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BANKING UNION

Public hearing with Claudia Buch, Chair of the ECB / SSM Supervisory Board

Banking Union Scrutiny

This briefing has been prepared for the public hearing with the Chair of the Single Supervisory Mechanism (SSM), Claudia Buch, scheduled for 2 September 2024. The previous hearing took place on 21 March 2024.

The briefing addresses:

- *ECB feedback to the EP's Banking Union annual report 2023,*
- *ECB Annual Report on supervisory activities 2023,*
- *Status quo of banks retreating from Russia,*
- *UK bonus cap abolition and its impact in Europe,*
- *the latest supervisory banking statistics for Q1 '24, and*
- *miscellaneous other issues (the next stress-testing exercises, the ECB Governing Council statement on macroprudential policies, the ECB Annual Report on Sanctioning Activities, the Asset Quality Reviews of FinecoBank and LHV Group, and the ECB Annual Banking Supervision Research Conference).*

ECB feedback to the EP's Banking Union annual report

On 25 March, the ECB published its response ("*Feedback on the input provided by the European Parliament*") to the Parliament's Banking Union 2023 Annual Report. It considers nine key issues in three main categories, namely **Risks, Banking Union and Capital Markets Union, and Governance**.

Regarding **risks**, the EP's report had given an overall positive picture of the state of the banking sector, but regretted a "*slight fall*" in the liquidity coverage ratios from 164% to 158% over the 12-months period until mid-2023. The ECB's response **confirms the good health of the sector**, and points out that the liquidity coverage buffers, while lower, are well above regulatory minima. At the same time, the ECB stresses that **banks will not**

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be immune to risks and unexpected events in the longer term. Heightened macroeconomic and geopolitical risks and changes in the competitive environment are cited and seen as supervisory priorities.

The EP's report itself had stressed three specific risks: interest rate risks, concerns over "*the significant level*" of sovereign debt on banks' balance sheets, and a deteriorating macroeconomic environment. The ECB responded that it had increased the **scrutiny of interest rate risk and credit spread risk** in the banking book; the ECB confirmed in particular that the directly supervised banks do not exhibit "*comparable vulnerabilities*" in terms of interest rate risk, referring to the US banks affected by the spring 2022 market turmoil. Regarding risks in the macroeconomic environment, the ECB points out that according to its stress tests, **banks under its supervision could withstand three years of severe economic downturn** and still end up with an aggregate core capital ("CET1") level of over 10%, "*well in excess of regulatory requirements*".

We would add that in 2023, the ECB shared more detailed information ("*Spreadsheet High-level individual results for banks not included in the EBA sample*") showing that in the stress test exercise, the capacity to comfortably withstand a severe economic downturn was not only observed at the aggregate level but most of the time **at the level of individual banks** as well; however, the ECB' spreadsheet did not disclose whether any individual bank has fallen below the required minimum capital level in that stress test exercise. The lowest category is in that respect **opaque**.

Finally, regarding the EP's **concern over sovereign debt**, the ECB acknowledges risks associated with the sovereign bank nexus and commits to a close monitoring. It mentions completion of the Banking Union and cross-border integration as potential mitigating factors. Some objective data on this topic can be found in the supervisory banking statistics - see the separate section in this briefing.

The EP report had also called for **further efforts to reduce non-performing loans (NPLs)**. In line with what we draw from the supervisory banking statistics in a separate section of this briefing, the ECB emphasises the important successes since the global financial crisis, but concedes that more recently, NPL numbers have slightly picked up again, citing consumer credit and commercial real estate as sources and pointing out early signs of future further deterioration of credit portfolios. What does not become clear from that discussion is whether banks that experience an increase of NPLs more recently are also those that had already seen high levels of NPLs in the past, or whether the increase takes place across the board; if evenly spread, the issue might be of lesser concern.

In the context of NPLs, the EP report noted a **lack of progress on the proposal for a directive on credit servicers, credit purchasers and the recovery of collateral** (AECE) (COM(2018)135) - the ECB responded that progress on that legislation "*is welcomed*" (sic), but emphasises at the same time the progress made with other legislation such as the Restructuring and Insolvency Directive, adopted in 2019, the adopted update to the Credit Servicing Directive and the pending proposal for a directive to harmonise certain aspects of insolvency law.

