Evolving risks, evolving supervision: reforming European banking supervision

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Chair of the Supervisory Board of the European Central Bank

July 2024
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>How is banking supervision organised in Europe?</td>
</tr>
<tr>
<td>2</td>
<td>How has the risk environment evolved?</td>
</tr>
<tr>
<td>3</td>
<td>How is European supervision responding?</td>
</tr>
</tbody>
</table>
How is banking supervision organised in Europe?
The Single Supervisory Mechanism (SSM) was established ten years ago in response to the financial crisis.
The Supervisory Review and Evaluation Process (SREP) performs a comprehensive assessment of risks and controls.

1. Is the business model viable and sustainable?
2. Are risk management and governance adequate?
3. Is the capital position at risk?
4. Is the bank exposed to liquidity and funding risk?

Overall SREP assessment

SREP decision

- Qualitative supervisory measures
- Quantitative liquidity measures
- Quantitative capital measures
Within the Single Supervisory Mechanism, the ECB and national supervisors cooperate closely.

Direct supervision

- Joint supervisory teams
- Significant institutions

Oversight

- National competent authorities
- Less significant institutions

ECB

Supervisory Board
How has the risk environment evolved?
Over the past decade, the resilience of European banks has increased and non-performing loans have declined …

Capital adequacy
(percentage)

Non-performing loans
(percentage)
...while liquidity ratios have improved.

Liquidity ratios
(percentage)

Liquidity coverage ratio
Net stable funding ratio (right-hand scale)
At the same time, the risk environment has been evolving, as reflected in the SSM supervisory priorities.

SSM supervisory priorities (2024-2026)

**Priority 1**
Strengthen resilience to immediate macro-financial and geopolitical shocks

**Priority 2**
Accelerate remediation of shortcomings in governance and the management of climate-related and environmental risks

**Priority 3**
Further progress in digital transformation and building robust operational resilience frameworks
How is European supervision responding?
The independent experts assessed the evolution of European banking supervision over the past decade.

- The independent expert group noted progress …
  - The SREP “has significantly helped to increase the resilience of the European banking sector and to promote a level playing field for all significant institutions.”

- … but it also indicated room for improvement:
  - “Today’s environment calls for a careful recalibration of the SREP and other supervisory processes.”
The reform of the supervisory process decided by the Supervisory Board in May 2024 has six objectives.

1. Focusing risk assessments
2. Better integrating supervisory activities
3. Using the full supervisory toolkit
4. Enhancing communication
5. Making methodologies more stable
6. Better use of IT systems and data analytics
Focusing risk assessments using multi-year assessments and a risk tolerance framework

1. **Risk tolerance framework** (introduced in 2023)
   - Not every risk is of the same relevance for every bank in every year.
   - Prioritise risk assessments

2. **Multi-year assessment** (introduced in 2023)
   - Risk assessment are spread over several years to focus on specific topics each year.
   - Risk assessment are updated every two years *if there is no material change in a bank’s risk profile.*
Better integrating supervisory activities to use synergies and optimise planning

- Stress testing and scenario analysis
- Horizontal thematic reviews
- Targeted deep-dive analysis
- Off-site supervision
- On-site inspections
- Internal model assessments
- Integrated supervisory activities

Better integrating supervisory activities to use synergies and optimise planning
Using the full supervisory toolkit and moving up the escalation ladder faster to ensure findings are being addressed.
Supervisory communication to banks needs to be clear, concise and timely – but SREP decisions can be long and complex.

Future SREP decisions will be more focused and conveyed earlier.
Making methodologies more stable to allow focusing on newly emerging risks

1. Is the business model viable and sustainable?
2. Are risk management and governance adequate?
3. Is the capital position at risk?
4. Is the bank exposed to liquidity and funding risk?

<table>
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<tr>
<th>Methodology to calculate overall SREP score</th>
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<th>SREP decision</th>
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<tr>
<td>Qualitative supervisory measures</td>
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<td>Quantitative liquidity measures</td>
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<td>Quantitative capital measures</td>
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Making better use of IT systems and data analytics to increase efficiency and save time on routine tasks

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<tr>
<th>Athena</th>
<th>Navi</th>
<th>Virtual Lab</th>
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<tr>
<td>AI-powered textual analysis platform</td>
<td>Graph and network analytics platform</td>
<td>SSM-wide digital collaboration platform</td>
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<tr>
<td>Agora</td>
<td>Heimdall</td>
<td>Gabi</td>
</tr>
<tr>
<td>Single data lake</td>
<td>Machine reading and analysis of fit and proper applications</td>
<td>Big data analytics</td>
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These reforms allow supervisors to more effectively respond to evolving risks.

• Good supervision requires …
  • a critical mindset
  • sound analysis of microeconomic and macroeconomic risks
  • follow-up on findings not yet addressed

• … and it needs to respond to evolving risks:
  • through strong supervisory and regulatory standards
  • by ensuring sufficient operational and financial resilience of banks
  • by addressing risks outside of the banking sector
Suggestions for further reading


- Buch, C. (2024), “Reforming the SREP: an important milestone towards more efficient and effective supervision in a new risk environment”, Supervision Blog, 28 May

- ECB Banking Supervision, Supervisory review (SREP)

- ECB Banking Supervision: SSM supervisory priorities for 2024-2026