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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 18 November 2024 in the ECON Committee. The previous hearing took place on 2 September 2024.

The briefing addresses:

- *First 10 years of the Single Supervisory Mechanism*
- *Capital requirements and EU Competitiveness*
- *State of play on the UniCredit participation in Commerzbank*
- *Latest supervisory banking statistics (Q2 2024)*
- *ECB consultation on its approach to options and discretions*
- *Climate risk scenario analysis in context of Fit-for-55 package*
- *Miscellaneous*

First decade of the Single Supervisory Mechanism (SSM)

Ten years ago (on November 4, 2014) the Single Supervisory Mechanism (SSM) became fully operational. In her opening remarks, at the inauguration ceremony of the ECB's new supervisory responsibilities, the first Chair of the Supervisory Board (Danièle Nouy) noted the following: "*We need the SSM to promote certainty in the banking sector and boost the confidence of European citizens and markets in the resilience of supervised banks. We need to ensure that European taxpayers will no longer foot the bill for ailing banks.*"

Over the past decade, SSM has focused on these aspects working to promote the resilience of banking system and to create a level playing field for banks across Europe. By ensuring close cooperation between

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national authorities and the ECB, more informed and effective supervisory decisions have taken place. While the SSM has been a significant milestone in strengthening banking supervision in the Euro Area by moving from national to European-level micro-prudential supervision, financial market integration remains far from. Not least the incomplete Banking Union (BU), particularly regarding its 3rd pillar EDIS, and a piecemeal progress on Capital Markets Union (CMU) continue to challenge full European integration. This was also highlighted by the current SSM Chair, Claudia Buch, in her speech on 6 November 2024.

The SSM is proud to say that in this period the banking system has remained resilient and highly liquid in the face of unexpected challenges (more recently including the COVID-19 pandemic, energy shock in midst of Russia's invasion of Ukraine and a period of high inflation). Since the global financial crisis, aggregate common equity tier 1 (CET1) ratio has increased from 12.7% in 2015 to 15.8% by mid-2024, the aggregate liquidity coverage ratio increased from 138% to 159% and NPLs have declined (from 5% in 2015 to less than 2% in 2023). This was, *inter alia*, due to stronger (international) regulatory standards, enhanced supervision and a more prudent capital and liquidity management frameworks. The effect of monetary and fiscal policies should not be underestimated either.

What has changed significantly over the past 10 years, and especially in recent years, is the environment in which banks operate. As Claudia Buch made a statement at the exchange of views with the Eurogroup on 4 November 2024, supervised banks are now operating under a different regime than before, facing number of risks such as geopolitical tensions, climate change-related risks and cyberattacks. In a way this is a way for SSM to evolve as well; in its response, the SSM decided in May to implement a reform package aimed at making European banking supervision more efficient, intrusive, and effective. These reforms should be fully effective by 2026. [1]

In times of heightened uncertainty, a resilient financial sector is important for a competitive EU economy. We can argue that the EU financial sector is in better shape than it was 10 years ago, however, it is still not fully integrated and a **better integrated financial sector would be a strong asset for the wider economy.** Notably, the 3rd pillar of BU is missing, the progress of capital markets union has been sluggish and Europe remains highly reliant on financing from banks. Therefore, work remains to be done so that the financial sector can better support the wider economy. In this respect, the three reports by Draghi, Letta, and Noyer (see also in the next section and our separate EGOV briefing) try to point out ways forward.

On the occasion of the 10th anniversary, the ECON Committee has commissioned from its **Banking Union expert panel three sets of papers that each cover one strategic aspects of the Banking Union's development**:

- How EU **case law** has shaped the Banking Union;
- The experience of **accountability and transparency** of the SSM and SRB; and
- The track record and potential for the Banking Union to foster **market integration**, and any lessons for CMU.

While the different authors place different emphasis, they agree **that the courts have been essential in shaping the SSM and the SRM** by their judgements; given the complexity and novelty of both mechanism the authors show how **the practice of the Banking Union's authorities, the legal challenges posed by stakeholders and the responses by the court have contributed to legal certainty over time** and what lessons can be drawn for EU institution building more generally (the first set of papers is summarised in this EGOV briefing).

[1] Latest edition of the Supervision newsletter is available here. In this edition, supervisory and finance officials, along with industry stakeholders, share their insights on the achievements and challenges of banking supervision in Europe.

The anniversary also marks a decade of parliamentary scrutiny over the SSM and SRB; the SSM Chair has regularly appeared at public hearings and occasionally at in-camera sessions before the ECON Committee. This EGOV briefing summarises the papers in which members of the BU expert panel have analysed the existing transparency and accountability mechanisms towards the EP, evaluating whether they are adequate and if improvements to the current framework are feasible going forward.