The ECB feedback moreover addresses the following issues raised in the EP report:

- *as regards the call to help banks make an orderly exit from **exposures to Russia**, the ECB points to intense monitoring and dialogue with banks (also see the related separate section of this briefing);*
- *as regards the importance of banks' role in transitioning to a **digitalised and carbon-neutral economy**, the ECB response focusses on banks' ESG risks which it considers a threat for banks and financial stability overall, therefore having made it a supervisory priority. The ECB mentions that it assesses, jointly with EBA, whether ESG risks should be reflected in regulatory capital requirements;*
- *the ECB's response concurs with a desire for a rapid and effective adoption of the **CMDI proposal** and for further work to establish **EDIS**;*
- *the ECB's response also concurs with the call on the Commission to maintain **Banking and Capital Markets***

__Union__ as policy priorities. The EP report furtheremore called on the Commission to assess impediments to __cross-border bank mergers__, while emphasising some risks therof, too. The ECB's response underlines the need for a more integrated banking union and further cross-border consolidation of banking groups, suggests that the benefits counterbalance potential concerns, and says that it will use all supervisory tools to address such concerns;

- *the ECB uses the reference to the negotiations over the AML legislation in the EP report as a peg to present its own __work with AML authorities__;*
- *as regards the call on supervisory authorities to use their powers to ensure __gender balance in financial institutions' management bodies__, the ECB responds that it does address the issue through the Supervisory Review and Evaluation Proces (SREP) and through fit-and-proper assessments, while it hints at possible limitations in that regard because of differences in applicable legislation at national level;*
- *as regards the EP's regret over the __lack of gender balance in the ECB's own Governing Council__, the ECB's response notes in this context its own call on Member States to ensure a gender balance in their respective shortlists and appointments.*

ECB Annual Report on supervisory activities 2023

On 21 March 2024, the day that Ms Buch came to the last hearing in ECON during the previous parliamentary term, the ECB published its [Annual Report]() on supervisory activities in 2023[1].

The following issues might still be worth noting or discussing from a scrutiny point of view:

- ***Brexit follow-up**: On p. 29 of the Annual Report, the ECB describes that after Brexit, some banks __relocated some business activities to subsidiaries in the euro area__, in particular trading desks. In the second quarter of 2020, the ECB initiated a __review of those activities__ to ensure that third-country subsidiaries do not operate as empty shells and comply with the ECB's [supervisory expectations on booking models](). The review apparently identified a number of __larger trading desks that were not in line with the ECB' expectations__. The ECB therefore took several individual decisions setting out binding requirements that those third-country subsidiaries will have to comply with. The wording in the Annual Report suggests in any case that not all of those banks have yet taken the necessary measures to comply with the ECB's expectations but only plan to do so ("Supervised entities plan to comply with the requirements of the desk-mapping review through the use of a combination of booking models"). That description leaves __unclear how many banks__ or how many trading desks are currently still __non-compliant__ with the ECB's expectations, whether any mitigating measures are already __overdue__, or by which __date__ the ECB expects those banks to implement the necessary changes. The respective section only says that "The ECB will continue monitoring the alignment of banks' booking models with supervisory expectations and will plan supervisory measures accordingly".*
- ***Supervision of entities with subsidiaries in Russia**: The ECB's Annual Report features a short section dedicated to the few directly supervised entities that have subsidiaries in Russia. The section reports that those banks are closely monitored by the ECB and that the they are scaling down their activities (i.e. __significant banks have reduced their exposures in Russia by 21.4%__ between the end of 2022 and the third quarter of 2023). Considering that those banks are closely monitored, the __data seems somewhat outdated__, though. Moreover, we find that the __rate of decrease is not particularly impressive__: it could simply be the result of maturing loans that were not replaced with new business. The Annual Report finally*

[1] The Parliament received an advance copy of the ECB Annual Report very briefly before the hearing, but we have not been able to comment thereon in our previous briefing, in order to respect the embargo period.

