to which they have actually achieved the goals set out in the supervisory priorities.

Box 3
Green finance

It has become clear that climate-related and environmental risks and the adjustment towards a more sustainable economy will have an impact on the financial system and might pose financial risks to euro area banks.⁴² For the second year in a row, the SSM Risk Map for 2020 has thus identified climate-related and environmental risks as one of the key risk drivers for euro area banks over a longer-term horizon. Against this backdrop, in 2019 the ECB conducted two surveys covering

⁴² See “Banking in a changing climate – preparing for what lies ahead”, *SSM Supervision Newsletter*, ECB, May 2019, and “Climate change and financial stability”, Special Feature A, *Financial Stability Review*, ECB, May 2019.

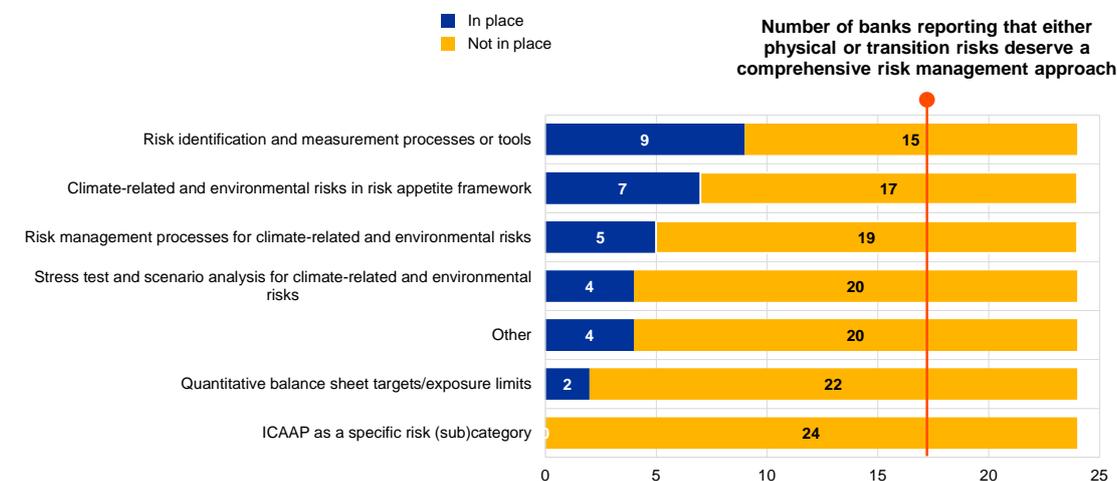
a total of around 30 significant institutions (representing around 44% of total euro area banking assets) and a number of less significant institutions to gain a better understanding of where banks stand when it comes to incorporating climate-related and environmental risks into their business strategy, their risk management and their governance frameworks.

In general, institutions are engaging with the issue of climate change. This engagement varies depending on the size, business model, complexity and geographic location of the bank. It is particularly evident from a “corporate” perspective, in that it focuses predominantly on outlining the bank’s contribution to sustainability objectives and on monitoring business opportunities arising from the growing demand for green financial products.

Chart

Banks’ risk management approaches to climate-related and environmental risks

(list of risk management approaches; number of banks)



Source: ECB staff calculations based on a voluntary ECB-EBA market practices survey covering 24 significant institutions.

Most of the banks surveyed reported that the potentially material risks were either physical or transition risks, but that there was room for improvement in terms of the incorporation of climate-related and environmental risks into their risk management frameworks (e.g. integration in the risk appetite framework, internal capital adequacy assessment process (ICAAP)) (see the **chart**). However, when integrating climate-related and environmental factors into these frameworks, banks are faced with certain methodological challenges. Accurate data and relevant indicators are scarce, as borrowers only disclose partial information and that information is not homogenous. Moreover, it is difficult to determine workable assumptions on how and when climate-related and environmental risks might materialise. This is due to uncertainty surrounding the implementation of state/government policies, the impact of potential technological progress and changes in market sentiment. At the current juncture, disclosures on climate-related and environmental risks are limited and often not very transparent in terms of the definitions and taxonomy, which makes it difficult to compare them. In addition, disclosures are mostly backward-looking, hence lack the forward-looking, long-term perspective that is particularly relevant for climate-related and environmental risks.

In light of the above, the ECB is of the view that banks should adopt a timely and strategic approach to dealing with climate-related and environmental risks, and increase their efforts to disclose meaningful information on these risks. In this regard, in December 2019 the European Banking

Authority (EBA) published the [Action plan on sustainable finance](#). This plan sets out some key policy messages and expectations for banks and encourages them to already start incorporating environmental, social and governance (ESG) factors into their strategies, risk management frameworks, disclosures and scenario analyses.⁴³ Indeed, banks are getting increasingly involved in joint industry initiatives to enhance their methodologies for measuring such risks and to contribute to broader and more comparable disclosures.

Looking ahead, the ECB plans to step up its dialogue with the industry to ensure that climate-related and environmental risks are adequately taken into account under the current regulatory framework. To that end, the ECB will formulate and communicate to banks its supervisory expectations on how they should take climate-related and environmental risks into account in their business strategies, governance and risk management frameworks, and on how they should enhance their disclosures to become more transparent in this regard. ECB Banking Supervision will also continue cooperating with the national competent authorities, financial regulators (e.g. the EBA and the Basel Committee on Banking Supervision), as well as with other central banks and supervisors (notably through the Network for Greening the Financial System) to further develop its supervisory approach to climate-related and environmental risks.

⁴³ The EBA has been extended several mandates over the period up to 2025 to assess the potential incorporation of ESG risks into the three pillars of prudential supervision.

2 Authorisations, enforcement and sanctioning procedures

2.1 Authorisations

2.1.1 Changes in the number of supervised entities

The annual assessment, in line with the SSM Framework Regulation⁴⁴, of whether a bank or banking group fulfils any of the significance criteria⁴⁵, was concluded in October 2019. It was supplemented by ad hoc significance assessments that were carried out following changes in group structures and other developments in banking groups. A total of seven banks were classified as significant in the course of 2019 or as of 2020, while nine banks were removed from the list of significant institutions. As a result, 117 institutions⁴⁶ were classified as significant as of 1 November 2019, down from 119 in the previous annual assessment of significance as of 14 December 2018 (see [Table 1](#)). The composition of the list of significant institutions (SIs) and less significant institutions (LSIs) has changed as a result of new group structures, a licence withdrawal, business relocations owing to Brexit, regulatory changes and other developments. While the number of SIs has fallen, they are generally becoming larger and more complex as banking groups consolidate or relocate activities from the United Kingdom to the euro area.

In 2019 seven banks were added to the list of ECB supervised entities.

- As a result of the annual significance assessment, one bank, Akcinė bendrovė Šiaulių bankas, was classified as significant after it became the third largest credit institution in Lithuania. It has been directly supervised by the ECB since 1 January 2020.
- Owing to Brexit, four banks, namely UBS Europe SE, J.P. Morgan AG, Morgan Stanley Europe Holding SE and Goldman Sachs Bank Europe SE, were expected to significantly increase their business activities in the euro area and were thus placed under the ECB's direct supervision in 2019.
- A new banking group led by Cassa Centrale Banca – Credito Cooperativo Italiano S.p.A. was classified as significant in 2019 because its assets exceeded €30 billion. The group was formed following the consolidation of a

⁴⁴ Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (OJ L 141, 14.5.2014, p. 1).

⁴⁵ These criteria are set out in Article 6(4) of the SSM Regulation.

⁴⁶ The [list](#) of SIs and LSIs published in December 2019 reflects (i) the significance decisions notified to the supervised institutions before 1 November 2019, and (ii) other changes and developments in group structures effective before 1 November 2019.

number of cooperative banks after a law was introduced in Italy to reform the sector.

- The ECB also took over the supervision of AS PNB Banka in April 2019 at the request of the Latvian Financial and Capital Market Commission. The ECB later declared the bank “failing or likely to fail”.

Meanwhile, nine banks were removed from the list of ECB supervised banks.

- Five banks became branches of SIs and were thus removed from the list while still being supervised as part of the group: Luminor Bank AB, Luminor Bank AS and branches of Barclays Bank plc in Germany, France and Italy.
- The ECB stopped directly supervising three banks following the amendments introduced by the revised Capital Requirements Directive (CRD V) that excluded development banks from the ECB’s supervisory remit: Landeskreditbank Baden-Württemberg-Förderbank, Landwirtschaftliche Rentenbank and NRW.BANK.
- One bank, namely ABLV Bank Luxembourg, S.A., had its licence withdrawn.

The list of supervised entities is updated throughout the year. The most recent version of the list can be found on the [ECB’s banking supervision website](#).

Table 1

Significant and less significant banking groups or stand-alone banks under European banking supervision following the 2019 annual assessment

	Total assets (EUR billions)	Number of entities at consolidated level	Number of entities at individual level	Average size at consolidated level (EUR billions)
SIs	21,377.5	117	1,004	182.7
LSIs	4,729.0	2,369	2,662	2.0

Source: ECB.

Notes: “Total assets” refers to the total assets of entities included in the list of supervised entities as published in December 2019 (with reference date of 1 November 2019). The; reference date for total assets is 31 December 2018 (or the latest available, as used for the latest significance assessment).

Comprehensive assessments in 2019

In July 2019 the ECB concluded a comprehensive assessment of Nordea Bank Abp, which had become subject to direct supervision by the ECB in 2018 as a result of the relocation of its headquarters from Sweden to Finland. In the same month, comprehensive assessments of six Bulgarian banks were completed, following a request by Bulgaria to establish close cooperation between the ECB and Българска народна банка (Bulgarian National Bank). The Bulgarian authorities are in the process of following up on the findings of the exercise, with the aim of initiating close cooperation in 2020 (see Section 4.1).

In May 2019 Croatia also submitted a request to establish close cooperation between the ECB and Hrvatska narodna banka (see Section 4.1). Following the

established procedure, the ECB thus initiated comprehensive assessments of five Croatian banks in September 2019, which are due to be completed in the second quarter of 2020.

An additional two banks materially increased their presence in SSM participating Member States in the context of Brexit. Comprehensive assessments of these banks were initiated in September 2019 and are due to be completed in the second quarter of 2020.

2.1.2 Authorisation procedures

Number of procedures

In 2019 national competent authorities (NCAs) notified a total of 3,569 authorisation procedures⁴⁷ to ECB Banking Supervision (see **Table 2**). These notifications comprised 34 licence applications, 15 licence withdrawals, 36 lapsings of authorisation⁴⁸, 110 acquisitions of qualifying holdings, 407 passporting procedures and 2,967 fit and proper procedures (individual assessments for management and supervisory board members, key function holders and third-country branch managers)⁴⁹.

Table 2
Authorisation procedures notified to the ECB

	Common procedures (SIs and LSIs)					SIs
	Licensing	Withdrawal of licence	Lapsing of authorisation	Qualifying holding	Passporting	Fit and proper procedures
2015	37	26	26	134	431	2,729
2016	24	42	178	142	252	2,544
2017	24	41	52	160	448	2,301
2018	43	26	82	100	419	2,026
2019	34	15	36	110	407	2,967

Note: The metrics applied to ensure reliability of the data aim to provide a full insight into the actual number of procedures notified and processed, without prejudice to possible minor inaccuracies as a result of temporary workflow-related issues.

Some 1,282 authorisation decisions were finalised⁵⁰ in 2019. Of these, the Supervisory Board submitted 556 draft decisions which were then approved by the

⁴⁷ These procedures refer to procedures that were officially notified to the ECB in the reporting period (i.e. incoming notification procedures). The number of authorisation procedures does not correspond to the number of supervisory decisions that were finalised or adopted in the reporting period (i.e. outgoing decisions).

⁴⁸ Lapsing of an authorisation means that, where national law so provides, the authorisation ceases to exist without requiring a formal decision to that effect; it is a legal effect that takes place as soon as a specific, well-defined trigger occurs, e.g. the express renunciation of a licence by the entity or the fact that the institution itself ceases to exist, for instance owing to a merger with another company.

⁴⁹ A limited number of requests for additional non-executive directorships is also included.

⁵⁰ Some decisions cover more than one authorisation assessment (e.g. fit and proper assessments of several board members of the same SI or acquisitions of qualifying holdings in different subsidiaries resulting from a single transaction). Some authorisation procedures do not require a formal ECB decision, notably including passporting and lapsing procedures.

Governing Council. The remaining 726 were approved by senior management within the framework for delegation⁵¹. These 1,282 authorisation decisions account for 54.41% of all ECB individual supervisory decisions.

Compared with 2018, trends in authorisation procedures diverged: the number of fit and proper procedures rose significantly, while the number of common procedures either decreased or, for qualifying holding and passporting procedures, remained more or less stable.

Developments in common procedures

The vast majority of licensing procedures in 2019 were associated with the establishment of new LSIs. As in previous years, the two main drivers of new bank applications were related to the planned withdrawal of the United Kingdom from the EU and the increasing use of digital innovations to provide services to EU clients (fintech business models).

The licensing procedures concerning SIs were primarily due to organisational restructuring or the need to extend a bank licence for additional regulated activities being planned by the bank. Two SI procedures concerned an extension of authorisation for investment services, and one concerned an extension of authorisation for the issuance of covered bonds. Another SI procedure related to a major corporate transformation, which involved a hive-down of its banking services to a newly established entity.

In January 2019 the ECB published the consolidated edition of the two parts of its [Guide to assessments of licence applications](#).

Withdrawal procedures arose mainly from banks that were voluntarily terminating their business activity or entering into mergers or other types of restructuring. This pertained, in particular, to licence relinquishments, which accounted for around half of all withdrawal procedures. Nevertheless, in a limited number of cases, the withdrawal of an authorisation was due to an institution's failure to meet prudential requirements or a failure to comply with rules on money-laundering prevention.

Just over half of all qualifying holding procedures concerned SIs. In 2019 only limited cross-border consolidation among SIs was observed. In terms of absolute numbers, the majority of qualifying holdings procedures notified to the ECB in 2019 related to internal reorganisations of the shareholding structure of supervised entities. First and foremost, these reorganisations sought to simplify the group structure and/or reduce costs.

⁵¹ These procedures refer to procedures which are subject to the delegation frameworks approved under Decision (EU) 2017/935 of the European Central Bank of 16 November 2016 on delegation of the power to adopt fit and proper decisions and the assessment of fit and proper requirements (ECB/2016/42), and Decision (EU) 2019/1376 of the European Central Bank of 23 July 2019 on delegation of the power to adopt decisions on passporting, acquisition of qualifying holdings and withdrawal of authorisations of credit institutions (ECB/2019/23).

A small number of procedures were related to acquisitions of stakes in SIs by private equity investors or other supervised entities, though no discernible trend was observed vis-à-vis 2018. Such cases are often complex, involve multifaceted assessments of a range of private and public stakeholders, and may have implications for future policies. In terms of materiality and depth of analysis, such cases represent the majority of the work done on procedures involving SIs.

Brexit again required significant supervisory efforts in 2019 in terms of assessing banks wishing to shift activities from their UK-based entities to the euro area. The ECB engaged continuously with these banks. An important focal point was to prevent these banks from setting up empty shells. To this end, the ECB discussed in detail with the banks their plans regarding internal governance, staffing and organisation, booking and hedging strategies and intragroup arrangements.

