ECB Banking Supervision Market Contact Group (BSMCG)

Wednesday, 7 July 2021, virtual meeting

MEETING SUMMARY

The Chair of the ECB's Supervisory Board, Andrea Enria, welcomed the members of the BSMCG to its first meeting and thanked all market participants for expressing their interest in joining this group. Mr Enria recalled that the aim of the BSMCG was to gather a wide range of views from market participants on the main risks and vulnerabilities of the European banking sector and to discuss the potential implications for banking supervision from a system-wide perspective, thereby helping to strengthen the ECB's analysis of the banking sector. Mr Enria noted that the ECB aimed to achieve a balanced composition of the group over time, seeking to involve a wide range of institutions and banking market stakeholders and envisaging a rotation in membership. With a view to ensuring greater diversity in the BSMCG, and in particular participation by female members, he had deliberately left a few seats available, which he hoped to fill ahead of the next meeting. To this end, Mr Enria explained that the call for expressions of interest in joining the BSMCG would be reopened on the ECB's banking supervision website during the autumn of 2021. The responses would be assessed against the predefined criteria outlined in the BSMCG's Terms of Reference.

1. European banking sector outlook

The presentation reviewed recent developments and key themes shaping banks' risk outlook. Key highlights included a positive outlook for credit quality underpinned by the expected economic rebound, expectations of resumed dividend pay-outs in 2021-22, continued pressures on profitability and business model while banks' valuations remain low, and the role of mergers and acquisitions to address market overcapacity.

Overall, BSMCG members mostly held the view that the credit risk outlook for banks was set to improve given the ongoing macroeconomic recovery, despite some remaining uncertainties related to the future development of the coronavirus (COVID-19) pandemic. Members acknowledged pockets of risks in vulnerable sectors – especially small and medium-sized enterprises – but highlighted that banks' exposures in these sectors were for the most part limited. Despite the consensus that a large wave of non-performing exposures was unlikely to materialise, members still stressed that the timely recognition of credit losses and adequate risk management practices by banks were key to keeping credit risk in check.

Looking beyond current trends in bank lending, members believed that factors such as subdued profitability and structural aspects including overcapacity in the banking system would continue to challenge the business models of European banks. New consolidation efforts and digital innovation were mentioned as possible ways of overcoming this challenge. According to some members, Europe needs a more concentrated banking system with stronger players, as is the case in the United States. Members also highlighted that the currently abundant inflows of corporate and household deposits were costly for banks to maintain as long as lending growth does not pick up.

BSMCG members were generally of the view that technological progress would accelerate the need for investments in information technology, particularly by larger banks, while also exposing banks to greater competition from larger fintech companies in certain market segments, such as payment functions. Moreover, members highlighted that while banks' technological progress required significant IT investments, a large part of such investments would be used to maintain legacy systems and only a small part would go towards IT innovation.

Members also thought that a resumption of dividend distributions and share buy-backs by banks would support investors' interest in the European banking sector at large. In this regard, some members expressed doubts about the effectiveness of the ECB's recommendation on restricting dividend distributions as a measure intended to boost lending. After explaining the rationale behind the measures taken by the ECB in this area, Mr Enria recalled that recent research had confirmed the effectiveness of the recommendation on dividend restrictions.

2. Challenges to banks from the non-bank financial sector

The presentation highlighted several challenges for the European banking sector, focusing on risks to banks stemming from leverage in the non-bank financial sector and interlinkages between non-bank financial institutions (NBFIs) and banks.

Members generally believed that the growing importance of NBFIs, which are less regulated and subject to much lower transparency and disclosure requirements compared with traditional banks, would warrant adequate attention by policymakers in the future. In this regard, increasing leverage and potential maturity mismatches were identified as potential vulnerabilities for NBFIs. Overall, members mostly held the view that while banks' exposures to NBFIs were not currently perceived to be a source of systemic risk, individual instances driven by search-for-yield behaviour might still give cause for concern. Members also thought that the recent Archegos case had been a timely reminder of the importance of adequate risk management practices in banks. The growth of special purpose acquisition companies, so far observed mainly in the United States, was also seen as posing potential reputational risks to banks. Potential risks related to exchange-traded funds were also mentioned, with one member recalling the market disruption in the United States in March 2020.

Finally, BSMCG members discussed different potential approaches that regulators could take to contain from the impact of excessive risk-taking by banks, such as increasing transparency through improved disclosure requirements or increasing capital requirements (for Pillar 2 requirements, as this would take too long to implement for Pillar 1 requirements).

3. ECB Banking Supervision’s communication strategy and transparency initiatives

BSMCG members expressed views about ECB Banking Supervision’s existing communication channels while also outlining potential areas for improvement. Members broadly welcomed the increased transparency of the ECB in its role as banking supervisor, highlighting recent blog posts and the regular supervisory banking statistics published on the ECB’s banking supervision website as good examples.

Members were generally of the view that market analysts would appreciate more granular information on the performance of supervised institutions, for example different types of breakdown (between listed and non-listed banks) in the supervisory banking statistics published on the website. Members highlighted that they would welcome more detailed/technical communication on the supervisory methodologies, in particular Pillar 2 guidance, and on the follow-up to the outcome of both the regular EU-wide stress test exercises and the planned stress test on climate-related and environmental risks. In this context, BSMCG members indicated that they would welcome greater clarity on the potential implications of such exercises for individual banks’ capital requirements. The coordination of public communication by the European Systemic Risk Board and ECB Banking Supervision was highlighted as another area for improvement.