

SREP 2021 Press Conference, 10 February 2022

1 Significant institutions in the current macroeconomic environment

2 SREP 2021: key findings and results

3 Credit risk

4 Business models and governance

5 Emerging risks

6 Looking ahead: supervisory priorities for 2022-24

1. Significant institutions in the current macroeconomic environment

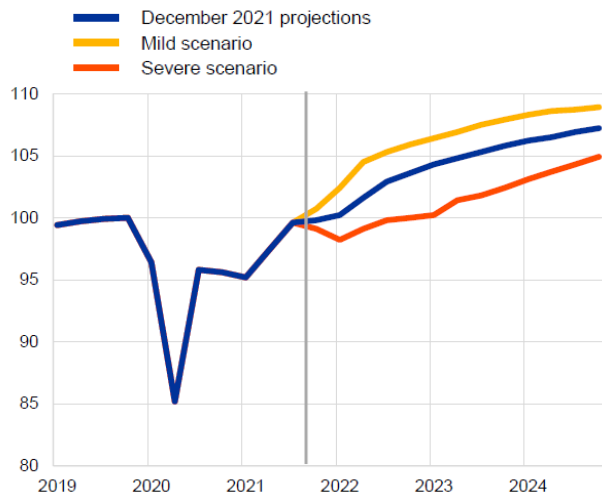
A resilient banking sector
navigating an uncertain
macroeconomic environment

1 Significant institutions in the current macroeconomic environment

The euro area economy is continuing to recover, but the evolution of the pandemic and supply bottlenecks are weighing on the outlook ...

Economic growth is projected to remain strong over the next three years, despite headwinds in the near term ...

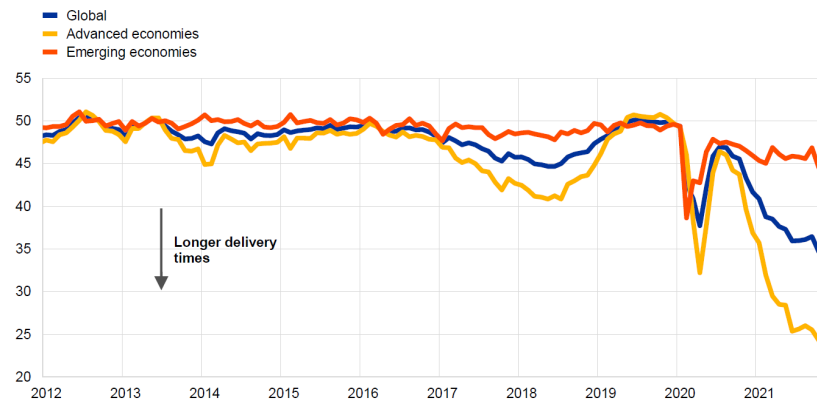
Euro area real GDP, including projections under alternative scenarios
(index, 100=Q4 2019)



Source: December 2021 Eurosystem staff macroeconomic projections for the euro area.
Note: The vertical line marks the start of the projection horizon.

... linked to uncertainty about the spread of variants of the virus and supply chain disruption weighing on economic activity and trade

Purchasing Managers' Index for suppliers' delivery times across regions
(diffusion indices, 50=no change relative to previous month)



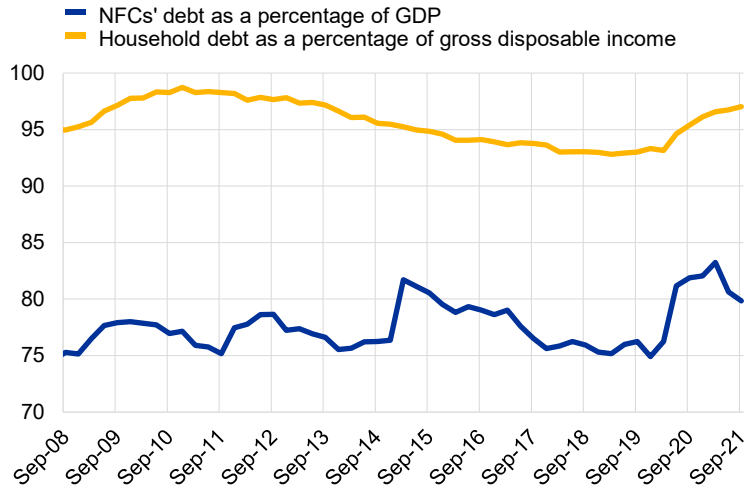
Source: ECB Economic Bulletin, Issue 8, 2021.

Notes: The global Purchasing Managers' Index for suppliers' delivery times quantifies developments in the time required for the delivery of inputs to firms and captures capacity constraints of a different nature (e.g. intermediate goods shortages, transportation delays or labour supply shortages). The latest observations are for November 2021.

1 Significant institutions in the current macroeconomic environment

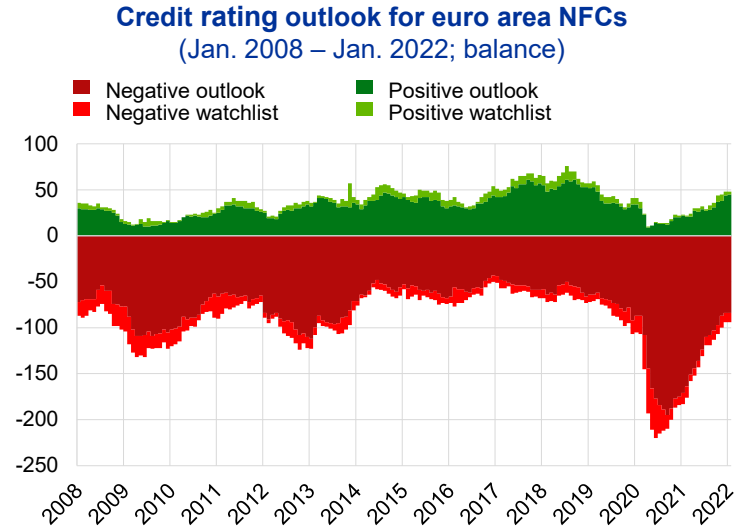
... highlighting potential medium-term vulnerabilities stemming from high private sector indebtedness and future challenges

Elevated corporate and household debt ratios in the euro area might pose a problem for borrowers' debt servicing ability ...



Sources: Eurostat and ECB.
Note: The latest observations are for September 2021.

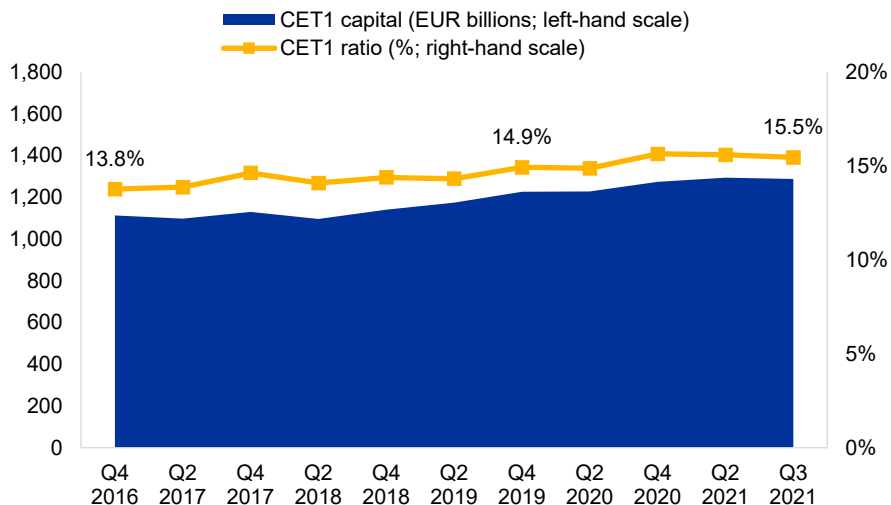
... as many euro area firms are still at risk of further credit rating downgrades, despite recent improvements



Sources: S&P and ECB calculations.
Notes: This chart shows stocks of positive/negative outlooks and watchlists for S&P ratings of NFCs domiciled in the euro area. The number of negative outlook and watchlist ratings is inverted. The latest observations are for 1 January 2022.

Significant institutions have maintained solid capital and liquidity positions ...