Finally, a third set of papers (summarised in this EGOV Briefing) demonstrates how the Banking Union was successful in ensuring a more resilient banking sector, but did not achieve much for integrating banking markets. The authors argue, with different emphasis, that this is due to a range of factors: **overbanking, a level playing field and regulatory framework tilted against larger cross-border banks, a crisis safety net that is not fully integrated and a lack of harmonisation when it comes to collateral enforcement and insolvency laws**. The authors also offer lessons for the CMU: the harmonisation that would help banking markets would also help CMU, not least since larger cross-border banks could offer better capital market services. Moreover, a single authority might achieve more immediate integration progress for CMU than for Banking Union since the obstacle of an incomplete safety net is not a constraint for CMU.

Capital requirements and EU competitiveness

Strengthening European competitiveness will require significant private sector investments, so it is not surprise that the reports by Enrico Letta on the Single Market and by Mario Draghi on European Competitiveness prominently present **recommendations for developing European capital markets**, a policy pursued since 2015 under the brand "Capital Markets Union (CMU)". A third report has been written by a French group of experts headed by Christian Noyer, which exclusively develops recommendations for a **savings and investment union** to support European competitiveness. A separate EGOV briefing **analyses and compares** the recommendations of the three reports to the extent they concern capital markets.

From a *BU scrutiny perspective*, the three reports are noteworthy because **they all treat, at least implicitly and to different extent, the banking prudential framework as a potential obstacle for competitiveness**.

The Draghi report suggests that a more competitive and well-integrated banking sector could best support the development of European capital markets. Against this background, **Draghi recommends to assess whether prudential regulation (i.e. capital requirements and the like) is in line with a strong and competitive banking system.** This recommendation remains general, and may aim at a range of capital and liquidity requirements. However, there is one more specific suggestion showing he has also the supervision and regulation of cross-border banks in mind. Namely, he recommends creating a **separate jurisdiction for cross-border banks**. We believe

Box 1: Are there any alternatives to higher capital requirements?

While a number of papers and policy reports have analysed aspects of regulatory capital requirements, the **optimal design and stringency of an efficient regulatory toolkit remain unclea**r. What is clear, however, is that this toolkit must address both cross-sectional and time-varying dimensions of risk, considering both micro and macro aspects, such as the impact of increasing capital requirements.

In a recent discussion note, Steven Ongena and Simona Nistor draw on lessons from the Swiss experience following the banking turmoil of March 2023. Authors analyse the rationale behind existing capital requirements, exhaustively review their current implementation, and consider the potential impacts of increasing them. While they suggest that higher capital requirements may warrant further consideration, they propose alternative approaches.

Some of these tools include **changes to bank licensing, deposit insurance, loan-to-value ratios, bank growth, mergers** and **acquisitions, political connections, managerial compensation,** and **dividend retention**.

this idea goes back to a paper by Ignazio Angeloni that the ECON Committee had commissioned. In a nutshell, the suggestion is that supervision and crisis management should first be fully integrated at the BU level for large cross-border banks, avoiding the political difficulties of extending the BU project to all banks. On that basis, those banks could be allowed to meet regulatory requirements at group level only, making substantive efficiency gains available. In this context, we would also point out another analysis done for the ECON Committee by the Leibniz Institute SAFE, which suspects that under the current Banking Union set up, less significant banks enjoy a competitive edge that hinders the development of cross-border banks which could better support capital markets.

Letta by contrast only emphasises the role of banks as investors in capital markets. In this context, he recommends, like Draghi does more broadly, to **reassess the capital requirements framework**. Like Draghi, he does not clearly specify further where the need for a review arises. This may concern capital requirements for specific activities supporting capital markets such as market making or underwriting securities, or more generally those for investing in debt and equity. It may also, like Draghi does, reflect the idea that more integrated cross-border banks could better support the development of capital markets.

Finally, all three reports argue that **securitisation of loans can play a constructive role for European competitiveness**. In this context, the reports agree that transparency and due diligence requirements, for issuers and investors, respectively, need to be simplified. Draghi and Noyer also insist that the current capital requirements for banks issuing and for banks investing in securitisation are too high. Thereby, **the reports criticise the regulatory framework adopted after the financial crisis** by the European legislator and the related requirements agreed at the Basel Committee level.

The direction of these reports stands in potential conflict with messages the SSM chair has been passing recently. For instance in this speech, she said: "[…] the suggestions being put forward to relax banking regulation and supervision to promote growth are misguided and could have negative side effects. [...] More resilient and better capitalised banks are better equipped to take risks, to compete, and to lend to the real economy, including during economic downturns. The reforms that have been implemented since the global financial crisis have made the banking sector more resilient and improved banks' ability to fund the real economy. Banking deregulation or more lenient supervision would compromise these achievements.

As to competitiveness and capital markets, Buch in particular points out that she thinks **current capital standards in the EU are not more restrictive than in the US** with their competitive economy and capital markets; in fact, she points to SSM analysis that European globally systemically important banks (G-SIBs) would face higher requirements under US jurisdiction; by contrast, those for small and medium sized banks would be lower, which does not immediately align with the idea that a competitive edge of less significant institutions in the BU hinders the emergence of competitive cross-border banks in the BU. By contrast to the idea that overbanking in Europe hinders the development of cross-border banks and capital markets, she also points out the constructive role of a large banking sector for ensuring small and medium-sized firms access to finance. At the same time, discussing banking competitiveness, she quotes an ECB analysis that **EU banks efficiency, measured as total factor productivity, has decreased** from 2.0% in 2007 to 0.8% in 2017; she suggests digitalisation as a remedy, without discussing the role that regulation and supervision may have played in this development.

