



7th ECB Banking Supervision Market Contact Group (BSMCG) meeting

Friday, 27 September 2024, physical meeting

MEETING SUMMARY

Claudia Buch, Chair of the Supervisory Board, opened the seventh meeting of the BSMCG. Ms Buch introduced the new members of the BSMCG after conducting the annual review of membership and outlined the agenda. Furthermore, she recalled that the exchanges of views with market participants are an essential component of the market intelligence activities conducted by ECB Banking Supervision to support its assessment of the main risks and vulnerabilities of the banking sector.

1. European banking sector outlook

BSMCG members stressed that the European banking sector had demonstrated broad resilience to the challenging macro-financial environment at present, thanks to strong capital positions and liquidity buffers, benign asset quality (though with sectorial dispersion) and resilient profitability. Nevertheless, some members pointed out that some banks had not significantly improved their profitability in spite of the higher interest rate environment. Overall, members agreed that the sluggish economic growth environment in Europe at present would be a significant drag to the banking sector as it would limit the expansion capacity of the private sector, while available resources would also remain unemployed (as in a low-growth environment loan demand is expected to be lower). Members thus cautioned that, in this environment, risks posed by balance sheet contraction by banks were thus arguably higher than those related to the management of their exposures, and pointed to improvements in banks' management of interest rate risk in recent years. Looking further ahead, members considered that growth-friendly policies were lacking in Europe and that prospects for further EU integration were dim, leading to considerable uncertainty about the future pace of macroeconomic growth in Europe. Taken together, members considered that such factors might negatively weigh on banks' ability to thrive in a low-growth environment from a medium- to long-term perspective, while also dampening both banks' valuations and investor sentiment towards the European banking sector in the present. In this context, some members also stressed the role that bank mergers can play in the future to increase the competitiveness of the sector as a whole.

Members also discussed the threats stemming from the heightened (geo)political uncertainty and its implications for both banks themselves and for investor appetite towards the banking sector more broadly. In this regard, members agreed that while the elevated geopolitical risk posed a significant threat to the banking sector, it was extremely difficult to assess its potential impact given the multiple channels through which this might potentially materialise. In this context, some members also highlighted the challenges related to measuring potential second-round effects triggered by (geo)political events, for example related to the impact of new trade barriers or to a potential fragmentation in climate policies. Members also stressed that the large number of upcoming elections would be a continual potential source for headwinds to the banking sector through both adverse financial market reactions and/or uncertainty about the future direction the adoption of global regulatory standards in different jurisdictions.

2. Challenges to banks' cyber and IT resilience

Members agreed that while the issue of cyber and IT resilience was one of the most pressing areas for banks at present, it was also very challenging to precisely assess risks in this domain, due to opacity and a lack of harmonised data. Data quality and comparability were thus highlighted as important aspects where progress was needed; the need to encourage banks to be more forthcoming in the disclosure of their adoption of new technologies was also mentioned in this regard. Some members also highlighted that it was difficult to measure banks' exposures to IT and cyber threats using conventional performance indicators as risks were multi-faceted in nature. Qualitative information related to internal governance and risk controls were thus seen as equally important as quantitative data, on reporting on IT budgets and investments, for example. Overall, members considered that it remained difficult for investors to adequately reflect this cyber and IT resilience in their assessment of banks' valuations. Members thus considered that it was extremely important for banks' board members to steer adequately and effectively their digital transformation agendas and to ensure that banks remain attractive to retain and hire new IT talent.

Notwithstanding these challenges, many members thought that the banking sector seemed to have made greater progress to increase its resilience to cyber threats than was the case in non-financial corporate sectors such as utilities companies. In this regard, it was pointed out that those banks which had invested early in new technologies such as artificial intelligence were already reaping its benefits, while other banks which were latecomers to the process were still lagging. In this context, many members agreed that IT and cyber resilience was a big hurdle inhibiting bank growth and noted the potential role, which consolidation might play in this regard, especially among smaller banks. However, members pointed out that cost synergies would be difficult to achieve for domestically oriented banks as there were large differences in the retail business across countries, which posed challenges to unify legacy IT systems. The fact that the complete overhaul of IT systems would carry a significant sunk cost in the short run, while its positive effects

would only be realised in the longer run, was also cited as an additional element which would make the digital transformation difficult for smaller banks.

Going forward, cyber incident insurance was highlighted as a necessary complement to strengthen banks' resilience to IT and cyber threats. In this regard, members considered that the market for cyber insurance has remained rather limited in Europe at present but expected it to develop further in the future. While members highlighted that cyber insurance alone cannot completely mitigate the risk, a growing cyber insurance market was expected to contribute to a better evaluation of the risks in this area.

3. Concluding remarks

Ms Buch concluded the meeting by thanking the members for their contributions and active participation in the discussions. The next meeting is expected to take place in early 2025.