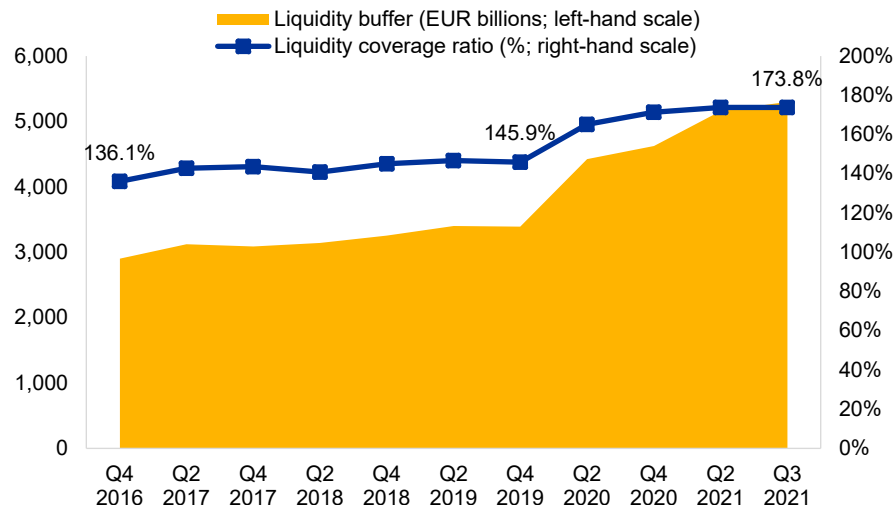
Significant institutions' aggregated CET1 ratio has increased further during the pandemic (+0.6 pp vs Q4 2019)



Source: Supervisory reporting.

Notes: This chart shows the transitional CET1 ratio. The sample for Q3 2021 comprises 113 SIs. The number of SIs can change from one reference period to another owing to amendments to the list of SIs following assessments by ECB Banking Supervision.

Liquidity coverage ratios (LCRs) have reached all-time highs (+27.9 pp vs Q4 2019), thanks in part to central bank support



Source: Supervisory reporting.

Notes: The sample for Q3 2021 comprises 113 SIs. The number of SIs can change from one reference period to another owing to amendments to the list of SIs following assessments by ECB Banking Supervision.

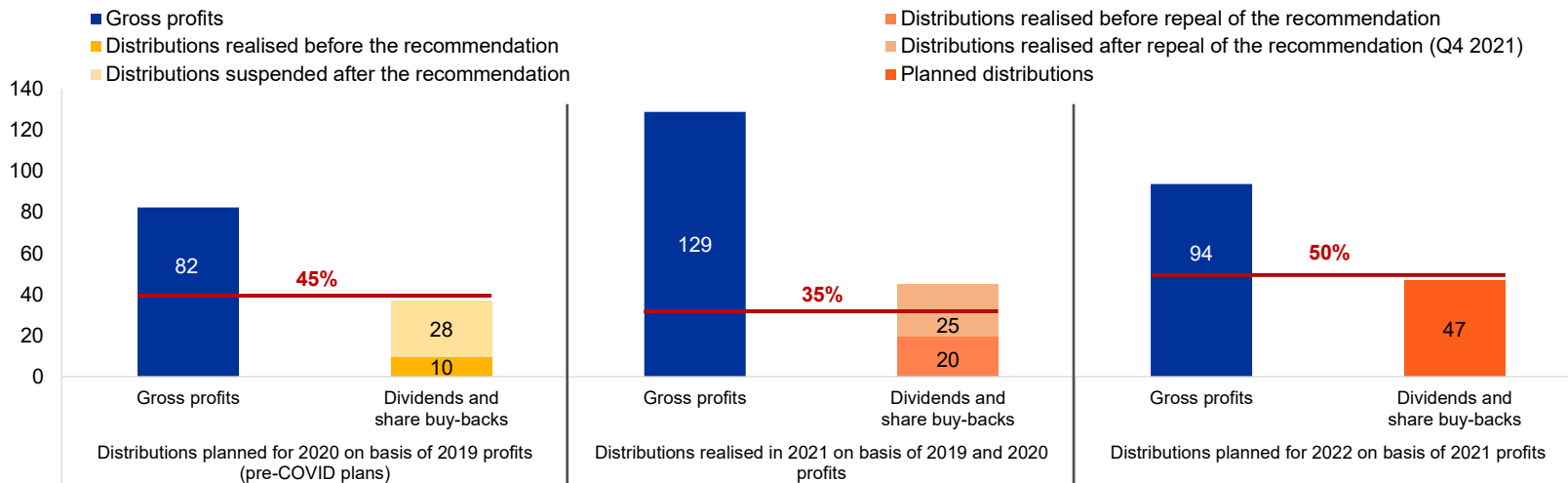
1 Significant institutions in the current macroeconomic environment

... with the planned pay-out ratio in 2022 similar to pre-pandemic levels

While significant institutions are catching up in terms of distributions, supervisors are assessing their plans in the light of current capital headroom and forward-looking trajectories, considering both baseline and adverse scenarios

Significant institutions' planned and realised distributions according to information available to JSTs

(EUR billions)



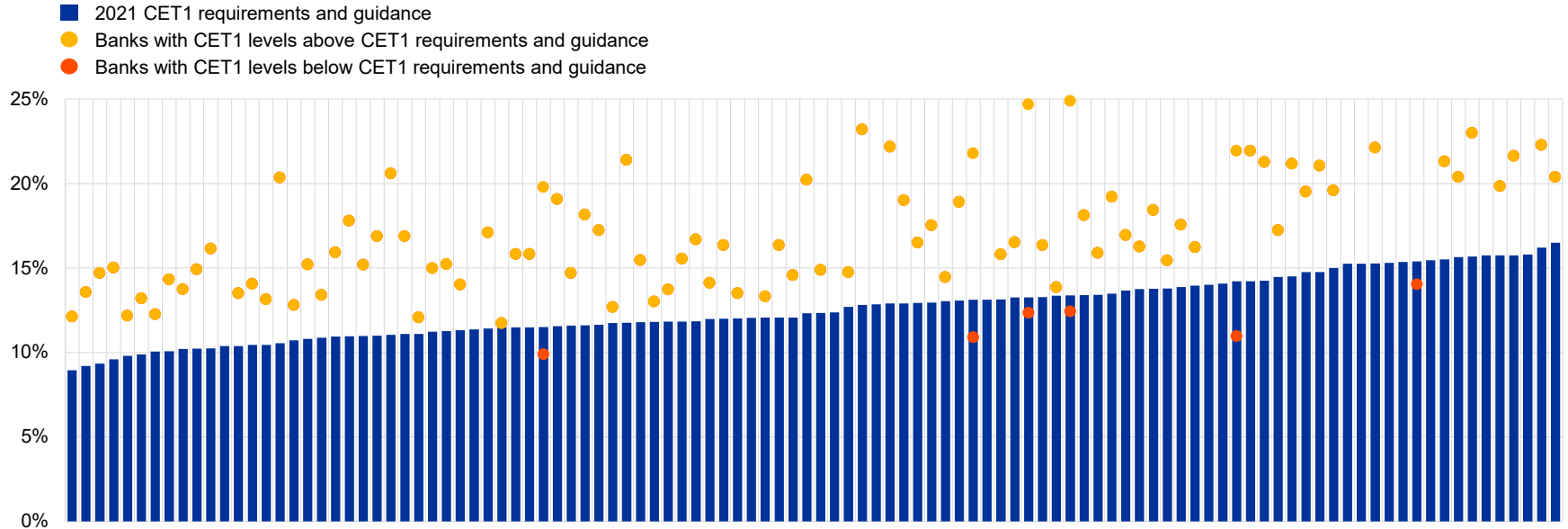
Source: JSTs' internal surveys on banks' profit distribution plans.

Notes: The number of SIs can change from one reference period to another owing to amendments to the list of SIs following assessments by ECB Banking Supervision. "Gross profits" are profits attributable to the owners of the parent company, in line with supervisory reporting, and do not include losses. As a reminder, on [27 March 2020](#) the ECB asked banks not to distribute dividends or buy back shares during the COVID-19 pandemic. A similar recommendation was made in [July 2020](#), and in [December 2020](#) the ECB asked banks to limit their distributions. Finally, in [July 2021](#) it was decided that the ECB's dividend recommendation would not be extended beyond September 2021.