For common procedures in general, in a few cases, mainly related to qualifying holdings, the applicants decided to withdraw their notifications after submitting the first drafts for case-specific reasons, including doubts or concerns raised by the supervisors during the initial assessment.

Developments in fit and proper assessments

In 2019 the ECB received a significantly higher number of fit and proper procedures than in 2018, owing to the reform and subsequent consolidation of the cooperative banking sector in Italy that resulted in the creation of two large cooperative banking groups. This also led to more than 200 small credit institutions being brought under the direct supervision of the ECB, for which around 1,000 board members were (re)appointed and had to be assessed in the course of the year.

Around 75% of all fit and proper procedures received in 2019 concerned members of the management body in its supervisory function. The remaining 25% concerned members of the management body in its management function (around 20%), key function holders (3%) and third-country branch managers (1%).

For around 40% of the members of management bodies that were assessed, the ECB identified concerns regarding one or more of the fit and proper criteria. Consequently, the ECB imposed conditions, obligations or recommendations on the SIs to address the identified concerns. The most common issues related to the experience and time commitment of board members.

The ECB's fit and proper assessments involve interacting with the relevant NCAs and the banks themselves. Whenever there are doubts or concerns raised about the suitability of a candidate, it often happens that either the candidates themselves or the institution decide to withdraw the application. Such cases therefore do not result in a negative decision. In 2019 applications were withdrawn in 12 procedures following the aforementioned interaction.

In August 2019 the ECB published a [report on the declared time commitment of non-executive directors in the SSM](#). The benchmarking data underlying this report

provide an overview of the time allocated by non-executive directors to their functions and aim to support banks and supervisors in assessing the suitability of non-executive directors.

In 2019 the ECB continued its intense dialogue with those banks that submit the highest number of fit and proper applications. The aim was to further enhance transparency and communication around fit and proper assessments and to support banks in submitting complete and accurate applications. As part of this ongoing dialogue, the ECB organised a roundtable in February 2019 with representatives of banks to discuss and underline the importance of fit and proper assessments in ensuring high-quality oversight by non-executive directors. The roundtable allowed for an exchange of views on governance best practices and common challenges regarding that issue. The outstanding issue is the fragmentation of the rules for fit and proper assessments across the euro area.

In cooperation with the NCAs, the ECB is also developing an online portal in order to manage the fit and proper application process more efficiently. The active involvement of the banks, as end users, in the design phase of the project was ensured through a series of workshops held in 2018 and 2019. Further details are provided in Box 2 on supervisory technology.

2.2 Breach reporting, enforcement and sanctioning

2.2.1 Enforcement and sanctioning

Under the SSM Regulation and the SSM Framework Regulation, the allocation of enforcement and sanctioning powers between the ECB and the NCAs depends on the nature of the alleged breach, the person responsible and the measure to be adopted (see the [ECB Annual Report on supervisory activities 2014](#)). In accordance with the applicable legal framework, the penalties imposed by the ECB within the remit of its supervisory tasks are published on the [ECB's banking supervision website](#). The penalties imposed by the NCAs following the request of the ECB are published on the same website.

Taking into account the 11 proceedings that were ongoing at the end of 2018, the ECB handled 34 sanctioning proceedings in 2019 (see [Table 3](#)). These 34 proceedings led to 11 ECB decisions.

Table 3**ECB enforcement and sanctioning activity in 2019**

	Enforcement and sanctioning proceedings
Ongoing proceedings at year-end 2018	11
Proceedings opened during 2019	23
Proceedings handled during 2019	34
of which finalised with ECB decisions imposing penalties	12
of which finalised with ECB requests addressed to NCAs to open proceedings	13
of which proceedings closed	1
of which ongoing proceedings at year-end 2019	8

Source: ECB.

Notes: Several ECB decisions addressed more than one proceeding. In 2019, 12 proceedings were finalised with six ECB decisions imposing penalties. A further 13 proceedings were finalised with five ECB decisions requesting that the relevant NCA open proceedings.

Of the 34 sanctioning proceedings handled in 2019, 21 were related to suspected breaches of directly applicable EU law (ECB decisions and regulations included) committed by ten SIs.

In 2019 the ECB adopted three sanctioning decisions, imposing three penalties on three supervised entities to an overall amount of €7.6 million. In addition, three sanctioning decisions were adopted in late 2018 against one supervised entity (to an overall amount of €0.6 million). These decisions were published in 2019. The aforementioned penalties were imposed for breaches committed in the area of own funds, capital requirements, reporting and large exposures.

One proceeding related to breaches of directly applicable EU law was closed during 2019, owing to the absence of a legal basis for imposing sanctions in that specific case. Another eight proceedings were still ongoing at the end of the year.

Regarding the remaining 13 sanctioning proceedings handled in 2019, the ECB had no direct sanctioning powers and could thus only request the NCAs to open proceedings. These proceedings were related to suspected breaches of national law transposing the provisions of the Capital Requirements Directive (CRD IV)⁵² – mostly concerning governance requirements – allegedly by SIs or natural persons. On the back of these proceedings, the ECB adopted five decisions requesting NCAs to open sanctioning proceedings within the remit of their national competences.

Following previous requests from the ECB to open proceedings, and having assessed the cases in accordance with their national law, in 2019 the relevant NCAs issued a reprimand and a pecuniary penalty amounting to €0.1 million.

A complete breakdown by area of infringement of the suspected breaches subject to the enforcement and sanctioning proceedings handled in 2019 by the ECB is shown in **Chart 24**.

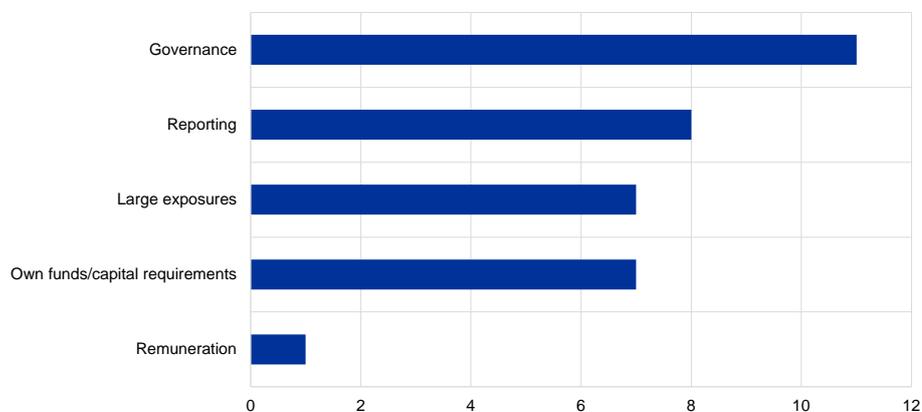
⁵² Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

In 2019 the ECB imposed three penalties amounting to €7.6 million. In addition, three penalties adopted in late 2018 were published in 2019

Following the ECB's request to open proceedings, and having assessed the cases in accordance with their national law, in 2019 the NCAs issued a reprimand and a pecuniary penalty of €0.1 million

Chart 24

Suspected breaches subject to enforcement and sanctioning proceedings



Source: ECB.

2.2.2 Breach reporting

In 2019 the ECB received 133 whistleblowing reports, an increase of 10% compared with the previous year

It is the ECB's duty to ensure that effective mechanisms are put in place to enable any person to report breaches of relevant EU law (a process commonly referred to as "whistleblowing"). Accordingly, the ECB set up a breach reporting mechanism, which includes a [pre-structured web platform](#) that can be accessed via the ECB's banking supervision website.

The ECB ensures full confidentiality of the whistleblowing reports received via the web platform or other channels (e.g. email or post) and takes into account all available information when carrying out its supervisory tasks.

In 2019 the ECB received 133 whistleblowing reports, which is a 10% increase on the previous year. Of these, 73 referred to alleged breaches of relevant EU law, 63 of which were considered to be within the ECB's supervisory remit and ten within that of the NCAs. The remainder referred mainly to alleged breaches of non-prudential requirements (e.g. consumer protection), which fell outside the scope of the breach reporting mechanism.

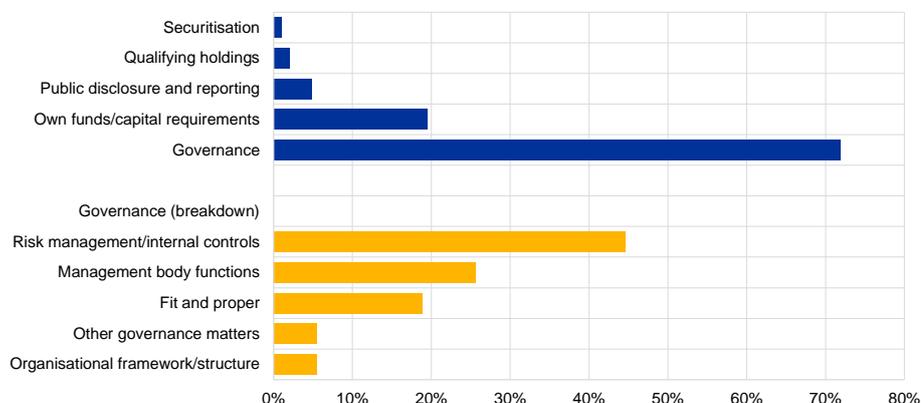
Among the most common alleged breaches reported were governance issues (72%) and inadequate calculation of own funds and capital requirements (19%). The complete breakdown is shown in [Chart 25](#). Governance-related issues referred mainly to risk management and internal controls, fit and proper requirements and organisational structure⁵³.

⁵³ "Risk management and internal controls" comprises the mechanisms or processes that an entity needs to have in place for the adequate identification, management and reporting of the risks it is or might be exposed to. "Organisational structure" refers to the extent to which an institution has well-defined, transparent and consistent lines of responsibility.

Chart 25

Alleged breaches reported via the “whistleblowing” mechanism

(percentages)



Source: ECB.

The relevant Joint Supervisory Teams were made aware of the information reported via the “whistleblowing” mechanism. The information was given appropriate consideration (e.g. by assessing its impact on the risk profile of supervised entities) and followed up on by the ECB as part of its supervisory tasks. The main investigatory actions taken in 2019 in relation to the whistleblowing reports on breaches of relevant EU law included:

- internal assessment based on existing documentation (79% of the cases);
- request for documents or explanations to the supervised entity (14% of the cases);
- request for an internal audit or on-site inspection (7% of the cases).

3 Contributing to crisis management

3.1 Crisis cases in 2019

3.1.1 The case of AS PNB Banka

ECB Banking Supervision determined on 15 August 2019 that AS PNB Banka was failing or likely to fail

Under the EU crisis management framework, the ECB can, after consulting the Single Resolution Board (SRB), determine that a supervised entity is failing or likely to fail (FOLTF). On 15 August 2019 ECB Banking Supervision determined that the Latvian significant institution (SI)⁵⁴, AS PNB Banka, was FOLTF in accordance with Article 18(4)(a) and (b) of the Single Resolution Mechanism Regulation (SRMR)⁵⁵. In particular, an on-site inspection carried out by the ECB found objective elements to support the determination that the assets of AS PNB Banka were worth less than its liabilities. In addition, the bank was also infringing the requirements for continuing authorisation in a way that justified the withdrawal of its authorisation by the ECB.

Lead-up to the FOLTF determination

AS PNB Banka had been consistently breaching Pillar 2 requirements since December 2017

Owing primarily to idiosyncratic weaknesses, AS PNB Banka had been consistently breaching its Pillar 2 requirements since 31 December 2017. These idiosyncratic weaknesses mainly resulted from (i) a large number of its assets being non-performing and concentrated in a small number of borrowers; (ii) a structural decrease in its operating income, which historically relied on fees from large international money transfers and maintenance fees from bank accounts for non-residents; and (iii) high administrative expenses driven by the compensation paid to the bank's board members and the cost of legal services.

AS PNB Banka had also breached additional requirements since March 2016

Moreover, AS PNB Banka had breached additional requirements, namely the large exposure limits in accordance with Article 395 of the Capital Requirements Regulation (CRR) since March 2016, and the national related party lending limit of 15% of eligible capital in accordance with Section 43(1) of the Latvian Credit Institution Law since February 2018.

AS PNB Banka was unable to restore compliance with the requirements and ran into serious capital problems

Despite repeated requests by the competent authorities (including the adoption of a decision on an early intervention measure by the ECB on 11 July 2019), AS PNB Banka was unable to restore compliance with the above-mentioned requirements.

⁵⁴ Following a request made by the Latvian Financial and Capital Market Commission, the ECB assumed direct supervision of AS PNB Banka on 4 April 2019. AS PNB Banka was therefore reclassified as a significant institution (see “[ECB takes over direct supervision of AS PNB Banka in Latvia](#)”, ECB press release, 11 March 2019).

⁵⁵ Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (OJ L 225, 30.7.2014, p. 1).

Moreover, the external auditor of AS PNB Banka's financial statement for 2018 issued a qualified opinion, stating that additional impairments and fair value adjustments were necessary. The total understated provisions and the unrecognised decrease in the fair value of its assets found by the auditor were so significant that, had the bank recognised them, it would have been in breach of its Pillar 1 requirements. AS PNB Banka's serious capital problems were further confirmed by the outcome of an on-site inspection on credit risk launched by the ECB. This inspection concluded that AS PNB Banka had a negative net worth as of 31 December 2018.

Consequently, the ECB's Supervisory Board and Governing Council adopted the FOLTF assessment for AS PNB Banka

AS PNB Banka failed to provide evidence that it would be able to replenish its capital within the timeline under the early intervention decision. In the light of this, and following the outcome of the on-site inspection, the Supervisory Board decided to start the FOLTF process and initiated a formal consultation with the SRB on 14 August 2019. Subsequently, the ECB's Supervisory Board and Governing Council adopted the FOLTF assessment for AS PNB Banka. On 15 August 2019 the FOLTF assessment was sent to both the SRB and the European Commission, in accordance with Article 18 of the SRMR. ECB Banking Supervision also notified all the relevant authorities of its decision in line with Article 81 of the Bank Recovery and Resolution Directive (BRRD)⁵⁶ and CRD IV.

Cooperation and information exchange with the SRB

ECB Banking Supervision informed the SRB as soon as it took over direct supervision of AS PNB Banka. The capital situation of the bank was discussed in detail with SRB representatives at crisis management meetings held by the ECB. The SRB was also invited to participate as an observer in the relevant meetings of the ECB's Supervisory Board. In addition, an ECB representative participated as an observer in all of the SRB executive sessions related to the case, including the meeting at which the SRB decided not to take resolution action.

Actions following the FOLTF assessment

ECB Banking Supervision withdrew the licence of AS PNB Banka in February 2020 upon a proposal by the FCMC

On 15 August 2019 the SRB decided not to take resolution action in the case of AS PNB Banka. It concluded that, while the conditions for resolution listed in Article 18(1)(a) and (b) of the SRMR had been met, the condition in Article 18(1)(c) relating to public interest had not. In parallel, the Latvian Financial and Capital Market Commission (FCMC) decided to impose a moratorium on AS PNB Banka, suspending financial activities with immediate effect. Furthermore, the FCMC, in its

⁵⁶ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

role as designated authority under Directive 2014/49/EU⁵⁷, determined that covered deposits of AS PNB Banka had become unavailable. On 22 August 2019 the FCMC filed an application⁵⁸ for the declaration of insolvency to the competent court. On 12 September 2019 the court declared AS PNB Banka insolvent and appointed an insolvency administrator. ECB Banking Supervision withdrew the licence of AS PNB Banka in February 2020 upon a proposal by the FCMC, which continues to supervise the insolvency proceedings.