*mentions that banks were asked to have clear exit strategies and corresponding roadmaps, making reference to a letter that Ms Buch's predecessor, Andrea Enria, sent to MEPs de Lange and Juknevičienė in June 2023. The ECB' Annual Report does not mention, though, that Andrea **Enria** took a very **clear stance** about the speed of progress in that letter ("I have repeatedly and publicly expressed **concerns about the disappointingly slow progress** made by banks in reducing risks stemming from ongoing operations in the Russian market", emphasis added). Given that Mr Enria's statement refers to the situation more than one year ago, the Annual Report could be clearer as to whether those concerns are still relevant or not (on the same issue, please see next section as well).*

- ***Internal model investigations:** The Annual Report sets out (see p. 33f.) that in 2023, the investigations **exposed several weaknesses**, indicating the banks' lack of preparedness in terms of model change requests. Moreover, approximately **one-third of the findings were of high severity**, of which roughly **half concerned shortcomings in the IT infrastructure** and the definition of default. Given that the Internal model investigations led to findings of which a considerable part is of high severity, and given that over the past two years, **99% of the investigations have been triggered by requests from the banks themselves** to assess model changes, model extensions or model approvals (as specified in the ECB's Supervision Newsletter of August 2023), one may question whether this area would need to be more actively monitored. The list of sanctions (link) includes cases in which banks used internal models that deviated from the approved form, which suggests that a regular check of the correct application of approved models is advisable.*

Status quo of banks retreating from Russia

As set out above, Andrea Enria, Ms Buch's predecessor, took a very clear stance last year about the speed of progress regarding the retreat of signficant banks from Russia, writing that from his point of view, there was a "*disappointingly slow progress*".

The Financial Times (FT) revealed in a series of articles that at least one bank under the watch of the ECB, Austria's **Raiffeisen Bank International** (RBI), apparently even aimed to **expand its business activities**: The FT reported in an article published on April 16 that RBI had posted dozens of advertisements for Russia-based jobs, in apparent **contradiction to its official pledge** to exit the market. Analysing those job advertisements, the FT saw clear indications of ambitious growth plans in Russia, as the majority of job advertisement were for sales management and customer service roles. The FT also cited one of the postings, which said its "*key goals are a multiple expansion of the active client base and stable double-digit income growth*".

Four weeks later, on May 15, the FT reported that "***Washington has warned Raiffeisen Bank International** the lender is at risk of having its access to the US financial system curtailed because of its operations in Russia, said a person with direct knowledge of the correspondence*" (emphasis added).

Two days therafter, on May 17, the FT reported that "*The **European Central Bank** has told all Eurozone lenders with operations in Russia to **speed up their withdrawal** plans because of fears they could be hit by US punitive measures*" (emphasis added), though the exact sequence of supervisory actions cannot be derived from that article.

Speaking on the sidelines of a G7 finance leaders meeting, **U.S. Treasury Secretary Janet Yellen** told Reuters on 25 May that European banks face growing risks operating in Russia; Reuters cited her saying "*We are looking at potentially a **tougher stepping-up of our sanctions** on banks that do business in Russia*" (emphasis added), though she has reportedly declined to provide specifics in that interview.[2]

On July 30, the FT reported that RBI's operations in Russia and Belarus accounted for more than half of its global profits in the first six months of 2024, and that the bank had warned that "*future dividend payments would be impacted by efforts to accelerate its* ***exit from Russia under pressure from regulators*** *as it reported record profit in the country*" (emphasis added).

While RBI may be the only significant bank that actually aimed to expand its business in Russia, the initial FT article published in April also shows that most of the **other significant banks** under the watch of the ECB **have not yet meaningfully reduced the headcount** in their Russian subsidiaries (at least not until the end of 2023), with one exception (see Table 1).

Table 1: Headcount of significant banks' subsidiaries in Russia

Bank	Country	Staff end 2021	Staff end 2023
Raiffeisen Bank International	Austria	9,327	9,942
UniCredit	Italy	4,383	3,171
Deutsche Bank	Germany	1,722	179
Intesa Sanpaolo	Italy	975	869
ING Groep	Netherlands	281	259
Commerzbank	Germany	136	126

Source: Financial Times, 16 April 2024, by Chris Cook, Sam Jones, Euan Healy and Owen Walker

[2] Please note that RBI published a statement on this issue, referring to a Reuters article of 15 May 2024 (see here).

UK bankers' "bonus cap" abolition - any impact on the Banking Union?

In a statement of October 2023, **UK authorities announced they will abolish the so called "bonus cap",** which was introduced as part of EU legislation in the aftermath of the global financial crisis. In the EU, the bonus cap is part of a framework of requirements in the Capital Requirements Directive and complementing Technical Standards and EBA Guidelines that seek to ensure that bankers' remuneration does not incentivise excessive risk taking. The bonus cap specifically limits the ratio of variable to fixed remuneration to 200%.[3] The concern with variable remuneration is that it grants high pay-outs to persons taking risks on behalf of the bank in function of earnings or share price or other variables. This may encourage excessive risk taking, as the personal downside risk when things go wrong is limited to the loss of the bonus, while the bank's potential losses - and eventually, those for the public purse - are not limited in the same way.