1 Significant institutions in the current macroeconomic environment

The vast majority of significant institutions have CET1 ratios that go beyond the new requirements and guidance, with very few exceptions

The P2G relief policy will not be extended beyond end-2022



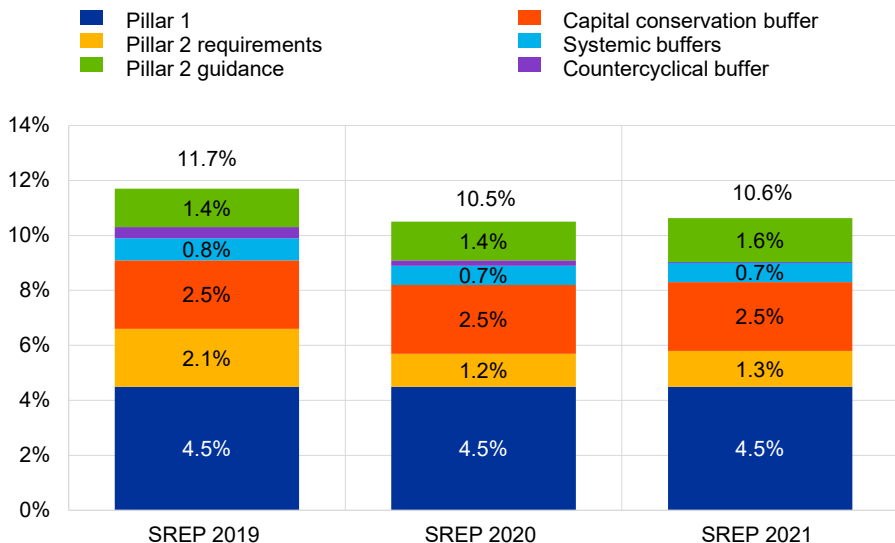
Sources: CET1 requirements and guidance include P2R/P2G based on 108 SREP decisions applicable as at Q1 2022, as well as any AT1/T2 shortfall that needs to be covered with CET1. CET1 ratios are as at Q3 2021. Systemic buffers (G-SII, O-SII and systemic risk buffer) and countercyclical capital buffers are as at Q1 2022.

2. SREP 2021: key findings and results

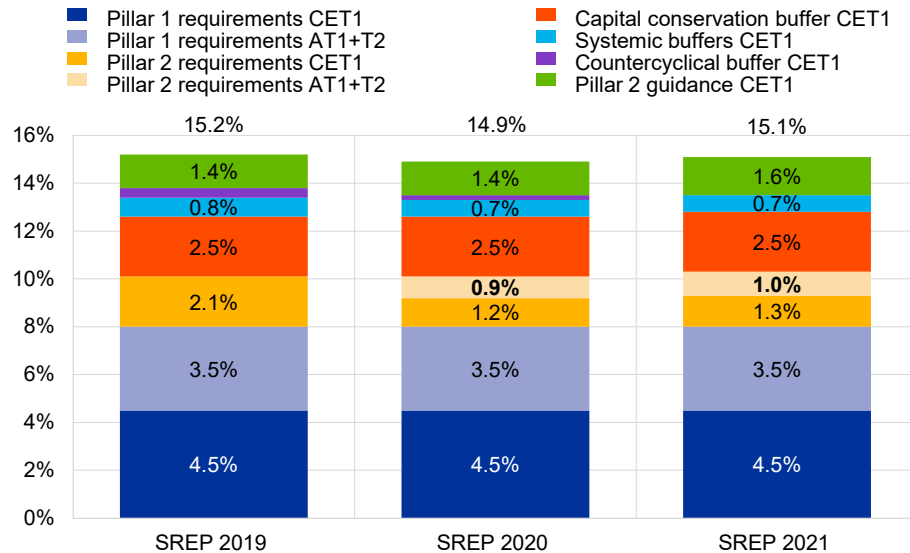
SREP requirements and guidance have increased marginally

There have been marginal increases in both Pillar 2 guidance (explained by the results of the EU-wide stress test in 2021) and Pillar 2 requirements (driven by add-ons due to shortfalls in provisioning for non-performing exposures (NPEs))

Overall capital requirements and guidance in CET1 as a percentage of risk-weighted assets



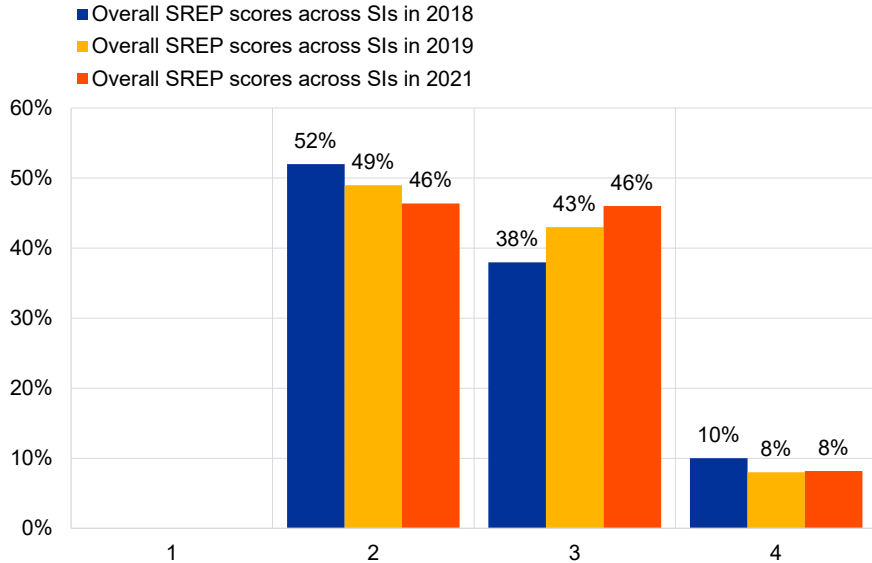
Overall capital requirements and guidance as a percentage of risk-weighted assets



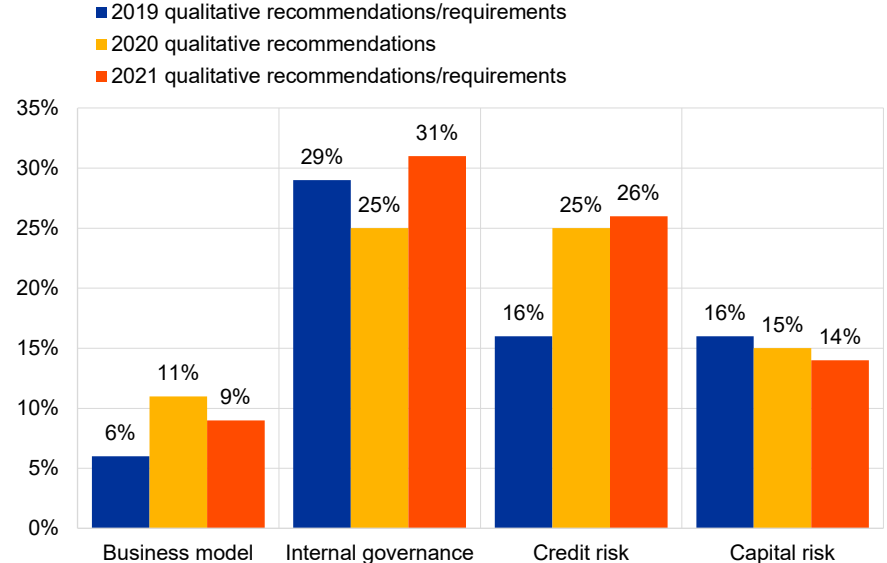
Source: SREP 2021 values based on 108 decisions applicable as at Q1 2022; SREP 2020 values based on 112 decisions; SREP 2019 values based on 109 decisions.
 Note: Capital requirements and guidance decided during an annual SREP assessment are applicable as of the following year.

SREP 2021 results are broadly stable relative to previous years' scores; credit risk and internal governance remain the primary focus of supervisory action

The percentage of banks scoring 3 has increased slightly over the last few SREP cycles ...



... with supervisors' remedial measures focusing primarily on credit risk and internal governance



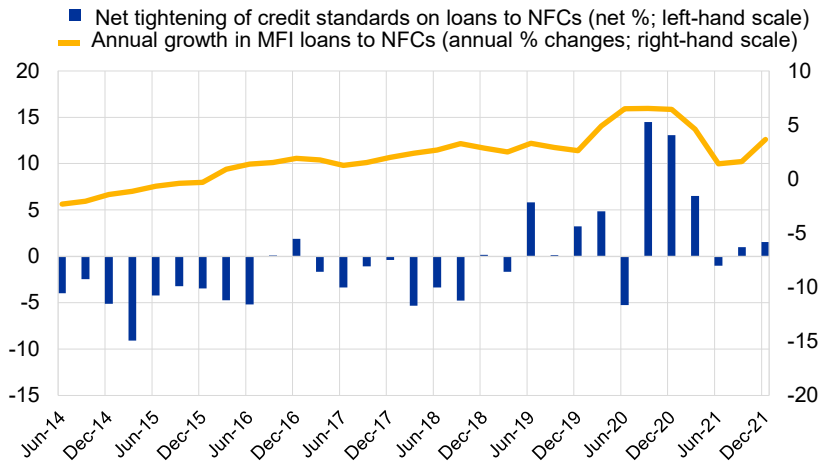
Sources: SREP 2021 values based on 108 decisions; SREP 2020 values based on 112 decisions; SREP 2019 values based on 109 decisions; SREP 2018 values based on 107 decisions.