Key lessons learned

The AS PNB Banka case again highlights the problematic misalignment between resolution triggers and insolvency/liquidation and licence withdrawal

As previously highlighted in the lessons learned from the ABLV Bank case reported in the ECB Annual Report on supervisory activities 2018, significant uncertainties arise from the lack of alignment between the triggers for FOLTF under the BRRD/SRMR, the triggers for liquidation proceedings under national insolvency laws and the triggers for the withdrawal of a licence under the national laws implementing CRD IV. Following the determination that AS PNB Banka was FOLTF and the SRB's decision that resolution was not in the public interest, insolvency proceedings could not start immediately as, under Latvian law, they are dependent on a court decision. This delay meant that further efforts, such as the FCMC imposing a restriction on activities (moratorium), were needed to prepare for the contingency that insolvency proceedings might not commence immediately.

The ECB had already flagged the issue of misalignment between triggers for FOLTF and insolvency/withdrawal of licences to the EU legislator following the ABLV Bank case. Consequently, BRRD II introduced a requirement for Member States to ensure that an entity for which resolution is not in the public interest is wound up in an orderly manner and in accordance with the applicable national law. While this addresses the issue to a certain extent, it is a very broad requirement and does not eliminate the misalignment between triggers for FOLTF and for the withdrawal of licences. It will therefore be important that BRRD II be transposed in a comparable manner across EU Member States to ensure a level playing field within the banking union. This might also mean that there will be a need to reform national regimes for exiting the banking business and possibly certain aspects of banking insolvency rules. Taken together, such actions would help to ensure the alignment of the different triggers and facilitate proper planning in times of crisis.

3.1.2 Communication on AS PNB Banka

Communication is a vital component in managing a crisis. Demonstrating that the responsible authorities are addressing a crisis can assuage market reactions and therefore reduce contagion risks. When a bank is failing or likely to fail, effective

⁵⁷ Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014, p. 149).

⁵⁸ "FCMC files an application for insolvency to the court against JSC 'PNB Banka'", FCMC press release, 22 August 2019.

communication with the public is crucial. Therefore, the ECB press release communicating the assessment that AS PNB Banka was FOLTF⁵⁹ provided relevant facts about the failing bank and clearly explained the supervisory response to the deficiencies identified by the competent authorities.

Coordination among the various stakeholders is essential in order to send a clear and comprehensive message to the public. In the case of AS PNB Banka, the ECB, the SRB and the FCMC collaborated closely on communication. On Thursday, 15 August 2019, following the ECB's assessment that AS PNB Banka was FOLTF, the SRB announced its decision that resolution was not in the public interest.⁶⁰ This was closely followed by coordinated announcements by ECB Banking Supervision and the FCMC concerning the ECB's FOLTF assessment and the FCMC's respective decisions imposing a moratorium and determining the unavailability of deposits.⁶¹

3.1.3 The case of Banca Carige

On 2 January 2019 the ECB appointed three temporary administrators and a three-member surveillance committee to take charge of Banca Carige and replace its Board of Directors. The decision came after the majority of the board members of Banca Carige had resigned.

The decision to impose temporary administration was an early intervention measure aimed at ensuring sustainable compliance with prudential requirements. This plan included strengthening capital and implementing de-risking measures in order to pursue a potential business combination. The temporary administrators were tasked with safeguarding the stability of Banca Carige by closely monitoring its situation, continuously informing the ECB and, if necessary, taking action to ensure that the bank restored compliance with capital requirements in a sustainable manner.

On 20 September 2019 the Extraordinary Shareholders' Meeting of Banca Carige approved a capital strengthening effort for a total amount of €900 million. This included the issuance of new shares (€387 million), the conversion of existing Tier 2 bonds into CET1 (€313 million) and the issuance of Tier 2 bonds (€200 million). The capital strengthening was led by the Italian Interbank Deposit Protection Fund (Fondo Interbancario per la tutela dei depositi (FITD)) and its Voluntary Intervention Scheme (VIS), together with Cassa Centrale Banca Credito Cooperativo Italiano, which took part as minority shareholder with an option to acquire Carige shares held by the FITD and the VIS in the future.

⁵⁹ "ECB has assessed that AS PNB Banka in Latvia was failing or likely to fail", ECB press release, 15 August 2019.

⁶⁰ "AS PNB Banka: SRB Decides No Resolution Required", SRB press release, 15 August 2019.

⁶¹ "FCMC, following the decisions of the ECB and SRB, suspends the provision of financial services by JSC 'PNB Banka' and decides on the unavailability of deposits", FCMC press release, 15 August 2019.

Following the execution of the capital increase at the end of December 2019, the new shareholders appointed Banca Carige's new governing bodies. Temporary administration was terminated at the end of January 2020.

3.2 Interaction with the Single Resolution Board

In 2019, as in previous years, ECB Banking Supervision and the SRB continued to cooperate closely in the exercise of their respective functions.

ECB Banking Supervision consulted the SRB on recovery plans

In accordance with the regulatory framework, ECB Banking Supervision consulted the SRB on 98 recovery plans it received from SIs for which the ECB is the consolidating supervisor. The feedback provided by the SRB was taken into account in the assessment of the recovery plans and, where appropriate, reflected in the bank-specific feedback letters.

The SRB consulted ECB Banking Supervision on resolution plans

Equally, in the context of the resolution plan consultation cycle, the SRB consulted ECB Banking Supervision on five batches of resolution plans (corresponding to around 30 resolution plans), including on the determination of the minimum requirement for own funds and eligible liabilities (MREL) and resolvability assessments. ECB Banking Supervision provided feedback after considering the possible implications from a going-concern perspective. In addition, ECB Banking Supervision was also consulted on the calculation of the ex ante contributions to the Single Resolution Fund, focusing its assessment on the potential impact on SIs.

In 2019 ECB Banking Supervision and the SRB continued to cooperate closely on all levels. The ECB's Supervisory Board invited the Chair of the SRB to participate as an observer in its meetings for items relating to the tasks and responsibilities of the SRB, while an ECB representative participated as an observer in the SRB's Executive and Plenary Sessions.

The implementation of the banking package increased the interactions with the SRB

At the technical level, the work on implementing the banking package⁶² enhanced and increased the interactions between ECB Banking Supervision and the SRB with respect to policy areas related to crisis management. Strong collaboration between ECB Banking Supervision and the SRB took place within the respective committees and across the relevant horizontal functions.

The Memorandum of Understanding in place between the ECB and the SRB (reviewed in 2017/18)⁶³ has allowed for further strengthening of the day-to-day cooperation and exchange of information between Joint Supervisory Teams and Internal Resolution Teams.

⁶² The banking package includes CRD V, CRR II, BRRD II and SRMR II.

⁶³ Memorandum of Understanding between the Single Resolution Board and the European Central Bank in respect of cooperation and information exchange.

3.3 Work on recovery planning

Recovery plans are intended to ensure that banks are resilient to severe financial stress

When assessing recovery plans, the ECB's main focus is to ensure that banks are prepared and able to restore their viability in periods of severe financial stress. This means that the plans need to include credible recovery options that can be implemented in an effective and timely manner. Sound recovery plans are a key element in making the European crisis management framework work effectively.

The benchmarking of the recovery plans of SIs conducted by the ECB in 2019 led to a number of important findings.

Many banks find it challenging to produce a credible estimate of their overall recovery capacity

First, while SIs' recovery plans are considered to be compliant with the minimum requirements for crisis management governance and the selection and calibration of recovery indicators, they still require further improvement to make them effective tools in crisis situations. In particular, the benchmarking confirmed that many banks find it challenging to produce a credible estimate of their overall recovery capacity (ORC)⁶⁴.

As a consequence, the ECB made communicating to institutions on how they could improve the calculation and reporting of their ORC a key focus in 2019. In June 2019 it organised a workshop with more than 180 participants from 88 banks. The ECB explained how to calculate a credible ORC, based on the best practices described in the [2018 ECB report on recovery plans](#). This involves creating a full list of credible options first, then taking account of constraining factors (e.g. mutual exclusivity, interdependencies between options, or the operational constraints in simultaneous deployment of multiple options) and, finally, assessing the sensitivity of recovery options to different scenarios when estimating the ORC.⁶⁵

One-third of banks do not yet set out sufficient short-term liquidity options in their recovery plans

A second key finding of the ECB benchmarking exercise was that one-third of the banks do not yet present sufficient liquidity options that could be implemented swiftly (in up to three months). Further work is planned to better understand the reasons for this and to ensure that banks address the need to have sufficient short-term liquidity options available in their recovery plans.

More banks have developed playbooks and conducted dry-runs in 2019

Finally, an encouraging finding of the ECB benchmarking exercise is that, in 2019, more banks developed playbooks and conducted dry-runs.⁶⁶ These are best practices and were highlighted and promoted in the 2018 ECB report as useful tools to increase the usability of recovery plans in crisis situations. 40% of all SIs now have a playbook and 27% have conducted their first dry-run.

⁶⁴ The ORC is the extent to which the recovery options would allow a bank to recover from a crisis situation.

⁶⁵ These scenarios have to be developed in line with the [EBA Guidelines on the range of scenarios to be used in recovery plans \(EBA/GL/2014/06\)](#).

⁶⁶ Playbooks are concise implementation guides to enable banks to quickly implement their recovery plans, while dry-runs are simulation exercises used to test key parts of banks' recovery plans.

3.4 Crisis management involving less significant institutions

Managing the crisis of a less significant institution (LSI) requires the relevant national competent authority (NCA) and the ECB to intensively exchange information and to coordinate closely – the NCA in its capacity as direct supervisor of the LSI and the ECB in its oversight function and in its capacity as competent authority for decisions on common procedures. The need for intensified cooperation arises when an LSI is approaching the point of non-viability. At this stage, the ECB and the NCA have to liaise on the withdrawal of the authorisation, the assessment of acquisitions or increases in qualifying holdings and the granting of new authorisations (e.g. for a bridge institution).

In this regard, the ECB cooperated closely with NCAs on approximately 15 cases concerning the financial deterioration of LSIs in 2019. In two of these cases, the ECB adopted a decision on the withdrawal of the licence following a FOLTF declaration by the respective NCA.⁶⁷ The grounds for withdrawing a licence usually are an institution's failure to meet prudential requirements or a failure to comply with the rules on the prevention of money laundering.

Such close cooperation in the area of crisis management aims to support the NCAs and the ECB in their respective tasks and ensure that the required information is available when urgent decisions need to be taken rapidly. The information exchanged, the actions taken and the cooperation between the ECB and the NCAs are proportionate to the risks posed by an LSI, also taking into account private sector solutions already identified by the NCA. Throughout 2019 the cooperation between the NCAs and the ECB was characterised by a regular and in-depth exchange of information. Among other things, this included setting up dedicated Crisis Management Coordination Groups made up of ECB and NCA staff to ensure effective cooperation and coordination between institutions. The intensified cooperation ensures that supervisory actions and decisions can be taken in a timely and coordinated manner whenever needed.

Unviable business models and low profitability, deficient governance systems and inadequate frameworks against money laundering were the main causes of financial deterioration in LSIs in 2019. In this respect, the distribution of crisis cases across jurisdictions also mirrored the fact that specific geographical areas covered by the SSM are more affected by structurally low profitability of the banking sector and are more exposed to AML risks.

Finally, the range of different national approaches and processes encountered during the intensified cooperation in crisis management also highlighted the need for a harmonised European approach for handling troubled banks. Even though European supervisory and resolution mechanisms have been established, much of the response to a crisis is still dependent on national resolution and insolvency laws – and subject to all the differences between them.

⁶⁷ The respective decisions on the withdrawal of a licence were notified to the supervised entities in November 2019 and January 2020.

4 Cooperating across borders

4.1 Enlarging the banking union through close cooperation

Non-euro area Member States can participate in the banking union through close cooperation

EU Member States whose currency is not the euro can request the establishment of close cooperation between the ECB and their national competent authority (NCA). The main conditions for this are set out in Article 7 of the SSM Regulation and the procedural aspects are specified in Decision ECB/2014/5 on close cooperation⁶⁸. Once close cooperation has been established, the NCAs of these Member States join the Single Supervisory Mechanism (SSM), while their national resolution authorities join the Single Resolution Mechanism (SRM). Participation in the SSM of NCAs of non-euro area Member States through close cooperation enlarges the banking union and supports a more integrated banking supervision, while also contributing to maintaining and deepening the Internal Market.

According to the SSM Regulation and Decision ECB/2014/5, a non-euro area Member State must make a formal request to the ECB in order to initiate the process of establishing close cooperation.

Bulgaria and Croatia have submitted requests to establish close cooperation

On 27 May 2019 Croatia became the second Member State to formally request the establishment of close cooperation in the area of banking supervision between its national central bank (Hrvatska narodna banka) and the ECB. This followed Bulgaria's request to establish close cooperation between Българска народна банка (Bulgarian National Bank) and the ECB, which was submitted on 18 July 2018.

The process to establish close cooperation consists of a legal assessment and a comprehensive assessment

The process to establish close cooperation entails two main elements. The first is a legal assessment of the relevant national legislation that obliges the NCA to adopt any measure requested by the ECB in relation to credit institutions once close cooperation is established. The assessment also takes into account the practical implementation of such legislation. The second element entails a comprehensive assessment of selected⁶⁹ credit institutions that are established in the Member State making the request. The comprehensive assessment includes an asset quality review and a stress test, based on ECB methodologies.⁷⁰ In addition, the ECB initiates a technical dialogue with the Member State's NCA to facilitate its smooth transition to the SSM supervisory approach.

⁶⁸ Decision of the European Central Bank of 31 January 2014 on the close cooperation with the national competent authorities of participating Member States whose currency is not the euro (ECB/2014/5) (OJ L 198, 5.7.2014, p. 7).

⁶⁹ The selected banks are chosen to ensure coverage that is consistent with Article 6(4) of the SSM Regulation and broadly comparable with the coverage of the comprehensive assessments conducted (i) in 2014, when the SSM was being set up, and (ii) in January 2015, when Lithuania adopted the euro. Institutions are identified on the basis of their size, risk profile and overall significance for the national economy. This involves taking into account several elements, such as the business model of the institution, its internal governance and risk management, its capital risks, its liquidity and funding risks, and its interconnectedness with the rest of the financial system.

⁷⁰ See "ECB updates manual for Asset Quality Review of banks", ECB press release, 20 June 2018.

Assessment of Bulgaria's request to enter into close cooperation

In 2019 the ECB continued with the assessment of Bulgaria's request to enter into close cooperation

In 2019 the ECB continued with the legal assessment required in the context of the future close cooperation with Bulgaria's NCA. Moreover, the [results of the comprehensive assessment of six Bulgarian credit institutions](#) were published on 26 July 2019. Българска народна банка (Bulgarian National Bank) has publicly endorsed the results of this comprehensive assessment. As two of the six banks fell short of the relevant thresholds used for the exercise, Българска народна банка (Bulgarian National Bank) is currently following up on the findings with a view to addressing the shortfalls before the ECB takes a decision on close cooperation.