According to different news sources, we understand that at least Goldman Sachs, Barclays and HSBC **have already adjusted their bonus policies after the abolition of the bonus cap and others may follow**. According to the Financial Times (FT) Deutsche Bank has argued for **abolishing the cap in the EU** in order to maintain a level playing field, while Banco Santander argued that removing the cap would better align incentives of staff with that of shareholders.

The discussion with the SSM chair might be an opportunity to seek her views about possible repercussions of the UK move for the Banking Union:

- *Are UK banks expected to take more risk going forward?*
- *Could higher risk taking by UK banks indirectly pose any risk for the Banking Union, and how would the ECB try to mitigate that?*
- *Does the abolition of the bonus cap in the UK potentially distort the competitive position of banks in the Banking Union, and how could supervisors and policy makers prevent unfair competition?*

[3] We note in this context the empirical findings of Stefano Colonnello, Michael Koetter, and Konstantin Wagner, though, that were recently published in the Journal of Accounting and Economics (2023, Vol. 76). Those researchers did not find evidence of an actual decline in risk-taking at the bank level around the introduction of the bonus cap in the EU, which suggests that one of the purported policy objectives of the bonus cap may in reality not have materialised. As to the limitations of that study, Colonnello, Koetter and Wagner notably caution that their analysis hinges on relatively small samples, and that compensation data was only collected from publicly available reports, meaning it was limited to data for top executives in management boards. As no data was available for non-board executives and middle management (such as traders, who might also be subject to the bonus cap if they qualify as material risk-takers), the effect of the bonus cap below the management board level could not be gauged in that study.

Latest supervisory banking statistics

The ECB published the latest supervisory data for the currently 110 directly supervised Significant Institutions ("SIs") on June 26. The data refers to the first quarter of 2024.

Figure 1: Distribution of capital ratios

(shows the median, the 5th and 95th percentiles plus the 1st and 3rd quartiles across 109 significant institutions)

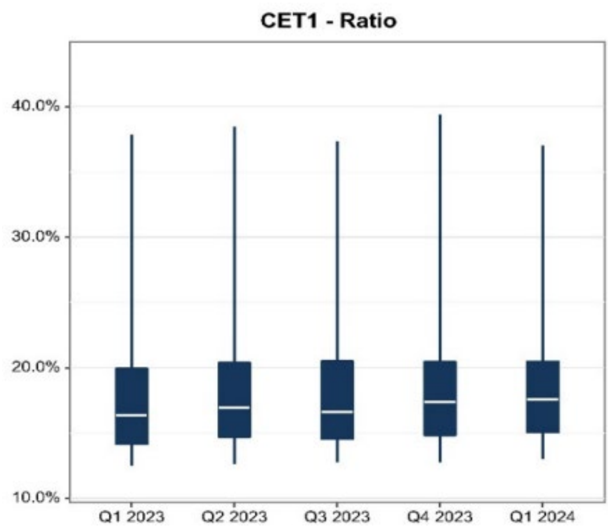
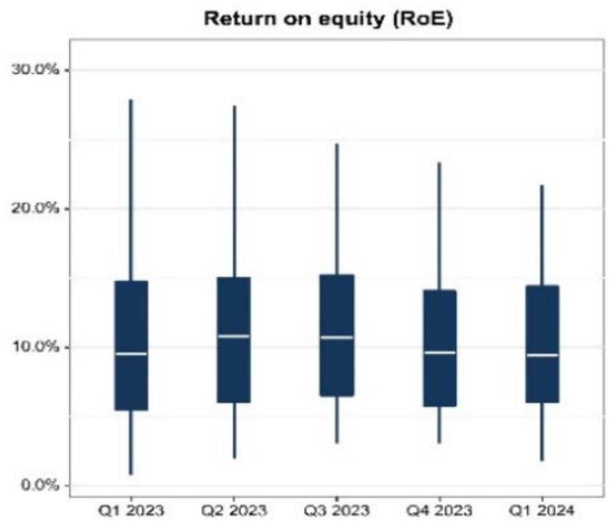


Figure 2: Distribution of profitability

(shows the median, the 5th and 95th percentiles plus the 1st and 3rd quartiles across 109 significant institutions)