3. Credit risk

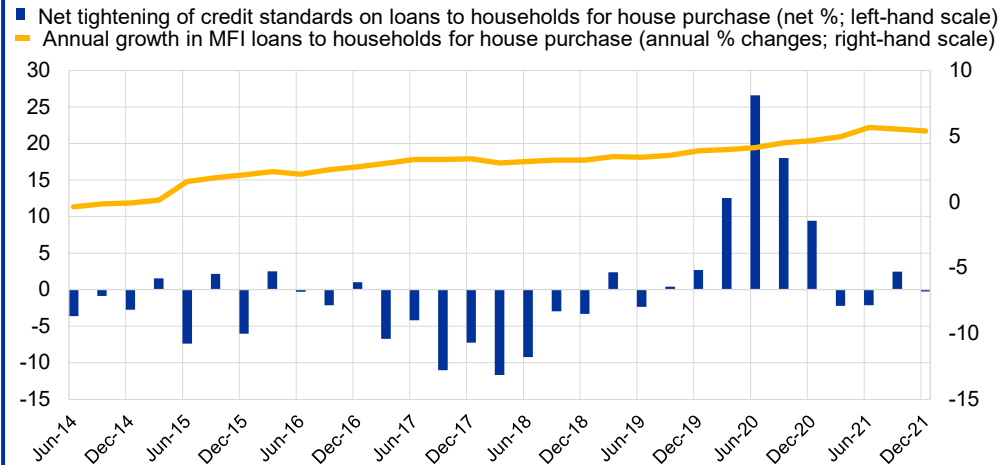
Credit risk controls remain the key focus

Growth in lending to NFCs has moderated after firms borrowed heavily at the start of the pandemic, while mortgage lending has driven growth in lending to households

After increasing at the start of the pandemic, growth in lending to NFCs has returned to pre-pandemic levels ...



... while growth in mortgage lending has remained high, despite recent tightening of credit standards

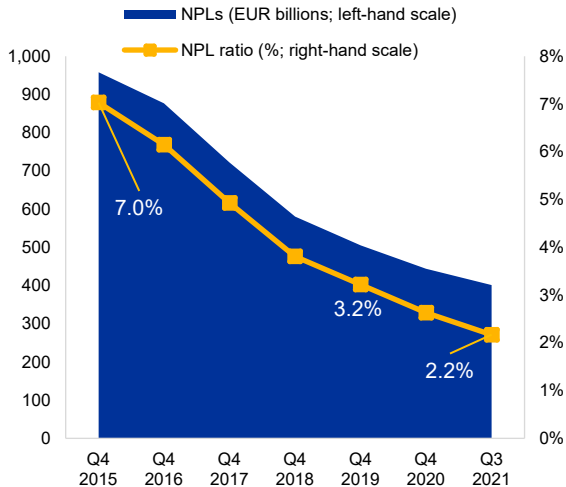


Sources: Euro area bank lending survey and BSI data.

Notes: The MFI sector excludes the Eurosystem. Loans are adjusted for loan sales and securitisation; in the case of NFCs, loans are also adjusted for notional cash pooling. Net percentages are defined as the difference between the sum of the percentages of banks responding "tightened considerably" and "tightened somewhat" in the bank lending survey and the sum of the percentages of banks responding "eased somewhat" and "eased considerably". The latest observations are for December 2021.

Stocks of non-performing loans (NPLs) have declined further, thanks in particular to the execution of high-NPL banks' strategies and exceptional public support measures

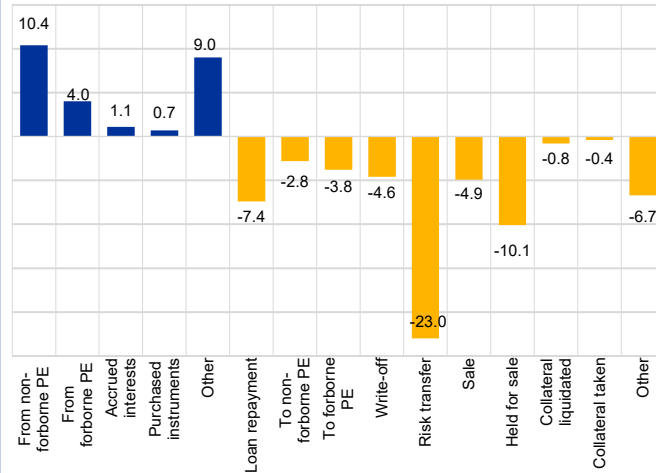
NPL ratios fell to 2.2% in Q3 2021, down from 3.2% pre-pandemic ...



Source: Supervisory reporting.
Notes: The sample for Q3 2021 comprises 113 SIs. The number of SIs can change from one reference period to another owing to amendments to the list of SIs following assessments by ECB Banking Supervision.

... driven by high-NPL banks' disposal of problem loans ...

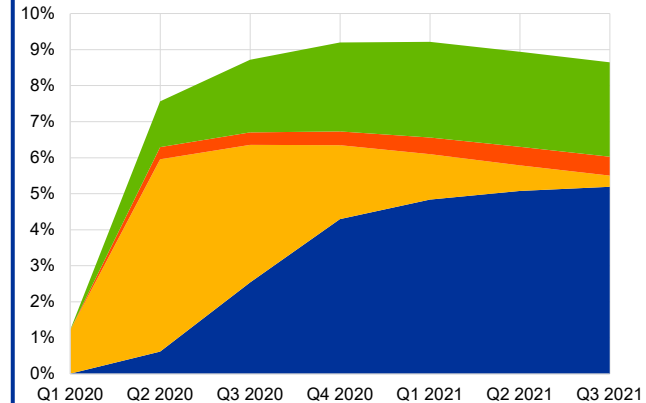
■ NPL inflows for high-NPL banks between Q4 2020 and Q3 2021 (EUR billions)
■ NPL outflows for high-NPL banks between Q4 2020 and Q3 2021 (EUR billions)



Sources: Supervisory reporting and ECB calculations.
Notes: This chart shows flows for high-NPL banks between Q4 2020 and Q3 2021. The sample for Q3 2021 comprises 23 SIs.

... and support measures which continued to prop up borrowers' repayment capacity

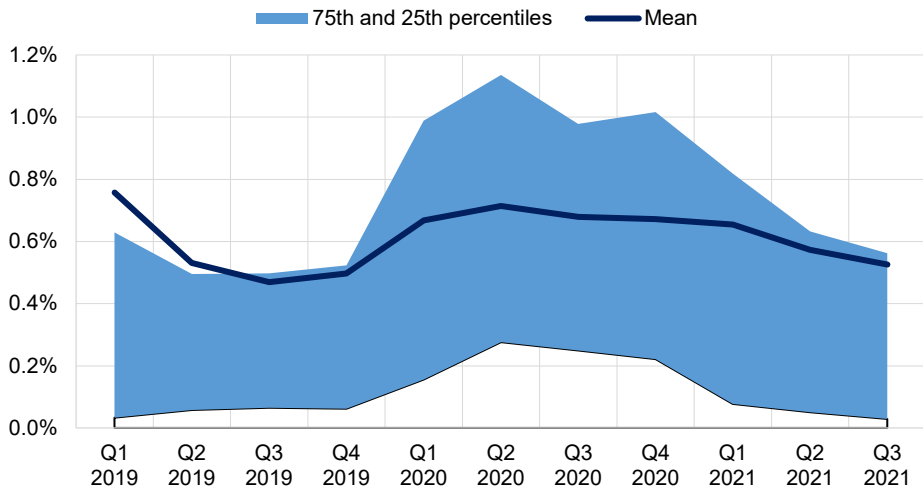
■ % of L&A subject to public guarantee schemes
■ % of L&A subject to COVID-related forbearance measures
■ % of L&A subject to EBA-compliant moratoria
■ % of L&A subject to expired COVID-related measures



Sources: Supervisory reporting and ECB calculations.
Notes: The sample for Q3 2021 comprises 113 SIs. The number of SIs can change from one reference period to another owing to amendments to the list of SIs following assessments by ECB Banking Supervision. Data on forbearances related to COVID-19 measures are unavailable for Q1 2020. L&A stands for loans and advances.