Assessment of Croatia's request to enter into close cooperation

The ECB began the assessment of Croatia's request to enter into close cooperation

In response to the request submitted by Croatia, the ECB adopted an Opinion⁷¹ on the Croatian draft legislation on 8 July 2019. The legislation was needed to establish the mechanisms for the functioning of close cooperation and for providing any information that the ECB may require for the purpose of carrying out the comprehensive assessment of Croatian credit institutions. On 7 August 2019 the ECB announced that five banks established in Croatia would be subject to the mandatory comprehensive assessment.⁷² The exercise began in September 2019 and is based on data as at 30 June 2019. Similarly to Bulgaria, the ECB can be expected to conclude its comprehensive assessment within approximately one year of the submission of Croatia's formal request.

No other formal requests for close cooperation were received in 2019, although some informal exchanges took place at a technical level with Member States to clarify relevant aspects of close cooperation.

4.2 European and international cooperation

As euro area banks have a presence in over 90 non-European jurisdictions (see [Figure 4](#)), the SSM cooperates extensively with other supervisory authorities outside as well as inside the EU. Consequently, the ECB is committed to facilitating cooperation, whether by contributing to supervisory colleges or developing cooperation tools such as Memoranda of Understanding (MoUs). MoUs have been negotiated with counterparties such as supervisory authorities of non-euro area EU Member States, third-country supervisory authorities and national market authorities.

⁷¹ Opinion of the European Central Bank of 8 July 2019 on national legislation to be adopted for the purpose of establishing close cooperation between the European Central Bank and Hrvatska narodna banka (CON/2019/25).

⁷² See "[ECB to conduct comprehensive assessment of five Croatian banks](#)", ECB press release, 7 August 2019. For further information on the comprehensive assessment in Croatia see Section 2.1.1.

Figure 5

Overview of the ECB's international and European cooperation activities



Source: ECB.

Cooperation with other EU supervisory authorities

The ECB regularly cooperates with the NCAs of non-euro area EU countries, in compliance with the provisions of CRD IV on joint decisions, cooperation and exchange of information between competent authorities in the EU.

So far, ECB Banking Supervision has also concluded MoUs with 15 EU supervisory authorities, including national market authorities. In addition, it has signed a Multilateral MoU setting out the practical modalities for exchanging information with 48 AML/CFT authorities supervising credit and financial institutions within the European Economic Area (see also Box 4). Therefore, in total, ECB Banking Supervision has concluded nine bilateral and multilateral MoUs with over 60 EU authorities.

In view of the United Kingdom's planned withdrawal from the EU, the ECB also concluded a cooperation framework with the UK Prudential Regulation Authority and the Financial Conduct Authority that will allow for continued and smooth supervisory cooperation and information exchange.

Box 4

The ECB and anti-money laundering

When creating the SSM framework, EU legislators chose to keep the responsibility for anti-money laundering and combating the financing of terrorism (AML/CFT) at the national level. National AML/CFT authorities are responsible for the supervision of credit institutions' compliance with and effective implementation of AML obligations.

However, it is important for the ECB to consider the outcomes of AML/CFT supervision when performing its supervisory tasks under Article 127(6) of the Treaty on the Functioning of the European Union and the SSM Regulation⁷³. This is further confirmed in the revised Capital Requirements Directive (CRD V), which was adopted by the European Parliament in April 2019. Recital 20 states that "(...) [Together with the authorities responsible for AML/CFT], the competent authorities in charge of authorisation and prudential supervision have an important role to play in identifying and disciplining [AML/CFT-related] weaknesses. Therefore, such competent authorities should consistently factor money laundering and terrorist financing concerns into their relevant supervisory activities (...)".

In parallel to the introduction of CRD V, which further clarifies the role of prudential supervisors with regard to AML/CFT, over the past two years there have been significant initiatives to strengthen the EU-wide framework for AML/CFT. The fifth AML Directive⁷⁴ entered into force on 9 July 2018 and is currently awaiting transposition into national law. In December 2018 the Economic and Financial Affairs Council endorsed an ambitious AML Action Plan to be implemented by the three European Supervisory Authorities, together with the ECB and the national prudential and AML/CFT supervisors. These initiatives are designed to foster cooperation between the authorities responsible for AML/CFT and prudential supervision and to enhance supervisory convergence by, among other things, providing common guidance on how to incorporate AML/CFT-related aspects into the prudential supervisory process.

⁷³ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

⁷⁴ Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU (OJ L 156, 19.6.2018, p. 43).

The fifth AML Directive introduced two important new elements with regard to the ECB's role in AML/CFT. First, by amending Article 56 of CRD IV, it allowed for the ECB to exchange confidential information with national AML/CFT supervisors. Second, it required the ECB to sign an agreement setting out the practical modalities for exchanging information with the national AML/CFT authorities supervising credit and financial institutions within the European Economic Area. The ECB has been exchanging information under this framework since the agreement was signed in January 2019.

The enhanced exchange of information between the ECB and EU AML/CFT supervisors is expected to favourably influence the conduct of both AML/CFT and prudential supervision at the EU level. As part of the ECB's approach, a set of supervisory information that is routinely created for the performance of prudential tasks is sent to EU AML/CFT supervisors on a regular basis. Supervisory information collected via on-site missions, for example, is sent on an ad hoc basis when the related findings are deemed relevant for the competent AML/CFT authority supervising the entity concerned. Conversely, the AML/CFT authorities send information to the ECB that they deem relevant and necessary for the performance of the tasks laid down by the SSM Regulation. In addition, ECB Banking Supervision has also strengthened its engagement in the area of AML/CFT by setting up a new horizontal AML coordination function consisting of a small team with three main responsibilities:

- to act as a “central point of contact” for AML/CFT issues related to SIs and facilitating information exchange with the AML/CFT authorities (including by signing additional memoranda of understanding with non-EU authorities);
- to set up, in cooperation with the national competent authorities (NCAs), an AML network of prudential supervisors to achieve a consistent system-wide approach for better integrating money laundering/terrorism financing risk into prudential supervision;
- to act as an in-house centre of expertise on prudential issues related to AML/CFT.

On this basis, ECB Banking Supervision's new AML coordination function has been coordinating the work within European banking supervision on enhancing the methodological approaches in the areas of authorisations and off-site and on-site supervision to ensure that AML/CFT-related aspects are consistently factored into the prudential supervisory process. It cooperates with the internal ECB AML/CFT Task Force, which brings together all of the relevant ECB business areas.

Cooperation with authorities from third countries

The ECB strives to engage in fruitful cooperation with third-country supervisory authorities and to facilitate ongoing cross-border supervision. So far the ECB has concluded MoUs with 13 third-country supervisory authorities. Where feasible, ECB Banking Supervision continues to rely on MoUs that had been agreed between euro area NCAs and third-country supervisory authorities before the SSM was established. The ECB also concludes numerous cooperation arrangements on a case-by-case basis where tailored solutions are needed.

To ensure consistency at the EU level, ECB Banking Supervision closely cooperates with the European Banking Authority (EBA) Network on Equivalence, which conducts

equivalence assessments of the confidentiality regimes of third-country supervisory authorities. MoUs for supervisory cooperation may only be concluded if the required equivalence of professional secrecy is met.

IMF Financial Sector Assessment Programs

The IMF's Financial Sector Assessment Programs (FSAPs) are comprehensive, in-depth assessments of a country's financial sector. They encompass (i) the identification of key vulnerabilities and the assessment of the resilience of the financial sector; (ii) the assessment of a country's financial stability policy framework, as well as its supervisory framework and practices; and (iii) the evaluation of financial safety nets and the financial system's capacity to manage and resolve a financial crisis.

ECB Banking Supervision is following up on the IMF FSAP for the euro area

The 2018 IMF euro area FSAP examined the new banking supervision and resolution architecture in the euro area. Following up on this FSAP, ECB Banking Supervision prepared an action plan to address the recommendations falling within the ECB's supervisory remit. ECB Banking Supervision continues to implement these recommendations, which are aimed at increasing its supervisory effectiveness, while the EU co-legislators are considering the recommendations that require modifications to EU law.

National FSAPs do not include assessments of European banking supervision

In its national FSAPs for euro area Member States, the IMF continues to take a holistic view of the banking system under review, while avoiding duplication of the euro area FSAP. By analogy with the handling of monetary policy in national IMF Article IV reports, national FSAPs should not include assessments of the effectiveness of the SSM's supervisory work. This general approach enables the IMF to align the scope of both national and euro area FSAPs with the new European banking supervision and resolution architecture. It helps ensure that IMF surveillance and advice continue to be effective and relevant for all the authorities concerned.

In 2019 the IMF concluded the national FSAPs for France and Malta, continued its work on the FSAP for Italy and launched FSAPs for Austria and Latvia. These national FSAPs assess all relevant non-banking aspects (e.g. insurance, securities, and pension funds activities) and entail a holistic assessment of banking issues, particularly those that fall under the remit of national authorities supervising less significant institutions or aspects related to anti-money laundering and combating the financing of terrorism.

The involvement of the ECB in national IMF Article IV consultations for euro area Member States relates to microprudential and macroprudential issues, in line with its responsibilities in these areas.

4.3 Contribution to developing the European and international regulatory framework

4.3.1 Contributing to the work of the Financial Stability Board

In 2019 ECB Banking Supervision actively contributed to the work of the Financial Stability Board (FSB), in particular in the areas of supervisory and regulatory cooperation, implementation of standards and resolution. It contributed to a number of important FSB deliverables in 2019 under the Japanese G20 Presidency, namely the review of the implementation of the [Total Loss-Absorbing Capacity \(TLAC\) Standard](#); a progress report on [market fragmentation](#); the finalisation of the evaluation of the effects of reforms on [small and medium-sized enterprise \(SME\) financing](#); and an assessment of vulnerabilities associated with [leveraged loans and collateralised loan obligations](#). ECB Banking Supervision also participated in the meetings of the FSB's regional consultative group for Europe.

As one of its three priority areas, the FSB is currently focusing on monitoring the implementation of global financial sector reforms and evaluating their effects. ECB Banking Supervision will continue to contribute to the FSB's work programme in a number of areas, including the evaluation of the effects of too-big-to-fail reforms for banks, effective practices in relation to cyber incidents, supervisory issues associated with benchmark transition, follow-up work on market fragmentation, and crisis management.

4.3.2 Contributing to the Basel process

In 2019 the Basel Committee on Banking Supervision (BCBS) continued to evaluate the impact of post-crisis reforms, conduct its Regulatory Consistency Assessment Programme (RCAP) and offer a forum for exchange between bank regulators and supervisors from various jurisdictions. ECB Banking Supervision contributed by participating in policy discussions, providing expertise in BCBS working groups, cooperating with BCBS members within the EU and across the globe, and supporting relevant impact analyses. Among other things, this work included (i) the revisions to the [market risk capital framework](#), which were endorsed by the BCBS's oversight body, the Group of Central Bank Governors and Heads of Supervision; (ii) the launch of the consultation paper on revisions to the [credit valuation adjustment risk framework](#); and (iii) the revisions to the [leverage ratio treatment of client cleared derivatives](#) and to the [disclosure requirements](#) to address "window-dressing" by supervised entities.

Throughout the year, the BCBS continued to work towards its objective of ensuring full, timely and consistent implementation of Basel III and, more generally, promoting strong banking supervision. It will continue this work in the years to come with the support of ECB Banking Supervision.

ECB Banking Supervision supports the full, timely and consistent implementation of the finalised Basel III package

ECB Banking Supervision also engaged in the BCBS' comprehensive work programme for evaluating the regulatory reforms that were adopted in response to the crisis. The programme assesses the effectiveness of individual standards, the interaction and coherence between standards, the risk of regulatory arbitrage, and the broader macroeconomic impact of the post-crisis reforms.

Five members of ECB Banking Supervision staff joined the BCBS data analysis team to contribute to the preparation of reports on the [impact of Basel reforms](#). Another staff member contributed to the G-SIB assessment team, which computes the scores used for the identification of global systemically important banks (G-SIBs).

4.3.3 Contributing to the work of the EBA

ECB Banking Supervision staff is represented in a total of 50 EBA committees and work streams

Throughout 2019 ECB Banking Supervision worked closely with the EBA towards their shared objectives of increasing financial stability and promoting consistent supervision across the European banking sector.

ECB Banking Supervision actively contributed to the EBA's work at all levels. In 2019 ECB Banking Supervision staff was represented in a total of 50 EBA committees and work streams. In five of these committees, ECB Banking Supervision staff took the roles of chair or co-chair. In the EBA Board of Supervisors, ECB Banking Supervision participated as a non-voting member.

The EBA and ECB Banking Supervision's joint work covered a range of issues. Substantial work went into preparing for the 2020 EU-wide stress test, and ECB Banking Supervision staff helped to develop the [methodology](#), governance arrangements, guidelines and the quality assurance manual, among other things. The ECB contributed, for instance, to the EBA's reply to the European Commission's [Call for Advice](#) on the implementation of the Basel III finalisation package. It also contributed to the EBA [Guidelines for the estimation of loss given default \(LGD\) appropriate for conditions of an economic downturn](#), the [Guidelines on loan origination and monitoring](#), the [Guidelines on ICT and security risk management](#) and the [Guidelines on the management of interest rate risk arising from non-trading activities](#).

The EBA follows a comply-or-explain procedure to foster regulatory harmonisation in the EU.⁷⁵ Under this procedure, the ECB, as the competent authority for the direct supervision of SIs, must inform the EBA whether it complies or intends to comply with newly issued guidelines and recommendations. In 2019 ECB Banking Supervision made notifications to the EBA with respect to ten guidelines and one recommendation, as documented on the ECB's banking supervision website.⁷⁶ So far, ECB Banking Supervision has consistently informed the EBA that it complies or

⁷⁵ Article 16 of Regulation 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

⁷⁶ [ECB compliance with EBA guidelines and recommendations](#).

intends to comply with all applicable guidelines as issued by the EBA or the Joint Committee of the European Supervisory Authorities (ESAs).

5 Organisational set-up of ECB Banking Supervision

5.1 Discharging of accountability requirements

In 2019 ECB Banking Supervision continued to engage closely with the European Parliament and the EU Council

This Annual Report constitutes one of the main accountability channels for ECB Banking Supervision vis-à-vis the European Parliament and the EU Council, as stipulated in the SSM Regulation. The Regulation provides that the ECB's supervisory tasks be subject to appropriate transparency and accountability requirements. The ECB attaches great importance to maintaining and fully applying the accountability framework that is set out in further detail in the Interinstitutional Agreement between the European Parliament and the ECB and in the Memorandum of Understanding (MoU) between the EU Council and the ECB.

Key issues discussed with the European Parliament were the finalisation of Basel III, anti-money laundering, green finance and the future of the banking union

With regard to interactions with the European Parliament in 2019, the Chair of the Supervisory Board spoke before the Parliament's Committee on Economic and Monetary Affairs: (i) to present the 2018 ECB Annual Report on supervisory activities (21 March); (ii) at two ordinary public hearings (4 September and 12 December); and (iii) in three ad hoc exchanges of views (21 March, 4 September and 12 December). Among the key issues discussed were the finalisation of Basel III, the role of the ECB in anti-money laundering, the supervisory approach to green finance and the future of the banking union.