Source: ECB

Core capital ratios ("CET1") remained broadly unchanged compared to the previous quarter and over the past 12 months across the whole distribution of banks, as shown in Figure 1. The aggregate **core capital ratio is currently at 15.7%**, compared to 15.5% 12 months earlier and visually, capital ratios seem stable at the lower end of the distribution in particular. The ECB specifically reports that there are **no banks with CET1 ratios below 10%**. The marked increase in aggregate profitability of the significant institutions (exceeding 10.0% return on equity) in the second quarter of 2023 has not continued in the following quarters, but **profitability stabilised at a level of 9.7%** in the first quarter of 2024, after 9.3% in the previous quarter. Meanwhile, as illustrated in **Figure 2**, **the least profitable** significant institutions, which saw improving levels of profitability over the previous twelve months, saw a deterioration in the first quarter of 2024.

*Please note that in all boxplots in the ECB's documentation, the end of the lower "antenna" or whisker of the boxplot marks the 5th percentile. That means that among 110 banks in the sample, there are 5 or 6 banks whose respective values are below the shown lower level; the deviation of those may be small, but it could also be large. It is unfortunate that the **ECB does not mark outliers** in their boxplots, for the sake of transparency.*

The state of significant institutions' loan books remains stable. The share of so-called **"Stage 2" loans** – that are loans that have experienced a significant increase in risk since they were granted and require particular provisions – had exhibited a marked increase by the end of 2023. That ratio has since somewhat improved. It reached **9.7% by end 2023**, close to the previous peak at 9.8% reached in the third quarter of 2022. Currently, the **ratio stands at 9.5%**. By contrast, the share of **"Stage 3" loans**, which are loans that already show objective evidence of credit impairment, has crept up slowly from quarter to quarter, reaching **2.27% in Q1 2024, compared to 2.18% one year earlier**.

For both groups of loans with a significant increase in credit risk, the coverage of provisions stands somewhat lower today than it stood a year ago, that is at 3.59% compared to 3.82% for stage 2 loans and 42.76% compared to 45.17% for stage 3 loans.

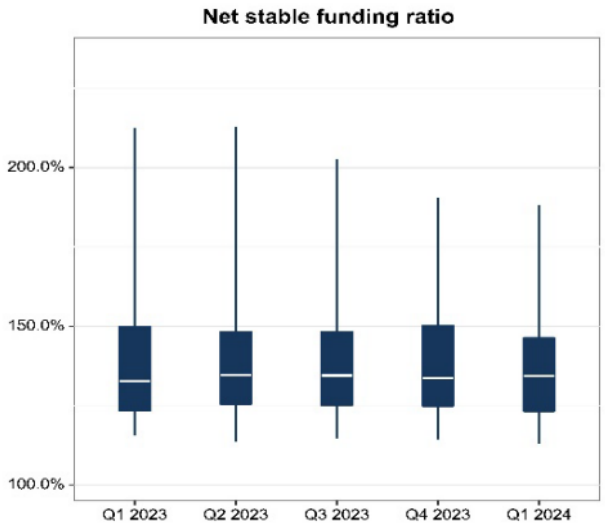
Separately from Stage 3 loans, the ECB reports also the narrower category of non-performing loans, which is useful given the attention these loans received in the aftermath of the great financial crisis. The strong reduction over the years of these loans has "bottomed out" at levels below 2.5%; they currently stand at 2.31% compared to 2.24% a year ago. The more detailed breakdown suggest however that there must be a certain single-digit number of banks that still exhibit NPL ratios around or above 5%.

The statistics also contain a **breakdown of general government debt held by SSM banks** at year-end 2023. Among total general government exposures held by SSM banks of EUR 2'900 bn (up from 2'855bn 6 months earlier), the largest aggregate exposures are those to France (EUR 644 bn), followed by those to Italy (EUR 410 bn) and Spain (EUR 360 bn). Conversely, the largest investor in general government debt is the French banking sector with holdings of EUR 957bn, followed by Spanish banks with EUR 496bn and Italian banks with EUR 493bn.