While banks' cost of risk is falling back towards pre-pandemic levels, signs of deterioration in credit quality continue to be observed ...

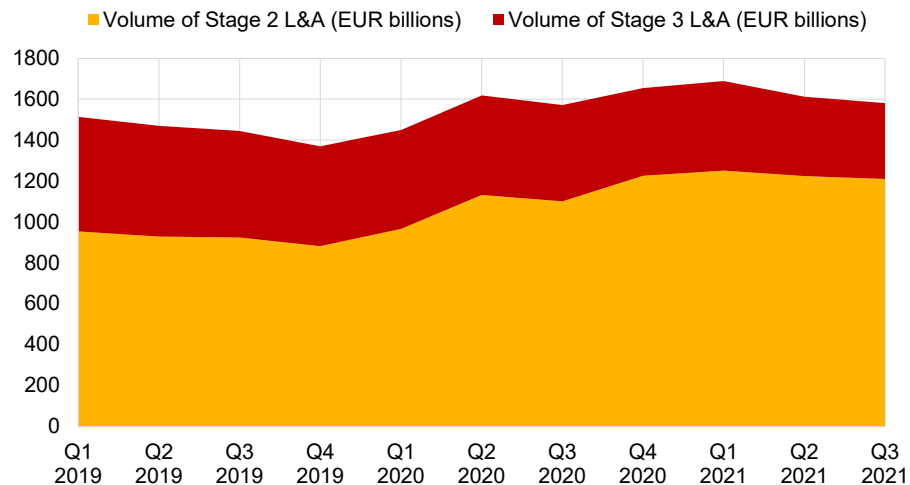
Following the peak observed in 2020, significant institutions' cost of risk is falling back towards pre-pandemic levels ...



Sources: Supervisory reporting and ECB calculations.

Notes: The mean represents a weighted average across SIs. The sample for Q3 2021 comprises 108 SIs. The number of SIs in the sample can change from one reference period to another owing to amendments to (i) the list of SIs following assessments by ECB Banking Supervision and (ii) banks' reporting requirements.

... but the volume of Stage 2 loans and advances did not decline in 2021, pointing to a latent deterioration in asset quality



Source: Supervisory reporting.

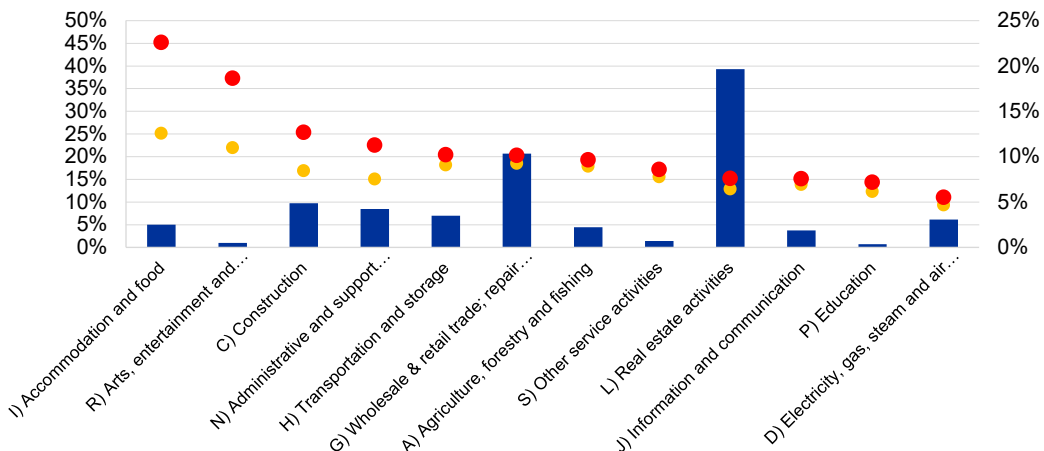
Notes: The sample for Q3 2021 comprises 103 SIs. The number of SIs in the sample can change from one reference period to another owing to amendments to (i) the list of SIs following assessments by ECB Banking Supervision and (ii) banks' reporting requirements.

... raising asset quality concerns in relation to specific sectors and loans that have benefited from support measures

Signs of deteriorating asset quality are particularly visible in certain economic sectors ...

Stage 2 L&A as a percentage of total L&A to NFCs, broken down by sector

■ Sector's share of total exposure to NFCs (right-hand scale) ● Q3 2020 (left-hand scale) ● Q3 2021 (left-hand scale)



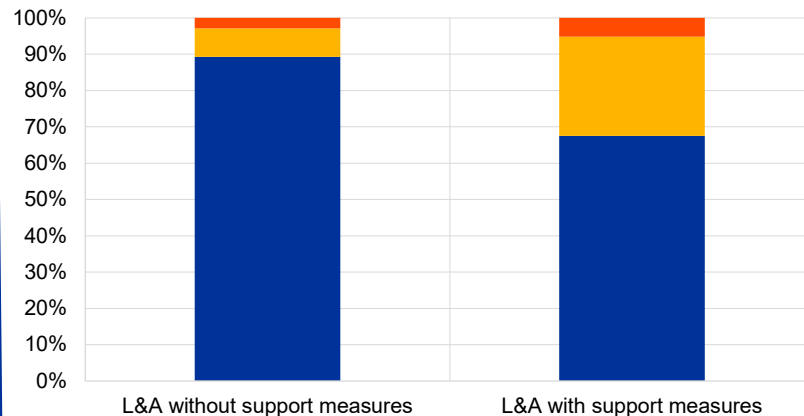
Source: AnaCredit.

Notes: This chart shows the economic sectors (NACE Rev. 2 classification) with the largest absolute increases in Stage 2 exposures between Q3 2020 and Q3 2021. The sample comprises credit institutions reporting the selected data points to AnaCredit as at September 2021.

... as well as for loans and advances benefiting from COVID-19 support measures

Performance of L&A with and without COVID-19 support measures as at Q3 2021

■ Performing L&A not in Stage 2
 ■ L&A in Stage 2
 ■ Non-performing L&A

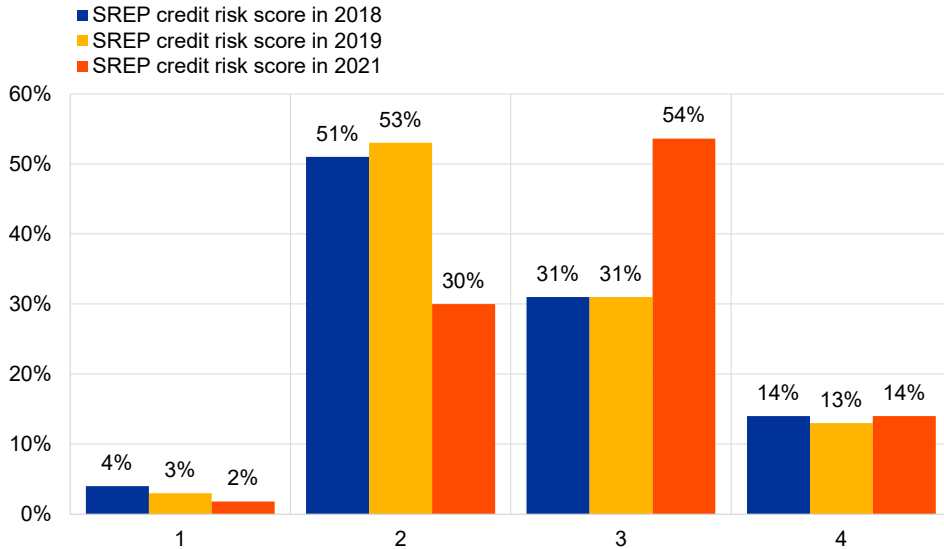


Source: Supervisory reporting.

Notes: The sample comprises 113 SIs. The number of SIs in the sample for a given reference period reflects changes resulting from amendments to the list of SIs following assessments by ECB Banking Supervision.