In accordance with the SSM Regulation and the Interinstitutional Agreement between the European Parliament and the ECB, following the ECB's proposal for his appointment as Vice-Chair of the ECB's Supervisory Board, Mr Yves Mersch was heard by the Parliament's Committee on Economic and Monetary Affairs on 4 September. The European Parliament approved the ECB's proposal in a plenary vote on 17 September and Mr Mersch was appointed by means of an implementing decision of the EU Council with effect from 7 October.

In the course of 2019 the ECB published 22 replies to written questions from MEPs on banking supervision matters. The letters addressed questions on a range of topics, including stress tests, ECB Banking Supervision's approach to mergers, as well as governance and conduct issues in the banking sector.

In addition, the ECB sent the records of proceedings of its Supervisory Board meetings to the European Parliament, as required under the Interinstitutional Agreement.

With regard to the EU Council, the Chair of the Supervisory Board attended two Eurogroup meetings, the first of which took place on 5 April. On that date, the Chair presented the 2018 ECB Annual Report on supervisory activities. On 9 October the Chair participated in an exchange of views on the execution of the ECB's supervisory tasks.

In 2019 ECB Banking Supervision continued to fulfil its reporting requirements towards national parliaments, as set out in the SSM Regulation. It published five replies to written questions from members of national parliaments.

In 2019 the ECB further contributed to the European Court of Auditor's (ECA) audit of the European Banking Authority (EBA) regarding the EU-wide stress-testing exercise for banks. In the context of the ECA's investigations into the implementation of the stress-testing framework by the EBA, the ECB provided information on the processes for stress test quality assurance, for estimating stress impacts and for reporting stress test results to the EBA.

The ECB took action to address the findings and recommendations made by the ECA in its audit reports and signed a MoU with the ECA on information sharing in the field of microprudential supervision

The ECB also reported to the ECA on the actions it had implemented to address the findings and recommendations from the first ECA report on the functioning of the SSM. To enhance its external accountability, and acting on one of the ECA's recommendations, the ECB carried out preparatory work for launching a survey of all relevant banking associations. The survey will help identify areas of concern and possible improvements and is planned to be conducted in the first half of 2020. Moreover, the ECB continued to work on addressing the recommendations of the ECA report on the ECB's crisis management for banks. Finally, as further detailed in Box 5, ECB Banking Supervision signed an MoU with the ECA on practical information-sharing arrangements in the field of microprudential supervision.

Box 5

Memorandum of Understanding between the ECB and the European Court of Auditors

The ECB highly values the audits conducted by the European Court of Auditors (ECA). It remains committed to cooperating closely with the ECA and providing it with all the information needed to facilitate its work. As a sign of the goodwill between both parties and of the shared intention to cooperate constructively in the context of ECA audits of ECB Banking Supervision, on 9 October 2019 the ECA and the ECB signed a [Memorandum of Understanding \(MoU\)](#). This MoU establishes practical information-sharing arrangements between the two institutions in the field of microprudential supervision. These arrangements will allow the ECA to seek and obtain all the documents and information that it needs to audit ECB Banking Supervision. Highly confidential documentation will be fully protected and access to sensitive bank-specific information will be granted in a controlled environment on-site at the ECB.

The MoU, while reiterating the independence of the ECB and the ECA in the exercise of their respective functions, aims to ensure appropriate transparency and accountability. The MoU solely covers ECA audits of the supervisory tasks conferred on the ECB by the SSM Regulation and reflects the ECA's audit mandate as attributed to it by EU law.

5.2 Transparency and communication

Communication is an important tool to ensure that the role of ECB Banking Supervision is well understood by both supervised banks and a wide range of

stakeholders in the banking system. ECB Banking Supervision thus disseminates information regularly. In this spirit, it continued to explain its activities via a wide range of communications channels in 2019, including the ECB's banking supervision website and a number of social media networks. ECB Banking Supervision is strongly committed to ensuring transparency regarding its supervisory activities, regularly informing the public of the latest developments and key supervisory concepts. In 2019 the Chair and Vice-Chair gave 25 speeches and the ECB representatives on the Supervisory Board gave 14 speeches; together, they gave 15 media interviews. ECB Banking Supervision published 28 press releases and nine letters to the directly supervised banks. Four further editions of the Supervision Newsletter, a quarterly digital publication with more than 6,300 subscribers, were also published in 2019. ECB Banking Supervision also published the outcomes of its core activities, such as the aggregate results of the Supervisory Review and Evaluation Process (SREP), the liquidity stress test, the comprehensive assessments of Nordea and six Bulgarian banks, and sanction decisions. The ECB continued to use the full range of social medial channels to inform the public of the latest developments and explain key concepts.

In addition, ECB Banking Supervision hosted and live-streamed its third Forum on Banking Supervision, which was attended by 180 representatives from banks, national competent authorities (NCAs), EU institutions, auditors, think tanks and the media. Continuing ECB Banking Supervision's efforts to reach out to younger audiences, the Chair participated in two ECB Youth Dialogues. The first, held at the Banco de Portugal in Lisbon, was attended by a group of 50 young finance industry professionals, while the second brought together about 350 students and alumni from the Sapienza University of Rome. ECB Banking Supervision also launched a public consultation on the supervisory fees framework⁷⁷, which concluded with a communications package detailing the process and outcome. In 2019 the ECB responded to more than 1,500 public enquiries focusing on banking supervision topics, which covered individual banks, licences and fintech. Furthermore, the ECB hosted 32 lectures to over 1,300 participants on topics relating specifically to the ECB's supervisory responsibilities.

5.3 Decision-making

5.3.1 Meetings and decisions of the Supervisory Board and Steering Committee

The ECB's Supervisory Board is composed of a Chair (appointed for a non-renewable term of five years), a Vice-Chair (chosen from among the members of the ECB's Executive Board), four ECB representatives and the representatives of the NCAs. If the NCA is not a national central bank, the representative of the NCA may be accompanied by a representative from their national central bank. In such cases,

⁷⁷ More information on the fees framework can be found in Chapter 6.

the representatives are together considered as one member for the purposes of the voting procedure.

In April 2019 the Governing Council of the ECB proposed the appointment of ECB Executive Board member Yves Mersch as Vice-Chair of the ECB's Supervisory Board. Following a hearing at the Committee on Economic and Monetary Affairs of the European Parliament, in September 2019 the European Parliament's Plenary approved a report recommending his appointment, which was confirmed by the European Council in October 2019.

In 2019 Edouard Fernandez-Bollo, Kerstin af Jochnick and Elizabeth McCaul were appointed as ECB representatives to the Supervisory Board, joining Pentti Hakkarainen, who was appointed in 2016.

Supervisory Board



Front row (from left to right): Gottfried Haber, Eric Cadiilhac, Jekaterina Govina, Ana Paula Serra, Liga Kleinberga (alternate for Kristíne Černaja-Mežmale), Andrea Enria, Yves Mersch, Catherine Galea, Anneli Tuominen, Margarita Delgado, Stelios Georgakis.
Middle row (from left to right): Denis Beau, Vladimír Dvořáček, Zoja Razmusa, Päivi Tissari, Maive Rute, Edouard Fernandez-Bollo, Alessandra Perrazzelli, Kerstin af Jochnick, Elizabeth McCaul, Irena Vodopivec Jean.
Back row (from left to right): Ed Sibley, Ilias Plaskovitis, Tom Dechaene, Felix Hufeld, Helmut Ettl, Pentti Hakkarainen, Kilvar Kessler, Claude Wampach, Joachim Wuermeling, Thijs van Woerden (alternate for Frank Elderson), Oliver Bonello.

Chair	Andrea Enria (since 1 January 2019)
Vice-Chair	Sabine Lautenschläger (until 11 February 2019), Yves Mersch (since 4 October 2019)
ECB representatives	Ignazio Angeloni (until 23 March 2019), Pentti Hakkarainen, Edouard Fernandez-Bollo (since 2 September 2019), Kerstin af Jochnick (since 1 October 2019), Elizabeth McCaul (since 1 December 2019)
Belgium	Tom Dechaene (Nationale Bank van België/Banque Nationale de Belgique)
Germany	Felix Hufeld (Bundesanstalt für Finanzdienstleistungsaufsicht), Joachim Wuermeling (Deutsche Bundesbank)
Estonia	Kilvar Kessler (Finantsinspektsioon), Madis Müller (Eesti Pank) (until 6 June 2019), Maive Rute (Eesti Pank) (since 8 November 2019)
Ireland	Ed Sibley (Central Bank of Ireland)
Greece	Ilias Plaskovitis (Bank of Greece)
Spain	Margarita Delgado (Banco de España)
France	Denis Beau (Banque de France)
Italy	Fabio Panetta (Banca d'Italia) (until 31 July 2019), Alessandra Perrazzelli (Banca d'Italia) (since 1 August 2019)
Cyprus	Yiangos Demetriou (Central Bank of Cyprus) (until 31 March 2019), Stelios Georgakis, acting SB member (since 1 January 2020)
Latvia	Pēters Putniņš (Finanšu un kapitāla tirgus komisija) (until 15 July 2019), Kristīne Černaja-Mežmale (Finanšu un kapitāla tirgus komisija) (since 15 July 2019), Zoja Razmusa (Latvijas Banka) (until 13 March 2020)
Lithuania	Vytautas Valvoniš (Lietuvos bankas) (until 20 September 2019), Jekaterina Govina (Lietuvos bankas) (since 7 January 2020)
Luxembourg	Claude Wampach (Commission de Surveillance du Secteur Financier), Eric Cadilhac (Banque centrale du Luxembourg)
Malta	Catherine Galea (Malta Financial Services Authority) (until 29 February 2020), Joseph Cuschieri (Malta Financial Services Authority) (since 1 March 2020), Oliver Bonello (Central Bank of Malta)
Netherlands	Frank Elderson (De Nederlandsche Bank)
Austria	Helmut Ettl (Oesterreichische Finanzmarktaufsicht), Andreas Ittner (Oesterreichische Nationalbank) (until 10 July 2019), Gottfried Haber (Oesterreichische Nationalbank) (since 11 July 2019)
Portugal	Elisa Ferreira (Banco de Portugal) (until 23 October 2019), Ana Paula Serra (Banco de Portugal) (since 24 October 2019)
Slovenia	Primož Dolenc (Banka Slovenije) (until 31 July 2019), Irene Vodopivec Jean (Banka Slovenije) (since 1 August 2019)
Slovakia	Vladimír Dvořáček (Národná banka Slovenska)
Finland	Anneli Tuominen (Finanssivalvonta), Mervi Toivanen (Suomen Pankki – Finlands Bank) (until 12 July 2019), Päivi Tissari (Suomen Pankki – Finlands Bank) (since 12 July 2019)

The ECB's Supervisory Board met 18 times in 2019. Of these meetings, 13 were held in Frankfurt am Main and four were held via teleconference. One meeting took place in Lisbon, upon the invitation of the Banco de Portugal.

The Steering Committee⁷⁸ of the Supervisory Board held seven meetings in 2019, all in Frankfurt am Main. In April the usual rotation of the five NCA members, who are appointed to the Steering Committee for a one-year term, took place.

In 2019 the ECB issued 2,356⁷⁹ supervisory decisions⁸⁰ addressed to specific supervised entities (see **Figure 6**). Of these, 961 decisions were adopted by the

⁷⁸ The Steering Committee supports the activities of the Supervisory Board and prepares the Board's meetings. It is composed of the Chair of the Supervisory Board, the Vice-Chair of the Supervisory Board, one ECB representative and five representatives of national supervisors. The five representatives of national supervisors are appointed by the Supervisory Board for one year based on a rotation system that ensures a fair representation of countries.

ECB heads of work units in line with the general framework for delegating decision-making powers for legal instruments related to supervisory tasks. The remaining 1,395 decisions were adopted by the Governing Council under the non-objection procedure on the basis of a draft proposal of the Supervisory Board. The bulk of the supervisory decisions related to fit and proper assessments (47.3%), SREP (8.6%), internal models (7.5%), own funds (7.0%), and qualifying holdings (5.5%) procedures.

In addition to the bank-specific final draft decisions submitted to the Governing Council for non-objection, the Supervisory Board decided on several horizontal issues, most notably the application of common methodologies and frameworks in specific areas of supervision. Some of these decisions were prepared by temporary structures mandated by the Supervisory Board. These structures comprised senior managers from the ECB and the NCAs. They carried out preparatory work on topics such as the SREP methodology and the simplification of processes in the SSM.

The Supervisory Board took the majority of its decisions by written procedure⁸¹.

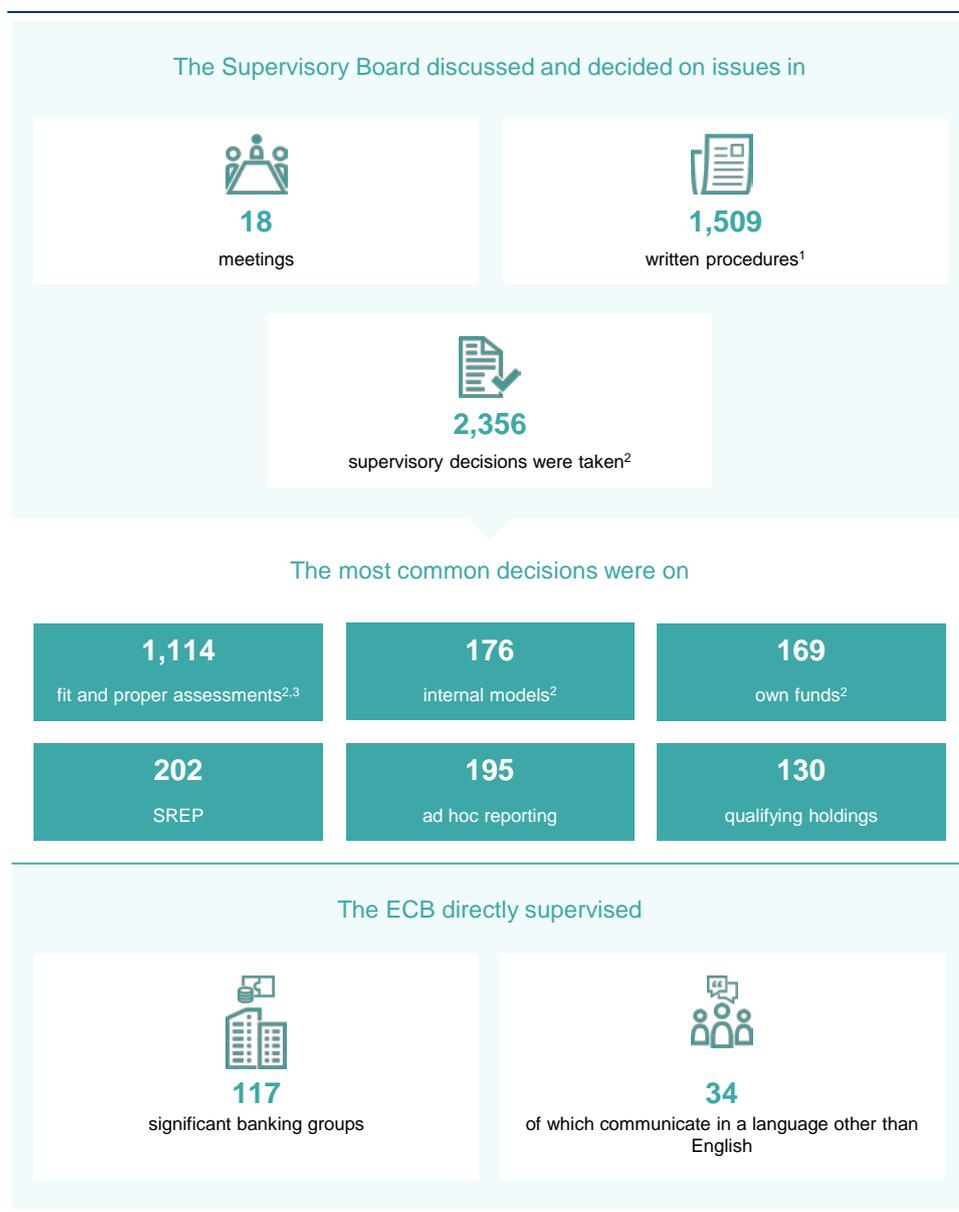
Of the 117 banking groups directly supervised by the ECB in 2019, 34 asked to receive formal ECB decisions in an EU official language other than English (compared with 35 in 2018).