The ECB statistics breaks down those exposures a bit further, showing how much exposure to each general government can be found on the balance sheet of significant institutions of each SSM Member State (several values are omitted for confidentiality reasons). That gives an idea about the exposures of significant institutions in each Member State to the general government sector of their home Member State (as a proxy for **"home sovereign exposures"**); the percentages in **Figure 5** should accordingly be read as a **measure of concentration** of home country sovereign debt (specifically, it shows the domestic general government exposures of a Member State's banks as a percentage of their overall government exposures); these percentages range from 21% in Austria to 66% in Greece. The **funding and liquidity positions remain broadly unchanged** across the distribution of significant banks. Considering the net stable funding ratios (NSFRs) **Figure 3** and the liquidity coverage ratios in **Figure 4**, variation of funding and liquidity over time seems to have largely taken place among the better-equipped banks, while the values for the banks closer to the NSFR and LCR regulatory minima of 100% appear stable.

Figure 4: Distribution of NSFRs

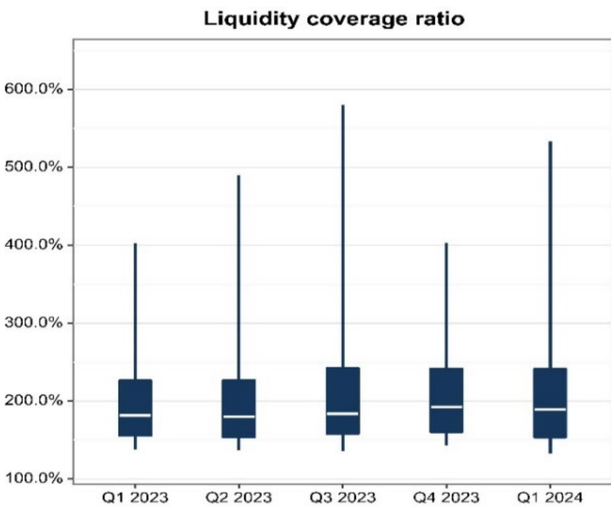
(shows the median, the 5th and 95th percentiles plus the 1st and 3rd quartiles across 109 significant institutions)



Source: ECB

Figure 3: Distribution of LCRs

(shows the median, the 5th and 95th percentiles plus the 1st and 3rd quartiles across 109 significant institutions)



Source: ECB

Figure 5: significant institutions' exposures to their home general government, as percentage of their overall general government exposures by end 2023

BE	BG	DE	EE	IE	GR	ES	FR	HR	IT	CY	LV	LT	LU	MT	NL	AT	PT	SL	SK	FI
49%	n/a	54%	34%	25%	66%	52%	61%	n/a	57%	n/a	37%	n/a	n/a	n/a	43%	21%	37%	25%	n/a	50%

Source: ECB, own calculations.

Miscellaneous

> 2025 stress test exercises

At the beginning of July, the European Banking Authority (**EBA**) published its draft methodology for the **2025 EU-wide stress test**, for informal consultation with the banking industry. While that bi-annual exercise essentially remains a constrained bottom-up approach with a static balance sheet assumption, there are some relevant changes compared to past stress tests, in particular the fact that income projections for fees and commissions will be derived from a supervisory top-down model. 54 significant banks from the euro area will participate in that exercise, covering approximately 75% of the EU banking sector. The results from that stress test will once again feed into the Supervisory Review and Evaluation Process (SREP), i.e. the annual supervisory review that imposes additional **individual capital requirements** to address banks' individual risk profiles. The EBA expects to publish the final methodology at the end of 2024, launch the exercise in January 2025, and release the results by the end of July 2025.

In the past, the **ECB** has always carried out a **parallel stress test** exercise, with the **same methodology** and parameters, for all those smaller significant banks that were not included in the EBA sample. However, while the EBA publishes detailed information about the individual stress test results, the ECB only publishes a much more limited set of information about individual stress test results, which of course raises the question as to why there is a **different disclosure approach** (in this context, one might like to keep in mind that the recent turmoil in the US banking sector was caused by middle-sized banks).

> Governing Council statement on macroprudential policies

On 28 June 2024, the ECB Governing Council published a statement on macroprudential policies[4], which recalls that many countries participating in the Banking Union continue to apply macroprudential measures (i.e. countercyclical capital buffers, systemic risk buffers, and/or some form of borrower-based measures). The **Governing Council calls on national macroprudential authorities to maintain current capital buffer requirements**, reminding of expected headwinds for future bank profitability, vulnerabilities in the form of high indebtedness continuing signs of overvaluation in real estate and financial markets, and geopolitical risks. **It also supports national authorities in their efforts to raise buffer requirements** as some countries could benefit from continuing to build releasable capital buffers to address vulnerabilities and create more flexibility for future actions. This is especially relevant in the residential real estate markets where, *inter alia*, the Governing Council calls for keeping existing borrower-based measures in place. The ECB regularly publishes an "**Overview of macroprudential measures**" that are implemented in countries participating in European banking supervision, the latest update marked with "30 June 2024" (link);