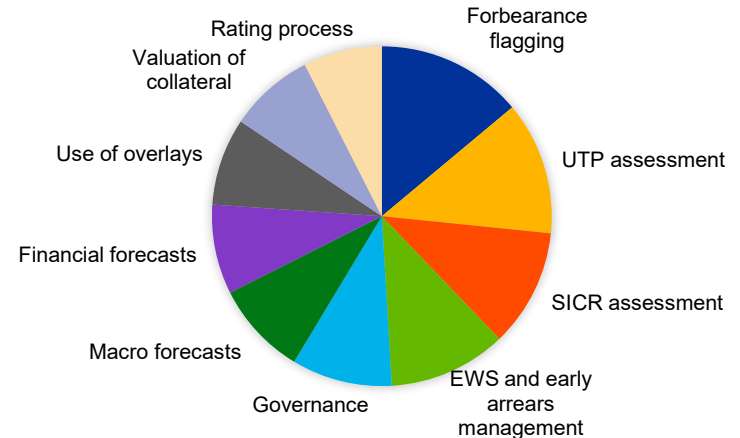
In SREP 2021 we followed up on legacy issues and made renewed efforts to improve credit risk controls

Poor scores for credit risk reflect supervisory concerns regarding banks' risk control capabilities ...



... as supervisors focused on the adequacy of provisioning processes

Breakdown of gaps between banks' practices and ECB expectations



Sources: SREP 2021 values based on 108 decisions; SREP 2019 values based on 109 decisions; SREP 2018 values based on 107 decisions.

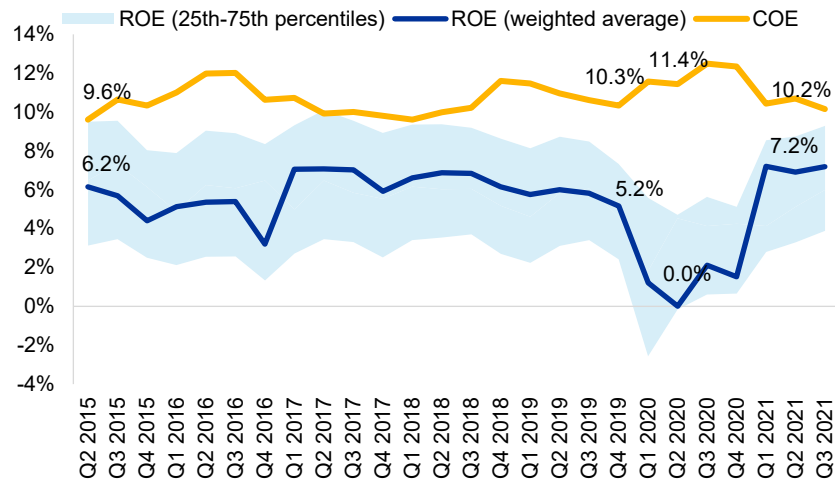
Note on right-hand chart: A letter to banks' CEOs spelled out the ECB's expectations. Their feedback and remedial actions were reviewed centrally, and supervisors communicated the results of that assessment to banks.

4. Business models and governance

Banks need to tackle structural
business model and
governance shortcomings

Significant institutions' profitability recovered in 2021 but remains structurally low overall

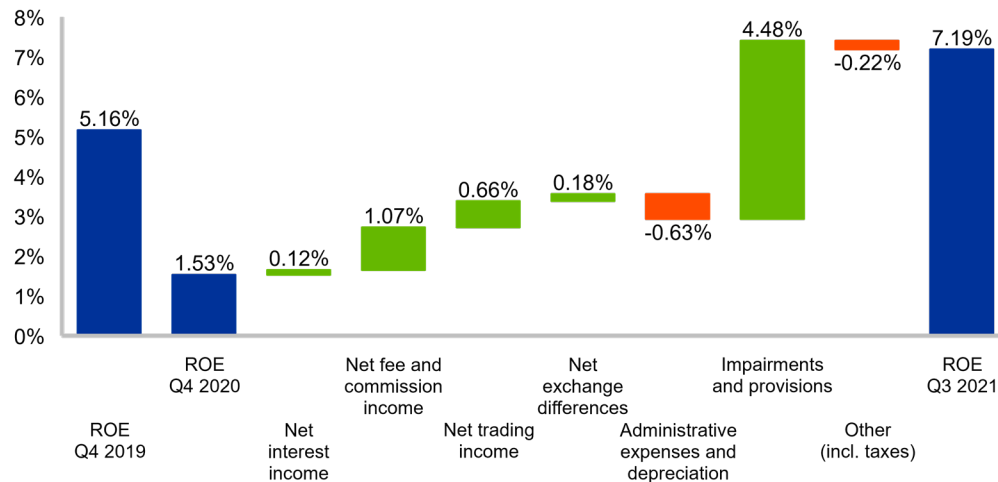
Significant institutions' profitability recovered in 2021 but remains structurally below COE in aggregate terms



Sources: Supervisory reporting and ECB calculations.

Notes: For return on equity (ROE), the sample comprises 113 SIs as at Q3 2021. The number of SIs can change from one reference period to another owing to amendments to the list of SIs following assessments by ECB Banking Supervision. Cost of equity (COE) is computed based on data for the 113 banks classified as SIs in Q3 2021 (constant sample) and following the methodology in the ECB publication "[Measuring the cost of equity of euro area banks](#)". The chart plots the weighted average using the book value of equity.

Main drivers of improved ROE are lower credit impairments, raising concerns about long-term sustainability, but enhanced revenue diversification is a positive sign

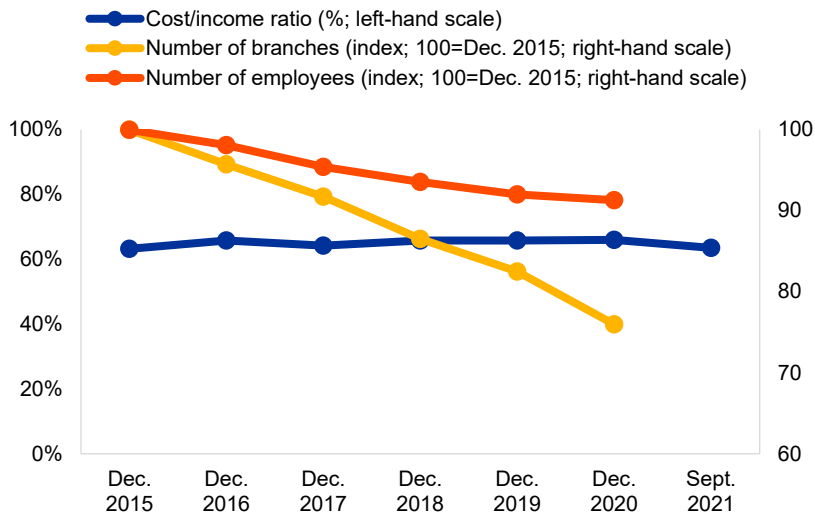


Source: Supervisory reporting.

Notes: The sample comprises 113 SIs for Q3 2021, 112 SIs for Q4 2020 and 113 SIs for Q4 2019. The chart displays linearly annualised profitability figures. The number of SIs can change from one reference period to another owing to amendments to the list of SIs following assessments by ECB Banking Supervision.

While structural business model vulnerabilities persist, ongoing efforts to address banks' efficiency may pay out in the longer term

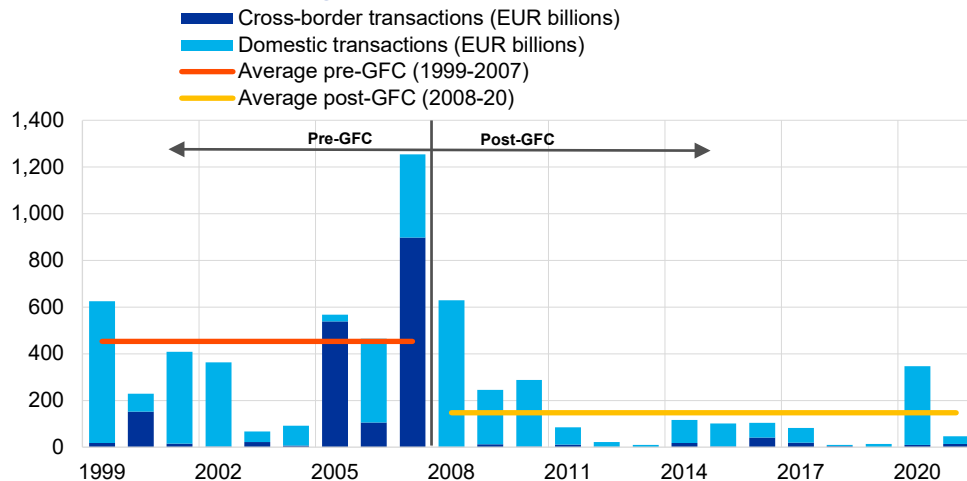
Sl's cost efficiency may benefit in the longer term from ongoing cost reduction programmes ...