⁷⁹ In addition to these supervisory decisions, the ECB has also implicitly approved 205 operations (such as the establishment of branches) by not objecting within the legal deadlines. Of these, 103 were approved by senior management within the framework for delegation.

⁸⁰ These decisions refer to decisions that were finalised or adopted in the reporting period (i.e. outgoing decisions). The number of supervisory decisions does not correspond to the number of authorisation procedures that were officially notified to the ECB in the reporting period (i.e. incoming notification procedures).

⁸¹ Under Article 6.7 of the [Supervisory Board's Rules of Procedure](#), decisions may also take place by written procedure, unless at least three members of the Supervisory Board who have a voting right object. In such cases, the item is put on the agenda of the subsequent Supervisory Board meeting. A written procedure normally requires at least five working days for consideration by the Supervisory Board.

Figure 6
Decisions by the Supervisory Board in 2019



Notes:

- 1) This figure includes written procedures for individual supervisory decisions and for other issues such as common methodologies and consultations of the Supervisory Board. One written procedure may contain several supervisory decisions.
- 2) This is the number of individual supervisory decisions addressed to supervised entities, or their potential acquirers, and instructions to national competent authorities on significant institutions or less significant institutions. One decision may contain several supervisory approvals. With the application of the delegation framework, not all of the supervisory decisions included in this number were approved by the Supervisory Board and adopted by the Governing Council. In addition, the Supervisory Board took other decisions on a number of horizontal issues (e.g. common methodologies) and institutional issues.
- 3) The 1,114 decisions on fit and proper assessments cover 2,967 individual procedures (see Section 2.1.2).

5.3.2 Further efforts to streamline the decision-making process

The delegation framework was further extended in 2019

One of the measures that significantly increased the efficiency of the decision-making process was the extension of the delegation framework⁸² by the Executive Board to additional types of routine ECB supervisory decisions, in line with the proposal of the SSM Simplification Group. In particular, in March 2019 the delegation framework was extended to decisions on supervisory powers granted under national law. In August 2019 the framework was further extended to decision-making powers with regard to passporting, the acquisition of qualifying holdings and the withdrawal of authorisations of credit institutions.

Furthermore, the information flow to the Supervisory Board was streamlined, automated, and improved in terms of quality. Likewise, enhanced tracking tools also helped to optimise and simplify the activities of the Supervisory Board.

5.3.3 Activities of the Administrative Board of Review

The Administrative Board of Review (ABoR)⁸³ is an ECB body comprised of members who are individually and collectively independent from the ECB and are entrusted with the task of reviewing decisions adopted by the Governing Council on supervisory matters upon an admissible request for review.⁸⁴

In 2019 four new requests for an administrative review of an ECB supervisory decision were filed with the ABoR (see [Table 4](#)). In the same year, the ABoR adopted five opinions, one of which related to a request for review submitted in 2018. In two opinions, it found that the requests were inadmissible. In one opinion, it proposed that the initial ECB decisions should be abrogated and replaced with new decisions. In another opinion, it proposed that the initial decision should be replaced with an amended one. And, in the final one, it proposed replacing the decision by a decision of identical content. In two of the cases, the ABoR conducted a hearing as part of its investigation phase, which gave the applicant and the ECB an additional opportunity to comment on the contested decision.

⁸² For further information see [ECB Annual Report on supervisory activities 2017](#).

⁸³ The ABoR is composed of five members: Jean-Paul Redouin (Chair), Concetta Brescia Morra (Vice-Chair), Javier Aristegui, André Camilleri, Edgar Meister (until 7 September 2019), Gerd Häusler (as of 18 December 2019), and two alternates: René Smits and Ivan Šramko. The Governing Council renewed the terms of office of Jean-Paul Redouin, Concetta Brescia Morra, Javier Aristegui, André Camilleri and René Smits in September 2019. The ABoR was established by virtue of Decision ECB/2014/16 concerning the establishment of an Administrative Board of Review and its Operating Rules. This has been amended by Decision (EU) 2019/1378 of the European Central Bank of 9 August 2019 (ECB/2019/27) to clarify the role of the alternates and the methodology for the apportionment of costs incurred by the applicants and by the ECB.

⁸⁴ Further background on the ABoR can be found on the [ECB's banking supervision website](#).

Table 4

Number of reviews performed by the ABoR

	2019	2018	2017	2016	2015	2014
ABoR opinions finalised	5*	4	4	6	6	3
ECB decisions confirmed after ABoR Opinion	1	3	4	1	2	2
ECB decisions amended/reasoning improved after ABoR Opinion	1	1	-	2	4	1
ECB decisions abrogated and replaced with new decisions after ABoR Opinion	2	-	-	-	-	-
Opinions finding request inadmissible	2	-	-	3	-	-
Request withdrawn	-	1	-	1	2	1

Source: ECB.

* One opinion covered two ECB decisions.

Topics under review and issues of relevance

The opinions finalised by the ABoR in 2019 touched upon several types of supervisory decisions and concerned the following issues.

- The possibility of anonymising the ECB's decision to impose an administrative penalty in respect of breaches of requirements set out in the Capital Requirements Regulation. Publication of the ECB's decision was postponed until the Governing Council had adopted the final decision following examination of the ABoR opinion.
- Interim measures of a procedural nature that were conducted as part of a licence withdrawal procedure.
- Interpretation of the EBA, ESMA and EIOPA Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector, in particular regarding the integrity of a proposed acquirer.
- The admissibility of a request for review of a failing or likely to fail status determined by the ECB under the SRM Regulation.
- Assessment of compliance with due process requirements, in particular the right-to-be-heard, and the limits to the margin of discretion granted to the ECB in the context of certain internal model decisions related to the ECB's TRIM project, also having regard to the [TRIM guide](#).

5.4 ECB Banking Supervision staffing

The medium-term stabilisation strategy for ECB Banking Supervision will start in 2020

In 2019 the total number of approved full-time equivalent positions (FTEs) for the five core ECB Banking Supervision business areas was 1,189 FTEs, compared with 1,099 FTEs in 2018.

In 2019 the ECB's Governing Council approved a headcount increase of 90 FTEs for core ECB Banking Supervision business areas and 18 FTEs for business areas that

provide shared services for SSM-related tasks. Of the former, almost half were in response to Brexit-related staffing needs. The remaining increase for core ECB Banking Supervision business areas in 2019 was primarily associated with internalising resources for stress-testing activities that had formerly been provided using support from external consultancies.

As for 2020, the stable budgeting principle is being applied to ECB Banking Supervision. This includes identifying possible upcoming internal and external resource drivers and specifying tangible areas where efficiency can be further improved. This commitment means that the budget of ECB Banking Supervision will stabilise from 2023 onwards and no systematic increases in resourcing are envisaged to be needed; this does not take into account the possible internalisation of consultants or future workstreams related to European banking supervision. The total need for additional resources across ECB Banking Supervision and related internal shared services for 2020 is 112.5 FTEs.

Internal reorganisation of ECB Banking Supervision

Organisational changes in ECB Banking Supervision that were approved by the Executive Board included the creation of one new division (Division XVI) and one new section in Directorate General Microprudential Supervision I. The aim was to realign the divisional structure with the target model established at the start of European banking supervision. The new division addressed two issues: span of control and the need to have adequate seniority when dealing with significant institutions (SIs).

Diversity

In terms of gender diversity, the percentage of female staff increased from 40% to 41% of all permanent and fixed-term staff in core ECB Banking Supervision business areas in 2019. The proportion of female staff in managerial positions increased slightly from 31% in 2018 to 32% in 2019. In non-managerial positions, the proportion of female staff also increased year on year, from 42% to 43%.

Collaboration within the Single Supervisory Mechanism

Successful execution of the tasks and objectives of European banking supervision relies on close collaboration between the ECB and the NCAs. In this context, the NCAs contribute resources not only to Joint Supervisory Teams (JSTs), but also to on-site supervision, horizontal projects and working groups.

With regard to JSTs, and according to the new staffing methodology as applied in 2019, ECB supervisors make up 37% of JSTs, with the other 63% made up of NCA supervisors (see [Table 5](#)).

Table 5**JST staffing provided by NCAs and the ECB**

	NCA	FTEs (host and home)
BE	Nationale Bank van België/Banque Nationale de Belgique	39.2
DE	Bundesanstalt für Finanzdienstleistungsaufsicht	93.3
	Deutsche Bundesbank	131.4
EE	Finantsinspeksioon	4.5
IE	Central Bank of Ireland	23.3
GR	Bank of Greece	23.6
ES	Banco de España	126.9
FR	Autorité de contrôle prudentiel et de résolution	99.6
IT	Banca d'Italia	86.5
CY	Central Bank of Cyprus	14.6
LV	Finanšu un kapitāla tirgus komisija	2.8
LT	Lietuvos bankas	3.7
LU	Commission de Surveillance du Secteur Financier	17.7
	Banque centrale du Luxembourg	2.6
MT	Malta Financial Services Authority	6.5
NL	De Nederlandsche Bank	48.3
AT	Finanzmarktaufsicht	12.6
	Oesterreichische Nationalbank	27.4
PT	Banco de Portugal	30.4
SI	Banka Slovenije	11.9
SK	Národná banka Slovenska	6.8
FI	Finanssivalvonta	19.6
ECB	European Central Bank	485.0
Total		1,318.2

Source: ECB.

Notes: Figures as at December 2019. The table above excludes the JSTs of banks that are no longer classified as SIs in 2020 and the JSTs of banks that have become SIs after relocating activities to the euro area as a result of Brexit.

In 2019 the SSM Training Curriculum continued to be expanded in order to cater for learning and development needs, foster a common supervisory culture and ensure that European banking supervision is able to tackle current challenges. In this vein, among other key things, a portfolio of training seminars on IT risk was added to the training curriculum, covering aspects such as banks' IT governance, IT strategy and operation and IT outsourcing. The training curriculum for coordinators in the JST context (such as JST coordinators, local coordinators or leaders of risk area groups) was also revised to better meet their needs. The goals for 2020 are to foster collaboration, improve administration and enrich the current training curriculum by providing more courses, new case-study-based courses and e-learning opportunities.

The training programme for SSM staff involved in inspections was also further improved by offering four full weeks of training sessions on different dates and across different locations. In total, more than 25 training sessions were offered, covering all major SREP risk types, as well as the soft skills and processes relevant

for inspections. More than 30% of the approximately 1,200 on-site inspectors working in European banking supervision benefited from this training programme.

In June 2019 a new feedback process, called JST Share and Connect, was introduced for the JSTs. This process is grounded in a legal basis that lays down the principles for defining objectives and sharing feedback in JSTs⁸⁵. The overarching goal of this process is to facilitate a dialogue on what is delivered and how, and on the way in which teams work together in order to achieve their annual objectives. The process is a result of two pilots, extensive exchanges between the ECB and representatives from the NCAs, and internal discussions between the Directorate General Human Resources, Directorate General Microprudential Supervision I and Directorate General Microprudential Supervision II.

Lastly, there were two programmes to increase intra-JST mobility. The first is an intra-JST exchange pilot which allows JST members to physically move from the ECB or an NCA to another institution for two weeks while staying in the same JST and working on the same tasks. The costs are covered under local business travel rules. The second programme is an intra-JST secondment programme through which members of staff from NCAs join the ECB on an ESCB/IO basis for three months. Both programmes had a positive effect on participants in terms of (i) gaining a better understanding of the work culture of the host institution and of the dynamics between the ECB and NCAs; (ii) fostering a shared SSM culture; and (iii) acquiring beneficial skills for their future roles in JSTs.

Staffing on-site missions

On-site inspections (OSIs) are planned and staffed in close cooperation with the NCAs, which provide most of the heads of mission and team members.

With a view to addressing a recommendation made by the ECA, European banking supervision is undertaking a multi-year effort to increase the share of cross-border⁸⁶ and mixed-team⁸⁷ on-site missions. The initiative pursues several objectives in order to:

- harmonise the application of the methodology for conducting OSIs and to spread on-site expertise across European banking supervision;
- safeguard mission quality and equal treatment of SIs, while acknowledging local specificities;

⁸⁵ Decision (EU) 2019/276 of the European Central Bank of 29 May 2019 laying down the principles for defining objectives and sharing feedback in joint supervisory teams and repealing Decision (EU) 2017/274 (ECB/2019/14) (OJ L 157, 14.06.2019, p. 61).

⁸⁶ In a cross-border on-site mission, the head of mission and at least one team member do not come from the relevant home/host NCA.

⁸⁷ In a mixed-team on-site mission, the head of mission comes from the relevant home/host NCA, and at least two team members do not come from the relevant home/host NCA.

- provide a supplementary view of a bank's situation through the eyes of non-national NCA staff;
- foster team spirit among on-site staff and build a common on-site culture;
- reinforce the reputation and credibility of European banking supervision.

In order to promote cross-border and mixed-team missions, several options have been made available to NCA inspectors. Notably, they can opt to be seconded to the ECB for the duration of the cross-border or mixed-team missions. In this case, they enter into an ESCB/IO contract with the ECB (instead of remaining under their NCA's current working regime); salary, travel and accommodation costs are covered by the ECB. This option was introduced in 2018 and has been widely used: in 2019, 186 ESCB/IO contracts were issued to NCA inspectors for cross-border and mixed-team missions, fostering staff exchange in European banking supervision. Through these contracts NCAs provided 61.3 FTEs to support these missions. Thanks to these arrangements, the ECB and the NCAs were able to staff a total of 73 cross-border missions and 19 mixed-team missions across European banking supervision in 2019.

The members of inspection teams on ESCB/IO contracts work under equal employment conditions. This facilitates the emergence of an inclusive team spirit and a common on-site culture. It also improves the interchangeability of on-site resources across European banking supervision. As an example, a shortage of specific expertise in a certain area can be addressed by allocating experts from another supervisory authority.