[4] Under the Single Supervisory Mechanism (SSM) Regulation (Council Regulation (EU) No 1024/2013), the ECB is responsible for assessing macroprudential measures adopted by national authorities in the countries participating in European banking supervision.

according to that list, the authorities in the following countries currently apply a **0% countercyclical capital buffer** (CCyB): Austria, Finland, Greece, Italy, Malta, Portugal, Spain, and Latvia[5]. In the other countries, the CCyB currently ranges between 0.5% and 2%.

> Annual Report on Sanctioning Activities in the SSM in 2023

On 7 June, the ECB published its Annual Report on Sanctioning Activities in the SSM, presenting statistics on sanctioning measures that the ECB and national competent authorities imposed in 2023 on significant and less significant banks. In 2023, the **total amount of fines amounted to EUR 25 million**; individually, the highest fine for a significant bank amounted to EUR 6.8 million respectively EUR 1.5 million for a less significant bank. A total of 227 formal sanctioning proceedings were completed in 2023; most penalties were imposed for **breaches relating to internal governance (37%), reporting (27%), and large exposures (23%).** The ECB publishes the sanctions that it imposes on significant banks on its **website**, providing not only the name of the supervised entity, amount, and area of infringement, but giving further information on the background as well.

> ECB concluded the asset quality reviews of FinecoBank and LHV Group

It's an established practice that all banks that come under the direct supervision of the ECB (classified as "significant institutions") undergo both an asset quality review (AQR) and a stress test. Since 2022, those two parts have been conducted as independent exercises, and the results published independently.

The ECB has directly supervised FinecoBank S.p.A., an Italian bank that specializes in online brokerage, since January 2022, and AS LHV Group, an Estonian banking and financial services company, since January 2023, and published the results of the AQR on 15 March 2024.

The overall purpose of the AQR is to review asset valuations from a prudential perspective, increase transparency regarding significant exposures, and assess the adequacy of their capital levels. The ECB reports that FinecoBank's AQR covered residential real estate and other retail portfolios, while LHV Group's AQR included small and medium-sized enterprises and real estate portfolios, representing more than 80% of their credit risk-weighted assets in both cases. While neither of those banks show a capital shortfall, the ECB' review had **quite a strong effect on the Common Equity Tier (CET1) ratio of AS LHV Group**, which was corrected by 271 basis points (ending up at 13.30% CET1, instead of 16.02% CET1), while the effect on FinecoBank S.p.A strong capital position was small both in absolute and in relative terms (a correction by 21 basis points; its CET1 position was corrected to 20.61%, instead of 20.82%).

> 2024 Annual ECB Banking Supervision Research Conference

The annual ECB Banking Supervision Research Conference focussed this year on the lessons learnt from the first decade of EU-level banking supervision, and on the challenges ahead. Claudia Buch held the first keynote speech at that conference in which she highlighted very clearly what the key strategic objectives of supervision are, namely "*identifying risks in banks and getting them to remediate weaknesses in a timely manner*", also pointing out that those objectives need to be translated into concrete, measurable indicators. However, the four indicators that she subsequently enumerated were all related to individual risks in banks, while there was no concrete indicator given that would allow to assess the ECB' role, its supervisory effectiveness, or in other words, whether the identified weaknesses were indeed remediated in a timely manner. In this context we would like to draw attention to the paper commissioned from Andrea Resti (see Annex) who delves into that aspect in more detail, cautioning that the actual effectiveness of a banking supervisor "*can only be measured with certainty when inadequacies are made apparent by a major crisis*".

[5] In Latvia, the CCyB shall be increased to 0.5% from 18.12.2024 and to 1.0% from 18.06.2025.

Annex: 10 years of parliamentary scrutiny over the Single Supervisory Mechanism (summary of a paper by Andrea Resti)

Ten years ago, the EU established the SSM to oversee banks in the euro area, while remaining open to participation from all Member States. Since its establishment, the SSM has experienced significant challenges, including the global COVID-19 pandemic, ongoing Russia's invasion of Ukraine, and multiple bank failures across the US and Europe (Switzerland). Although the creation of the SSM is widely regarded as a success, there is room for improvement, particularly in strengthening accountability arrangements with other EU bodies, such as the EP. Some authors have questioned the ECB's ability to ensure adequate transparency and democratic legitimacy, while others have called for amendments to the EU Treaties to enhance accountability or emphasized a "gap in the European Parliament's ability to hold the ECB accountable for its actions."