Sources: Supervisory reporting and ECB Banking Structural Statistical Indicators (SSI).
 Notes: Cost/income time series considers a changing sample of institutions, which comprises 113 Sl's as at Q3 2021. ECB SSI database includes euro area (changing composition) institutions, and latest available data are for 2020.

... and further consolidation efforts which, while peaking in 2020, remained rather muted in 2021

Total assets of target banks in market-driven M&A transactions

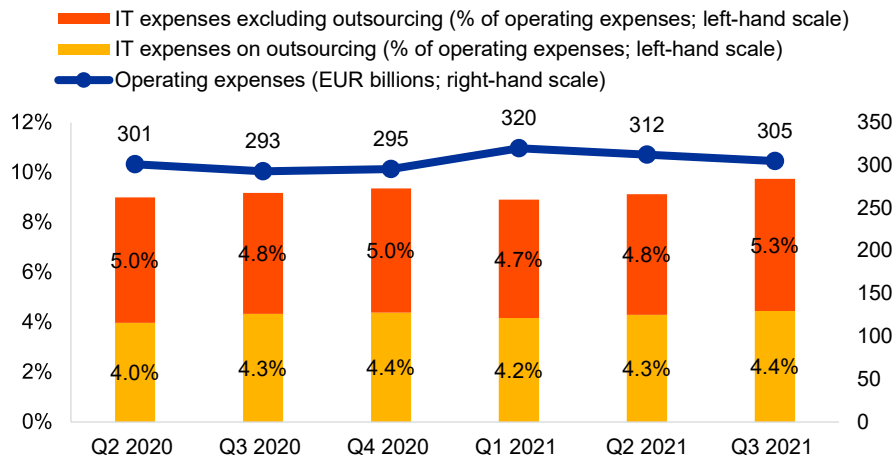


Sources: Dealogic, Orbis Bank Focus, Refinitiv and ECB calculations.

Notes: Relevant M&A transactions exclude the acquisition of assets, repurchases, privatisations, leveraged buyouts, joint ventures and restructurings. They meet the following criteria: (1) the acquired stake is above 10%, corresponding to a qualifying holding; (2) the initial stake is below or equal to 50%; and (3) the final stake is above 50%. In cases where multiple banks are involved in a deal as target and/or acquirer, at least one of the targets and/or acquirers have to be domiciled within the euro area. GFC stands for global financial crisis.

Sound digital transformation strategies seen as a catalyst to foster efficiency, but related IT/cyber risk challenges need to be tackled

Banks' efforts on IT investment and spending are expected to strengthen digitalisation in the industry and deliver efficiency gains ...

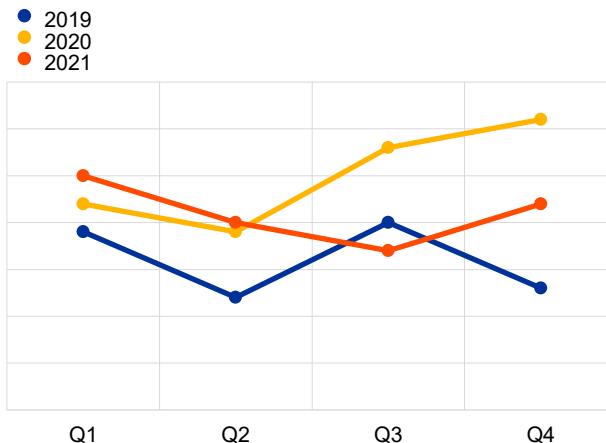


Sources: Supervisory reporting and ECB calculations.

Notes: The sample consists of 110 SIs. The number of institutions is consistent over the reference periods represented. Chart displays linearly annualised operating and IT expenses figures. The cut-off date for data was 24 January 2022.

... but new risks associated with online banking, such as cyber incidents, need to be addressed

Evolution of number of reported cyber incidents by significant institutions

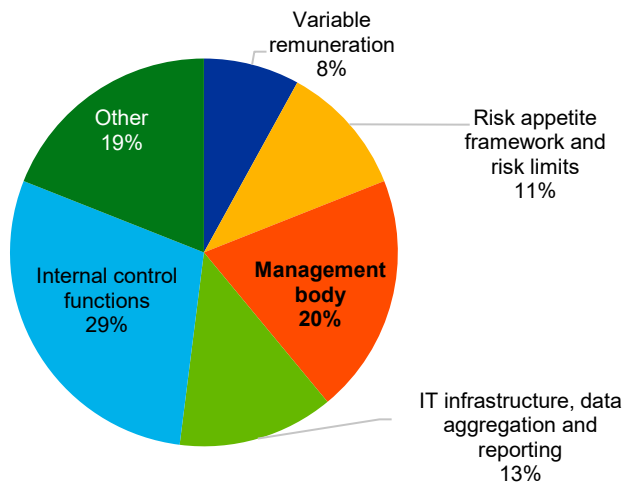


Sources: ECB cyber incident reporting and ECB calculations.

Notes: The reporting sample consists of all significant institutions. The number of SIs can change from one reference period to another owing to amendments to the list of SIs following assessments by ECB Banking Supervision.

Structural deficiencies of management bodies call for a focus on collective suitability and diversity as key drivers of effectiveness

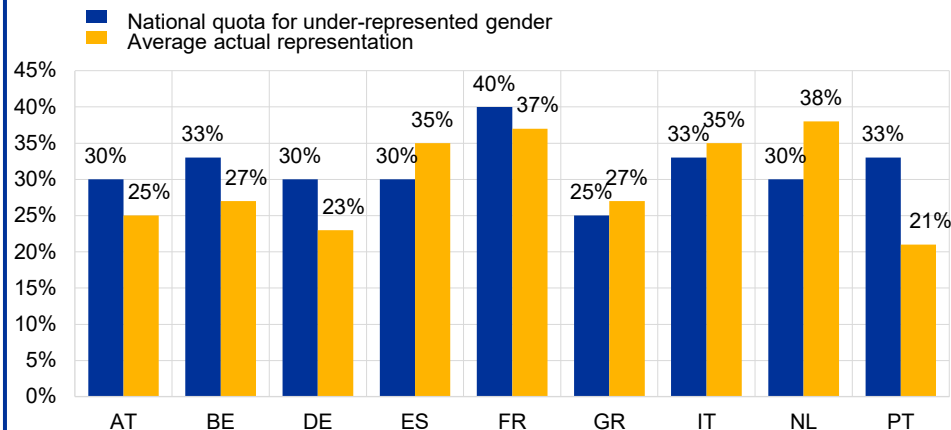
Deficiencies related to functioning, oversight and capacity to challenge of management bodies were key findings of SREP 2021 in the area of internal governance



Source: SREP 2021 measures for internal governance (Element 2) based on 108 SREP decisions.

Many banks need to make further efforts to reach gender targets and thereby enhance effective governance

Actual vs national gender quotas for management bodies



Source: ECB stocktake conducted in 2021.

Notes: The sample comprises 93 SIs. National gender quotas for management bodies apply in nine of the euro area countries (displayed in the chart); in the other euro area countries banks are left to determine their own targets. The scope and application of the quotas may differ according to national legislation.

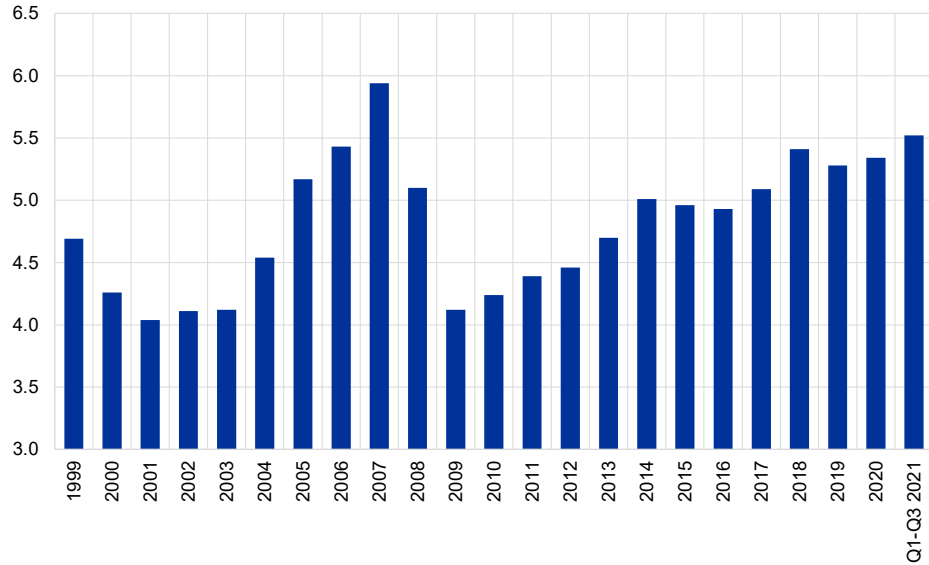
5. Emerging risks

... stemming from exuberance in financial markets and climate-related and environmental risk

Vulnerabilities are growing in the leveraged finance segment on the back of search for yield, higher leverage and weaker covenants ...