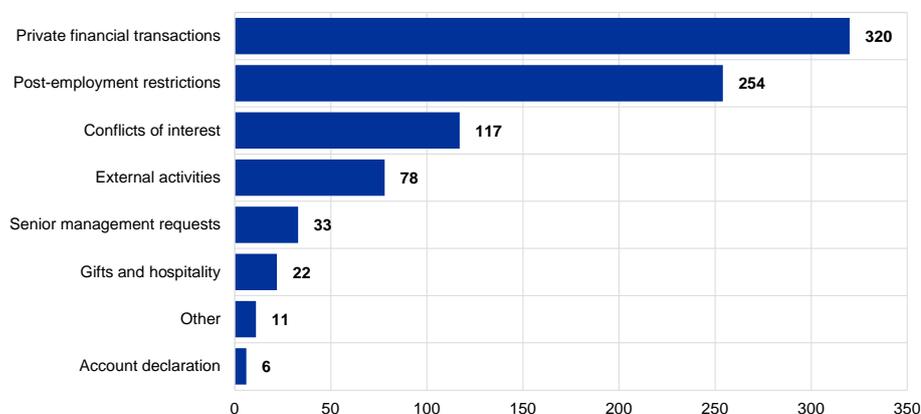
5.5 Implementing the Code of Conduct

Under Article 19(3) of the SSM Regulation, the ECB is required to have a [Code of Conduct](#) that governs ECB staff and management involved in banking supervision and that addresses any concerns regarding conflicts of interest. The relevant provisions are contained in the ECB's Ethics Framework, which is implemented by the Compliance and Governance Office (CGO).

Throughout 2019 the CGO continued in its efforts to build a strong ethics culture across the ESCB and European banking supervision and to support the continuous harmonisation of ethical standards and implementation practices through the Ethics and Compliance Officers Task Force (ECTF). Within the ECB, all newly recruited ECB Banking Supervision staff members have undergone a mandatory e-learning programme and were invited to further enhance their level of awareness of ethical dilemmas through dedicated workshops. Moreover, the CGO responded to about 1,850 requests on a wide range of topics, nearly half of which were submitted by ECB Banking Supervision staff. More than 40% of these requests concerned staff members' private financial transactions, followed by requests on post-employment restrictions and conflicts of interest issues (see [Chart 26](#)).

Chart 26

Overview of requests from ECB Banking Supervision staff received in 2019



Source: ECB.

In addition to advising all ECB staff on ethical issues, the CGO also organised compliance monitoring exercises on staff members' private financial transactions. While the exercise did identify a limited number of instances of non-compliance, around 25% of which related to ECB Banking Supervision staff, none of these instances involved intentional misconduct or other serious cases of non-compliance.

Of those members of staff involved in banking supervision who resigned from their post in 2019, two cases triggered a cooling-off period in line with the Ethics Framework.

With the entry into force of the [Single Code of Conduct for high-level ECB Officials](#) on 1 January 2019, the ECB's Ethics Committee assessed the newly introduced [Declarations of interests](#) submitted by all members of the Supervisory Board; the completed declarations were then published on the ECB's banking supervision website. In addition, the Committee issued 17 opinions related to high-level ECB officials involved in banking supervision, the majority of which were related to conflicts of interest.

Cooperation among supervisory authorities and the building of a corporate and ethics culture across European banking supervision gained further traction via the ECTF. It has become a hub for information exchange and a forum for supporting coherent implementation of the Single Code across the Single Supervisory Mechanism.

5.6 Applying the principle of separation between monetary policy and supervisory tasks

In 2019 the principle of separation between monetary policy and supervisory tasks was mainly applied to the exchange of information between different policy areas.⁸⁸

In line with Decision ECB/2014/39 on the implementation of separation between the monetary policy and supervision functions of the ECB⁸⁹, this exchange of information was subject to a need-to-know requirement: each policy area had to demonstrate that the information requested was necessary to achieve its policy objectives. In most cases, access to confidential information was granted directly by the ECB policy function that owned the information. This was done in line with Decision ECB/2014/39, which allows access to information pertaining to anonymised data or non-policy sensitive information to be granted by the policy functions directly. Intervention by the Executive Board to resolve possible conflicts of interest was not necessary.

Under Decision ECB/2014/39, the involvement of the Executive Board was nonetheless required in a few instances to allow for the exchange of non-anonymised information relating to individual banks or policy-sensitive assessments. Access to the data was granted on a “need to know” basis after assessing the business case, and for a limited period of time, to ensure that the need-to-know requirement was met at all relevant points in time.

Separation at the decision-making level did not raise concerns, and no intervention by the Mediation Panel was required.

5.7 Data reporting framework and information management

5.7.1 Developments in the data reporting framework

In accordance with Article 140(4) of the SSM Framework Regulation, the ECB is responsible for organising the processes relating to the collection and quality review of data reported by supervised entities.⁹⁰ The main objective is to ensure that banking supervisors use reliable and timely supervisory data.

⁸⁸ Decision ECB/2014/39 also contains provisions relating to organisational aspects.

⁸⁹ Decision of the European Central Bank of 17 September 2014 on the implementation of separation between the monetary policy and supervision functions of the European Central Bank (ECB/2014/39) (OJ L 300, 18.10.2014, p. 57).

⁹⁰ The Capital Requirements Regulation specifies the reporting obligations under FINREP (FINancial REPorting) and COREP (COMmon REPorting) for credit institutions. These reporting obligations are further detailed in Commission Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council. FINREP is the framework for collecting financial information from banking institutions, while COREP is the framework for collecting information relative to the Pillar 1 calculation.

Additional data quality checks are published on the ECB's banking supervision website. As part of its data quality review, in 2019 the ECB updated the [list of additional data quality checks](#) developed jointly with the NCAs, which can be found on the ECB's banking supervision website. The aim of these checks is to complement the validation rules published by the EBA and to enhance the quality of supervisory data. Also in 2019, the ECB started to publish the outcome of its data quality assessment of the supervisory data, which are transmitted under the EBA's Implementing Technical Standards. The results are published on a quarterly basis and are available at an aggregate level to the public in the [supervisory data section](#) of the ECB's banking supervision website.

Aggregated supervisory data and selected Pillar 3 disclosures are published on the ECB's banking supervision website

In 2019 the ECB further increased the transparency and availability of supervisory data published on the [ECB's banking supervision website](#). First, the ECB introduced a quarterly press release highlighting the trends of key ratios on capital adequacy, asset quality and liquidity. In addition, the ECB now uploads the aggregated supervisory data to the ECB statistical data warehouse, allowing users to easily download time series. Finally, the ECB continued its extended publication of Pillar 3 information at bank level: in addition to three solvency and leverage ratios disclosed by SIs at the highest level of consolidation in the 19 euro area countries, the 2019 publication also included, for all global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs), the liquidity coverage ratio disclosure template (EU-LIQ1), which covers high-quality liquid asset amounts, cash outflows and inflows, and their respective breakdowns.

There was further work on data integration in 2019

Progress has also been made on increasing reporting efficiency and reducing the reporting burden for banks. First, the Banks' Integrated Reporting Dictionary (BIRD)⁹¹ was further enhanced to include asset encumbrance requirements, resolution planning and FINREP version 2.8 in its database. The inclusion of COREP credit risk according to the internal rating-based approach and the standard approach, securitisations, and FINREP non-performing loans is currently being finalised. The use of the BIRD input layer to derive the various reporting requirements, as described in the dictionary, is being tested to correct possible inconsistencies and prove the validity and operability of the BIRD.

The ECB also supports the EBA in its mandate stemming from Article 430(c) of the revised Capital Requirements Regulation (CRR II) to assess the feasibility of an integrated system for collecting statistical, resolution and prudential data. Such an integrated system should aim to increase the efficiency of reporting using common definitions and avoiding overlaps, improve data sharing across authorities and increase data quality.

⁹¹ The [Banks' Integrated Reporting Dictionary \(BIRD\)](#) is an initiative of the ECB and the national central banks in the ESCB in close cooperation with the European banking industry. The BIRD was designed to alleviate the reporting burden for banks. Its content, published on the ECB's website, comprises a precise description of the data which should be extracted from the banks' internal IT systems to generate the reports and clearly defined rules for transforming these data as required by the authorities.

5.7.2 The SSM information management system

Supervisors rely on the SSM Information Management System (IMAS) to support their daily activities. IMAS is a common IT platform that allows supervisors to share information regardless of whether they are located in the ECB or an NCA and of whether they are part of a JST or a specialised function. IMAS therefore facilitates the implementation of the one-team approach and helps ensure compliance with the relevant access rights policy. IMAS contributes to efficient and harmonised supervisory activities by implementing processes such as the SREP, on-site inspections and authorisations procedures, accurately and effectively through automated workflows that track and record all relevant information. This ensures comparability across banks and supports horizontal analyses.

A new database called IDRA (IMAS Data Reporting and Analytics) allows for flexible access to supervisory data and has introduced new data management capabilities for all IMAS users, thereby supporting advanced analytics.

5.7.3 Stress-testing platform and OSI Credit application

Stress test exercises and credit file reviews conducted by European supervisors are supported by a dedicated IT system called STAR (Stress Test Account Reporting). The STAR platform provides end-to-end support for stress test processes, from the collection and analysis of stress test data to the provision of feedback to participating institutions. It brings efficiency gains by automating processes and supporting the analysis of stress test results and allows users from the ECB, NCAs and participating institutions to work on a centralised online platform that is secure and compliant with the SSM's access right policy.

The STAR infrastructure also supports the OSI Credit application, which was developed to improve the efficiency and harmonisation of credit risk missions. It contributes to the various steps of the credit risk missions, automates workflows, produces reports, and provides a platform for further analysis of loan portfolios.

6 Reporting on budgetary consumption

6.1 Expenditure for 2019

The SSM Regulation requires the ECB to dispose of adequate resources to carry out its supervisory tasks effectively. These resources are financed by a supervisory fee that is borne by the entities subject to ECB supervision.

The expenditure incurred for supervisory tasks is separately identifiable within the ECB's budget. The budgetary authority of the ECB is vested in its Governing Council. The Governing Council adopts the ECB's annual budget following a proposal by the Executive Board in consultation with the Chair and Vice-Chair of the Supervisory Board for matters related to banking supervision. The Governing Council is assisted by the Budget Committee (BUCOM), which consists of members from all of the NCBs of the Eurosystem and the ECB. BUCOM assists the Governing Council by providing it with evaluations of the ECB's reports on budget planning and monitoring.

Expenditure in 2019 was broadly in line with estimates

The expenditure incurred by the ECB for the conduct of supervisory-related tasks primarily consists of the direct expenses of the [ECB Banking Supervision Directorates General](#). The supervisory function also relies on shared services provided by the existing support business areas of the ECB, which include premises, human resources management, administrative services, budgeting and controlling, accounting, legal, communication and translation services, internal audit, and statistical and information technology services.

In April 2019 the Governing Council adopted the ECB decision on the amount to be recovered through supervisory fees in 2019. This decision set the estimate for annual expenditure for banking supervisory tasks at €559.0 million.⁹² At the end of 2019 the ECB's expenditure for supervisory tasks amounted to €537.0 million (see [Table 6](#)). The incurred expenses were 4% less than the estimate communicated in April 2019, signalling the progression towards greater stability in expenditure planning. The resulting surplus of €22.0 million will be offset in full against the total amount to be levied for the fee period 2020, which, under the revised fees framework, will be invoiced ex post⁹³ in 2021.

⁹² Decision (EU) 2019/685 of the ECB of 18 April 2019 on the total amount of annual supervisory fees for 2019 (ECB/2019/10) (OJ L 115, 2.5.2019, p. 16).

⁹³ As of the fee period 2020, ECB supervisory fees will be calculated using the actual annual costs, i.e. after the closure of the fee period. See Section 6.2 for more information on the changes to the fees framework.

Table 6**Cost of the ECB's supervisory tasks by function**

(EUR millions)

	Actual expenditure 2019	Actual expenditure 2018	Actual expenditure 2017
Direct supervision of significant institutions	317.5	304.8	242.9
Oversight of less significant institutions	34.1	28.7	24.0
Horizontal tasks and specialised services	185.5	184.4	169.8
Total expenditure for banking supervision tasks	537.0	517.8	436.7

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

The ECB groups its costs using a function-based classification to enable the separation of costs. For its supervisory tasks, the principal activity-based groupings are:

- direct supervision of significant banks or banking groups;
- oversight of the supervision of less significant banks or banking groups (indirect supervision);
- performance of horizontal tasks and specialised services.

The classification is determined on the basis of the costs incurred by the business areas of the ECB that are responsible for the respective supervisory tasks. For each grouping, the costs reported include the allocation of shared services provided by the ECB's support business areas. The ECB also uses these classifications to identify the split of the annual costs to be recovered through annual supervisory fees from supervised entities based on their supervisory status as significant or less significant. The methodology defined in Article 8 of the Fees Regulation for the split of annual supervisory fees provides that the costs associated with horizontal tasks and specialised services are allocated proportionally, based on the full cost for the supervision of significant institutions and the cost of overseeing the supervision of less significant institutions, respectively.

The costs of directly supervising significant banks or banking groups mostly comprise the costs of the ECB's participation in Joint Supervisory Teams and of on-site inspections. They also include the costs associated with the TRIM. The oversight of the supervision of less significant banks or banking groups encompasses oversight activities and authorisation tasks. Horizontal tasks and specialised services comprise activities such as those carried out by the Secretariat to the Supervisory Board, macroprudential tasks including those related to stress testing, supervisory policymaking, statistical services and dedicated legal services.

Table 7**Cost of ECB Banking Supervision by expenditure category**

(EUR millions)

	Actual expenditure 2019	Actual expenditure 2018	Actual expenditure 2017
Salaries and benefits	272.6	246.0	215.0
Rent and building maintenance	60.9	58.8	53.0
Other operating expenditure	203.5	213.0	168.8
Total actual expenditure for banking supervision tasks	537.0	517.8	436.7

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

The largest portion of costs incurred for supervisory activities is related to salaries and benefits, together with the associated expenditure on rent and buildings and other staff-related costs such as business travel and training.

In 2019 the actual annual expenditure increased by 4% compared with 2018. This increase was primarily driven by the growth in approved ECB headcount. This, in turn, led to a corresponding increase in costs related to premises and to activities such as business travel.

In addition to its internal resources, the ECB engages external consultancy services to provide either specialised expertise or integrated consultancy under qualified internal guidance to address temporary resource shortages. In total, the ECB spent €68.7 million on consultancy services for core supervisory tasks in 2019, €7.1 million less than in 2018. The largest single activity requiring consultancy support was the TRIM, with external support costs amounting to €34.9 million for 2019. The TRIM project will soon be concluded, with some activities becoming regular tasks as of 2020. Also in 2019, €21.4 million was spent on external resources for the comprehensive assessments, with a further €2.1 million spent on Brexit preparations. The remainder of consultancy expenditure was primarily used for the conduct of “regular” on-site supervision tasks, including cross-border missions. More information on these activities can be found in Chapter 1.

Outlook for banking supervision fees in 2020

After five years of operation, European banking supervision is moving from an establishment phase towards maturity and the costs of banking supervision have evolved as a result. In the next phase the ECB will focus on sustainable cost management. In this regard, the ECB is committed to rigorously pursuing efficiency improvements on an ongoing basis through internalisation measures where possible, maintaining resource discipline and continuously improving productivity, which, it should be noted, may require initial investment. The ECB has made this commitment in order to move towards cost stability in the medium term.

In 2019 the Governing Council approved a net increase of 112.5 FTEs for 2020 – 59.5 FTEs for core banking supervision areas and 53 FTEs for related shared services. In line with the stabilisation strategy, these numbers include 44 FTEs that

The ECB is committed to sustainable cost management in carrying out its supervisory tasks

have been approved for the internalisation of resources that otherwise would need to be provided using consultancy support (particularly for IT services supporting data reporting and information management). Further internalisation measures are still under review and may result in future increases in FTEs.