In his paper (link), Andrea Resti analyses how the key channels of accountability between the ECB and the EP's ECON Committee have been used since 2014, offering recommendations for improving the ECB's accountability in the short term. The democratic oversight and accountability exercised by the EP over the ECB's supervisory functions are governed by an Interinstitutional Agreement, which details procedures such as reports, public hearings and confidential discussions, ECB replies to MEPs' letters, access to information, and information and dialogue on ECB acts. All the listed procedures are key interaction channels between the two institutions.

Resti further delves into the details of the interaction between the ECB and the EP; before doing so, author explores the longstanding debate on balancing independence and accountability in banking supervision - a debate that predates the establishment of the SSM. Independence is crucial for avoiding conflicts of interest and political pressure, thereby enhancing supervisors' credibility in the markets and contributing to a stronger banking system. However, Resti emphasises that supervisors must also be held accountable to ensure democratic oversight. This balance not only provides necessary checks and balances but also justifies the existence of independent agencies in the eyes of the public.

Drawing on publicly available information, earlier research, and a review of the latest public hearing minutes, Resti analysed the questions MEPs have been asking during their meetings with the SSB Chair (see Figure 6). In the last legislative term, the focus has shifted away from major issues like state aid and stress tests, largely because the rules governing these areas and SREP decisions have become more transparent over time. The author also observes that the ECB is now being consulted more frequently on upcoming regulatory priorities and its positions on new legislation currently being discussed with the Commission and the Council.

Figure 6: Main topics asked by the MEPs during the hearings with the SSB chair

	2014-2016	2019-2021	2022-2024*
Number of questions	*205*	*129*	*74*
Stress tests	21%	6%	1%
SSM internal organisation	18%	8%	1%
Legislative proposals	14%	18%	20%
NPLs/capital shortfalls	19%	19%	9%
Bank practices / profits / competition	9%	6%	14%
Recapitalisation / State aid	5%		
Resolution, FLTF decisions	5%		8%
Covid-19		16%	
Climate action		7%	1%
Digital changes			7%
ECB monetary policy		12%	3%
Others	7%	8%	35%

Source: Andrea Resti's paper

Resti's main contribution in the paper is outlining possible directions for improving the interaction between the EP and the SSM, aimed at strengthening accountability arrangements.

First of all, promoting closer interactions between MEPs and the SSM is essentially a constrained "optimisation exercise". The most effective options are those that can be quickly implemented, requiring both parties to enhance their relationship while respecting each other's roles. While these options may be difficult to enforce without full support, they are unlikely to threaten the supervisor's independence and could be highly beneficial in the medium-to-long term. Therefore, areas for interaction and collaboration should be chosen to ensure the SSB Chair views investing in dialogue as advantageous for their supervisory role.

By acknowledging that some of the interaction channels have faced growing disapproval over time, it is important to consider the role of public hearings as the primary channel of information exchange. Due to time constraints, those hearings do not allow for follow-up questions. On the other hand, EP annual reports, which provide a comprehensive summary, are aimed at the general public, the ECON committee, and SSB Chairs. To address these issues, the author suggests that the ECB and EP should **rely on a dedicated group of experts who can commit the necessary time and effort**. For example, enhancing the role of the Banking Union Working Group could be one way to do that.

Secondly, to improve transparency while maintaining confidentiality, the ECB could provide the EP with studies based on publicly available data from financial statements, Pillar 3 reports, and the EBA's "transparency" database. Exploring ways to release supervisory data to the public, including independent analysts and researchers, Resti suggests that a "cooling-off period" (e.g., one or two years) could help to ensure that confidentiality does not lead to opacity, while allowing for independent scrutiny of banking system risks and vulnerabilities.

Finally, since the SSB Chair's mandate is not renewable, MEPs are not in the position to penalise their behaviour by denying a second term. Rather, efforts should be made to inform the public about the Parliament's evaluation of the SSB Chair's approach to accountability. Resti finds that one way to do this could be by inserting a special section in the EP's Banking Union report when the Chair is midway through their term.

Full paper available on EP homepage: 10 years of parliamentary scrutiny over the Single Supervisory Mechanism

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