Leveraged loans underwriting is attracting non-financial corporates with increasingly higher levels of leverage ...

Average leverage levels in the primary European leveraged loan markets

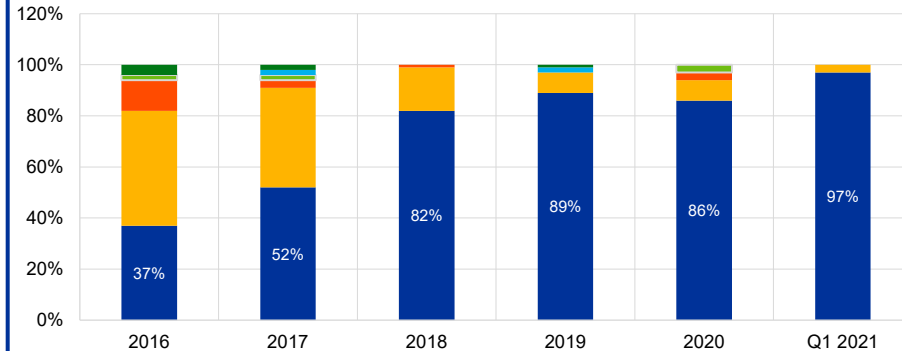


Source: S&P Leveraged Commentary & Data (LCD), Q3 2021.

Notes: Leverage is computed as total debt/EBITDA using pro-forma and unadjusted EBITDA levels. EBITDA stands for earnings before interest, taxes, depreciation and amortisation.

... while contracts include weaker covenants, implying higher risk for European banks

- Traditional: 3 or 4 maintenance financial covenants
- No financial covenants
- Cov-loose: deals with 1 or 2 maintenance covenants and cov-loose deals which may change to cov-lite
- Cov-loose: 1 or 2 maintenance financial covenants
- Cov-loose: maintenance financial covenant only
- Cov-lite: springing RCF maintenance financial covenant

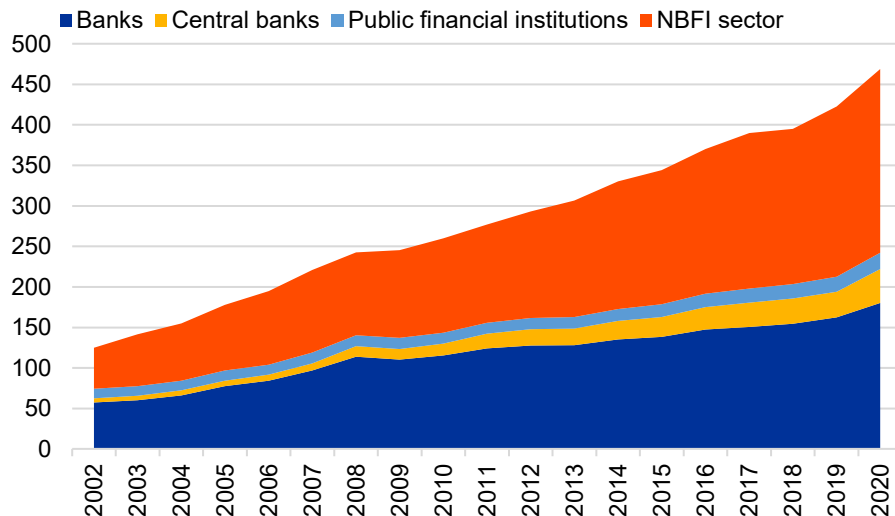


Source: Reorg Research, Q1 2021. Note: Figures based on Reorg calculations

... but also towards NBFIs where higher risk-taking and lagging transparency observed in some segments have triggered large losses for some banks

Financial assets in the NBFIs sector have grown continuously over the past two decades ...

Evolution of global financial assets across sectors
(USD trillions)



Source: Financial Stability Board, Global Monitoring Report on Non-Bank Financial Intermediation 2021.
Note: Financial assets held in the euro area and 21 other countries (AR, AU, ...) from 2002 to 2020.

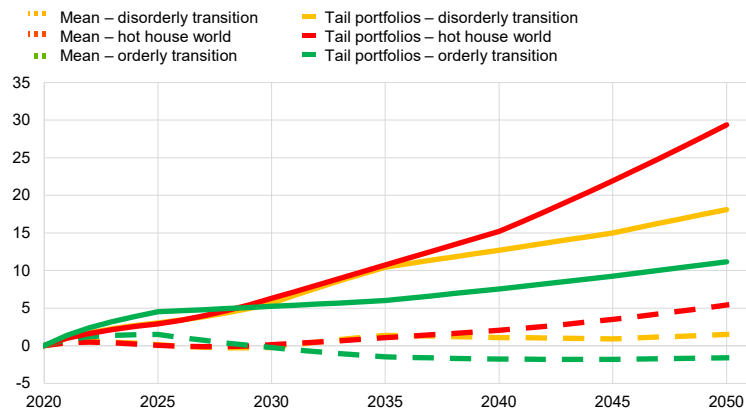
... and search for yield has led banks to strengthen business with some riskier and less transparent counterparties

- **Business with funds more profitable than the traditional corporate lending:** Some SIs have significant exposures to private credit funds, often owned by private equity
- **Additional leverage is created when a bank finances a fund owning leveraged transactions,** for instance in the case of direct exposures to a hedge fund owning parts of leveraged buyouts
- **Concerns related to indirect exposure:** since those funds offer loans also to mid-sized corporates, banks would likely be under pressure to refinance those portfolios in the event of a credit crunch

Banks' management of climate-related and environmental risk lagging behind despite major challenges ahead

While climate-related and environmental risks may pose significant challenges in the medium to long term ...

Evolution of euro area banks' credit portfolio probabilities of default between 2020 and 2050 (percentages)

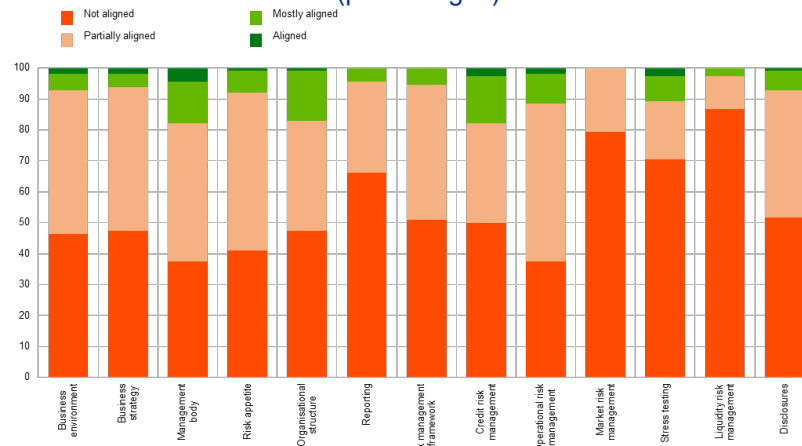


Sources: ECB calculations based on NGFS scenarios (2020), AnaCredit, Orbis, Urgentem and Four Twenty-Seven data (2018).

Notes: The sample of bank exposures covers around 80% of total AnaCredit exposures held by approximately 1,600 euro area banks which reported non-zero exposures in the AnaCredit database in December 2018. For a full description, see ECB, "ECB economy-wide climate stress test", *Occasional Paper Series*, No 281, September 2021.

... the majority of significant institutions are not aligned or only partially aligned with supervisory expectations

Significant institutions' alignment with the 13 supervisory expectations set out in the ECB's Guide (percentages)



Source: ECB Banking Supervision, "The state of climate and environmental risk management in the banking sector", November 2021.

Notes: The assessment covered significant institutions at the highest level of consolidation as at 1 January 2021. For a full description of the 13 supervisory expectations, see ECB Banking Supervision, "Guide on climate-related and environmental risks", May 2020.

6. Looking ahead

Supervisory priorities for
2022-24

6 Looking ahead: supervisory priorities for 2022-24

2022-24 supervisory priorities tackle the impact of the pandemic, banks' long-lasting vulnerabilities and emerging risks