Consequently, the managed growth in the expenditure for supervisory tasks will continue in 2020, increasing by 12% compared with 2019. This increase in costs is partially attributable to (i) the expected increase in the number of banks that will be supervised as a result of countries entering into close cooperation agreements with the ECB; and (ii) Brexit. At the same time, at the highest level of consolidation, there will be an increase in the number and/or size of banks and banking groups that are supervised. Therefore, all other things being equal, the fee per bank or banking group may not rise at the same rate as the ECB's expenditure.

Table 8
Estimated cost of ECB Banking Supervision in 2020 by function

(EUR millions)

	Estimated expenditure 2020	Actual expenditure 2019	Actual expenditure 2018
Direct supervision of significant institutions	345.3	317.5	304.8
Oversight of less significant institutions	37.7	34.1	28.7
Horizontal tasks and specialised services	220.7	185.5	184.4
Total expenditure for banking supervision tasks	603.7	537.0	517.8

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

As of the fee period 2020, ECB supervisory fees will be calculated using the actual annual costs of banking supervision, i.e. after the closure of the fee period.

The annual supervisory fee for 2020, to be levied in 2021, will only be known at the end of the fee period and will comprise the actual expenditure for the full year adjusted for (i) the surplus of €22.0 million carried forward from the 2019 fee period; and (ii) amounts reimbursed to or collected from individual banks for previous fee periods, late payment interest received and non-collectable fees. The net value of these adjustments relating to the financial year 2019, but not reflected in the ex ante 2019 fee calculation, amounted to €0.1 million. The values for 2020 will only be known at the end of the fee period.

Based on the information currently available, it is anticipated that the total amount to be levied in 2021 will be similar to that levied in 2019. The ratio of the total amount to be levied to each category of institution is estimated to be 90% for significant institutions (SIs) and 10% for less significant institutions (LSIs), which corresponds to the allocation of actual expenditure in 2019.

Table 9**Estimated total amount to be levied for 2020 by category**

(EUR millions)

	Estimated expenditure 2020	Carry forward to 2020 fee period	Other adjustments	Estimated total amount to be levied 2020	Total amount levied in 2019
Supervisory fees	603.7	-22.0	Not yet known	581.7	576.0
of which:					
fees for significant institutions or significant groups	544.3	-23.1	Not yet known	521.2	524.2
fees for less significant institutions or less significant groups	59.4	1.1	Not yet known	60.5	51.8

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

6.2 Fees framework for 2019

Together with the SSM Regulation, the Fees Regulation provides the legal framework within which the ECB levies an annual supervisory fee for the expenditure it incurs in conducting its supervisory tasks. The Fees Regulation establishes the methods for: (i) determining the total amount of the annual supervisory fee; (ii) calculating the amount to be paid by each supervised institution; and (iii) collecting the annual supervisory fee.

Closure of the review of the ECB supervisory fees framework

The outcome of the review of the ECB's supervisory fees framework was published on 17 December 2019. The ECB launched the review in June 2017 with a public consultation calling for feedback and suggestions for possible improvements to the framework. Following the closure of the public consultation, the ECB analysed all the comments received from the public and also conducted its own internal review of the framework. The outcome was presented in the form of proposals for improving the framework in a second public consultation launched in April 2019. By holding two public consultations, the ECB engaged in meaningful dialogue with the public on the supervisory fee methodology. The ECB appreciates the feedback received and has attempted to address the concerns of individual stakeholders wherever possible, while ensuring that the supervisory fees framework remains fair and transparent.

The amended Regulation and associated Decision are applicable to the calculation of the annual supervisory fees for the 2020 fee period⁹⁴. The main changes made to the framework are summarised below.

⁹⁴ Regulation (EU) 2019/2155 of the ECB amending Regulation (EU) No 1163/2014 on supervisory fees (ECB/2019/37) (OJ L 327, 17.12.2019, p. 70). Decision (EU) 2019/2158 of the ECB on the methodology and procedures for the determination and collection of data regarding fee factors used to calculate annual supervisory fees (ECB/2019/38) (OJ L 327, 17.12.2019, p. 99).

The amended fee framework applies from the fee period 2020 onwards

Levying supervisory fees ex post: supervisory fees are no longer levied on the basis of estimated supervisory costs. Instead, the fees are calculated using the actual annual costs of banking supervision, i.e. after the closure of the fee period.

Discount on the minimum fee component for smaller LSIs: the minimum fee component was halved for LSIs with total assets of €1 billion or less. According to data from 2019, roughly 60% of LSIs benefit from this discount, effectively reducing their fees by between 3% and 50%. The supervisory fees for LSIs that do not benefit from the discount have moderately increased by approximately 3%.

Reuse of supervisory data available at the ECB: eliminating the separate provision of fee factors leads to efficiency gains for more than 90% of supervised entities and groups. Fee factors cannot be derived from the supervisory data for (i) supervised groups that exclude assets of subsidiaries in non-participating Member States and third countries in the calculation of their fee; or (ii) branches that are not required to report supervisory financial information pursuant to Regulation (EU) 2015/534⁹⁵. Therefore, these institutions need to continue providing fee factors via a dedicated process.

Amending the requirement to submit auditor verifications for total assets data of branches: for most fee-paying branches, the obligation to provide auditor verification of the branch's total assets data for the purpose of the ECB supervisory fee was disproportionate to the supervisory fee payable. Therefore, fee-paying branches are now permitted to submit a management letter approving their fee factor instead of an auditor's statement.

Language versions of the fee notice: the ECB will issue the fee notices in all official languages of the EU.

As 2020 is a transitional year, the supervisory fees for 2020 will not be invoiced until 2021. The fees for the actual costs incurred for banking supervision tasks for the financial year 2020 will be invoiced in the first half of 2021. In order to transition from an ex ante collection to an ex post collection of fees, the surplus for the 2019 period, and adjustments arising from fee-relevant activities in 2019 that were not included in the 2019 fee calculation, will be included in the 2021 fee to be levied.

The ECB will send regular communications to fee-paying institutions throughout the transition period to advise them on what these changes mean in practical terms and to guide them through the new processes.

Total amount levied in 2019

In April 2019 the ECB decided that the total amount to be recovered through supervisory fees in 2019 would be €576.0 million. This was based on the expected expenditure for the full year 2019, amounting to €559.0 million, as adjusted for (i) the

Fees of €576.0 million were levied by the ECB for conducting supervisory tasks

⁹⁵ Regulation (EU) 2015/534 of the European Central Bank of 17 March 2015 on reporting of supervisory financial information (ECB/2015/13) (OJ L 86, 31.3.2015, p. 13).

deficit of €15.3 million carried forward from the 2018 fee period; and (ii) €1.7 million (net) reimbursed to individual banks for previous fee periods.

The amount to be recovered through annual supervisory fees is split into two parts. This split is related to the status of supervised entities as either significant or less significant, reflecting the varying degrees of supervisory scrutiny applied by the ECB.

Table 10
Total income from banking supervision tasks

(EUR millions)

	Actual income 2019	Estimated income 2019	Actual income 2018
Supervisory fees	537.0	559.0	517.8
of which:			
fees for significant institutions or significant groups	484.9	508.7	473.3
fees for less significant institutions or less significant groups	52.1	50.3	44.5
Other	7.0	0.0	6.0
Total income from banking supervision tasks	544.0	559.0	523.8

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

As explained in Section 6.1, there is an overall surplus of €22.0 million between the actual expenditure incurred for banking supervisory tasks in 2019 and the amount estimated in the same year. This surplus will reduce the fees to be levied for the fee period 2020.

Following the publication of the total amount to be levied for 2019, it came to light that there was an inconsistency in the amounts allocated to each category of banks from the deficit carried forward from the fee period 2018. This resulted in a €0.7 million undercharge to SIs and a €0.7 million overcharge to LSIs in the total 2019 fee. This has been taken into account in the surplus that will reduce the fee in 2020.

Table 11
Amounts to be carried forward to the 2020 fee period by category

(EUR millions)

	Actual cost 2019	Estimated cost 2019	Correction for actuals 2018	Carry forward to 2020 fee period
Supervisory fees	537.0	559.0	0.0	-22.0
of which:				
fees for significant institutions or significant groups	484.9	508.7	+0.7	-23.1
fees for less significant institutions or less significant groups	52.1	50.3	-0.7	1.1

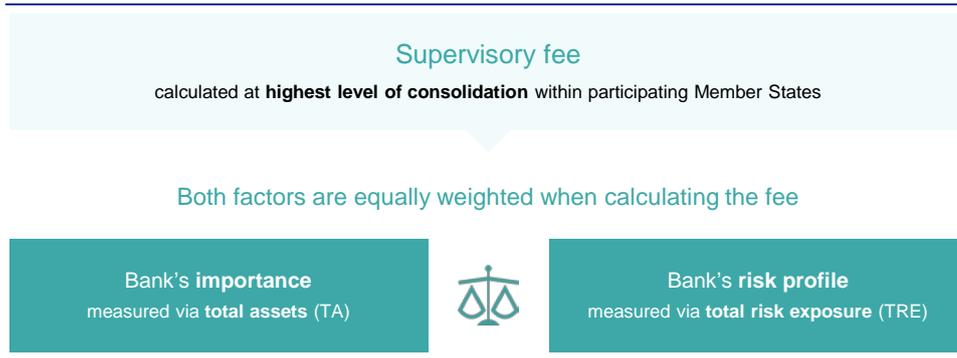
Source: ECB.

Individual supervisory fees

At bank level, the fees are calculated according to a bank's importance and risk profile, using annual fee factors for the supervised banks with a reference date of 31 December of the previous year. The supervisory fee calculated per bank is then charged through annual payments (see **Figure 7**).

Figure 7

The variable fee component is determined by a bank's importance and its risk profile



The supervisory fee is set at the highest level of consolidation within Member States participating in the SSM. It contains a variable fee component and a minimum fee component. The latter applies equally to all banks and is based on 10% of the total amount to be recovered.⁹⁶

Article 7 of the Fees Regulation provides that the following changes in the situation of an individual bank require an amendment of the corresponding supervisory fee: (i) a change in the supervisory status of the supervised entity, i.e. the entity is reclassified from significant to less significant or vice versa; (ii) a new supervised entity is authorised; or (iii) an existing authorisation is withdrawn. Changes related to previous fee periods which resulted in new supervisory fee decisions by the ECB totalled €1.8 million in 2019, of which €1.7 million was included in the annual supervisory fees invoiced in 2019.

More information on [supervisory fees](#) is available on the ECB's banking supervision website. These pages are updated regularly and are published in all official EU languages.

Other income related to banking supervisory tasks

The ECB is entitled to impose administrative penalties on supervised entities for failure to comply with obligations under EU banking prudential regulation (including

⁹⁶ For the smallest significant institutions, with total assets of €10 billion or less, the minimum fee component is halved. As of 2020 the minimum fee component is also halved for small less significant institutions with total assets of €1 billion or less.

ECB supervisory decisions).⁹⁷ The related income is not taken into account in the calculation of the annual supervisory fees. The Fees Regulation ensures that neither damages payable to third parties nor administrative penalties (sanctions) payable to the ECB by supervised entities have any influence on the supervisory fee. The administrative penalties on supervised entities are recorded as income in the ECB's profit and loss account. In 2019 the income arising from penalties imposed on supervised entities amounted to €7.0 million.⁹⁸

⁹⁷ Further information on enforcement and sanctions can be found in Section 2.2.

⁹⁸ The income arising from penalties stated here (€7.0 million) and that stated in Section 2.2 (€7.6 million) differ owing to differences in the timeline for booking the income.

7 Legal instruments adopted by the ECB

This section lists the legal instruments concerning banking supervision that were adopted in 2019 by the ECB and published in the Official Journal of the European Union and/or on the ECB's website. It covers legal instruments adopted pursuant to Article 4(3) of Regulation (EU) No 1024/2013 and other relevant legal instruments.

7.1 ECB regulations

ECB/2019/37

[Regulation \(EU\) 2019/2155](#) of the European Central Bank of 5 December 2019 amending Regulation (EU) No 1163/2014 on supervisory fees (OJ L 327, 17.12.2019, p. 70)

[Corrigendum](#) to Regulation (EU) 2019/2155 of the ECB of 5 December 2019 amending Regulation (EU) No 1163/2014 on supervisory fees (OJ L 330, 20.12.2019, p. 106)

7.2 ECB legal instruments other than regulations

ECB/2019/1

[Recommendation](#) of the European Central Bank of 7 January 2019 on dividend distribution policies (OJ C 11, 11.1.2019, p. 1)

ECB/2019/4

[Decision \(EU\) 2019/322](#) of the European Central Bank of 31 January 2019 on delegation of the power to adopt decisions regarding supervisory powers granted under national law (OJ L 55, 25.2.2019, p. 7)

ECB/2019/5

[Decision \(EU\) 2019/323](#) of the European Central Bank of 12 February 2019 nominating heads of work units to adopt delegated decisions regarding supervisory powers granted under national law (OJ L 55, 25.2.2019, p. 16)

ECB/2019/10

[Decision \(EU\) 2019/685](#) of the European Central Bank of 18 April 2019 on the total amount of annual supervisory fees for 2019 (OJ L 115, 2.5.2019, p. 16)

ECB/2019/14

[Decision \(EU\) 2019/976](#) of the European Central Bank of 29 May 2019 laying down the principles for defining objectives and sharing feedback in joint supervisory teams and repealing Decision (EU) 2017/274 (OJ L 157, 14.6.2019, p. 61)

ECB/2019/23

[Decision \(EU\) 2019/1376](#) of the European Central Bank of 23 July 2019 on delegation of the power to adopt decisions on passporting, acquisition of qualifying holdings and withdrawal of authorisations of credit institutions (OJ L 224, 28.8.2019, p. 1)

ECB/2019/26

[Decision \(EU\) 2019/1377](#) of the European Central Bank of 31 July 2019 nominating heads of work units to adopt delegated decisions on passporting, acquisition of qualifying holdings and withdrawal of authorisations of credit institutions (OJ L 224, 28.8.2019, p. 6)

ECB/2019/27

[Decision \(EU\) 2019/1378](#) of the European Central Bank of 9 August 2019 amending Decision ECB/2014/16 concerning the establishment of an Administrative Board of Review and its Operating Rules (OJ L 224, 28.8.2019, p. 9)

ECB/2019/38

[Decision \(EU\) 2019/2158](#) of the European Central Bank of 5 December 2019 on the methodology and procedures for the determination and collection of data regarding fee factors used to calculate annual supervisory fees (OJ L 327, 17.12.2019, p. 99)

[Corrigendum](#) to Decision (EU) 2019/2158 of the ECB of 5 December 2019 on the methodology and procedures for the determination and collection of data regarding fee factors used to calculate annual supervisory fees (OJ L 330, 20.12.2019, p. 105)

[Code of Conduct for high-level European Central Bank Officials](#) (OJ C 89, 8.3.2019, p. 2)

[Memorandum of Understanding](#) between the European Court of Auditors and the European Central Bank regarding audits on the ECB's supervisory tasks (9.10.2019)

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

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