Nevertheless, Buch does think that the SSM "can always improve in terms of **making supervision more effective, more efficient and less complex**". Concretely however, **she traces regulatory complexity back to three factors** (1) an unavoidable component, due to "complexity of modern banking", (2) "input received during consultations", i.e. special treatments requested by the industry itself, (3) national regulations and the use of national options. She considers the possibility of mitigating the latter through **directly applicable**

regulations rather than directives (she might imply integrating more provisions of CRD into CRR). She also thinks (large) banks can reduce complexity by simplifying the landscape of internal risk models.

Finally, as regards **securitisation**, she finds that "Post-GFC regulatory reforms related to securitisation have served us well." She does not seem to preclude a change to securitisation capital requirements, but sees a need for that **to be impact assessed and decided by the Basel Committee**. In our understanding, by contrast to the European Commission that has launched a public consultation, there is however no review planned at the Basel level so far; in the speech, Buch herself in any case does not hint she would use her Basel membership to request work at that level.

At the Commissioner's hearing on 6 November, *Maria Luís Albuquerque*, the Commissioner-designate for financial services, shared that her focus will be on strengthening the EU's financial system to support the EU economy. She plans to improve its competitiveness by ensuring easy access to capital and reducing regulatory burdens as well as to encourage other countries to adopt Basel III standards. She noted: ***"That also means that the Basel III standards should be fully implemented.*** *We have already postponed for one year a part of the framework, the fundamental review of the trading book, and we will also have, obviously, to keep an eye on the need to maintain as much as possible a level playing field,* ***because it is important that our banking sector is competitive also at the international level."***

State of play on the UniCredit participation in Commerzbank

Initial rumours of a potential merger between Commerzbank and UniCredit first surfaced around 2019. At the time Commerzbank was exploring strategic options, including potential partnerships after merger talks with Deutsche Bank fell through in April of that year (see Reuter's article). UniCredit was considered another potential candidate, given its interest in expanding its presence in Germany. However, discussions did not lead to an official deal and Commerzbank ultimately decided to pursue other strategies.

Five years later, renewed speculation about a potential deal has remerged. UniCredit started to invest in Commerzbank in 2023 when it acquired 3% of its shares, just below the first threshold of 5% where it would have had to disclose its stake in Commerzbank (see FT's article). After that, UniCredit gained an additional 1.7% in August 2024 through a total return swap, still staying below 5%. On 10 September, UniCredit acquired 4.5% from the German government, raising its total interest to 9%, which is when they first made their intentions public. They later increased their stake to 22% through two total return swaps (supposedly with Barclays and Bank of America for 5% and 6.53%, respectively). Some analysts (like S&P) believe this move could signal **a strategic step toward a merger**, with UniCredit seeking to expand its presence in Germany. While UniCredit is open to increasing its stake, the German government holds about 12% of Commerzbank, which adds complexity to any possible scenario in which UniCredit would look for a larger, or even controlling stake in Commerzbank[2]. Yet if the ultimate objective is a combination of interests of the two banks, this would be the **first significant cross-border bank deal since the last global financial crisis** (the last one being the takeover of ABN Amro by the Royal Bank of Scotland (RBS) in 2007, which contributed to RBS's collapse).

According to the press, Unicredit has applied to the ECB for a "qualifying" stake of up to 29%[3] and in any case not for a controlling stake. However, Andrea Orcel (CEO of UniCredit) told in an interview in September with the German newspaper *Handelsblatt* that a **joint leadership of both banks** would be

[2] Latest financial results released in November for Q3 2024 can be accessed here for Commerzbank and UniCredit.

[3] Below the 30% threshold, where UniCredit would have to make a mandatory offer.

beneficial for all stakeholders. According to the same newspaper, Orcel has repeated more than once that he is **not interested in a hostile takeover**. He also stated that he would not pursue a tie-up without the German government's approval.

While talks continue, UniCredit would have to wait for an official approval of the ECB to actually acquire the desired stake shares, and have the associated voting rights (see FT's article)[4]. In fact, during the Monetary Dialogue on 30 September, **ECB President Christine Lagarde** was asked about the merger where she **expressed that such mergers are "desirable," given that they allow for economies of scale and align with the ambition of a single market.** They could also position European banks more favourably on a global level; in fact, analysis by ECB staff shows that bank mergers and acquisitions are favourable from the perspective of improving banks' profitability and overall performance[5]. Furthermore, Lagarde on that front noted: "*I think I'm pushing an open door if I say that if banks are relatively small, if their profitability is relatively low, if their scope and scale is significantly smaller, they stand at a competitive disadvantage relative to the largest American and Chinese banks at the moment.*" The ECB has generally shown support for cross-border mergers **as a way to enhance competitiveness within the EU banking sector**, also capable of responding to global challenges. However, Lagarde said that such mergers bring risks that require careful assessment to ensure regulatory compliance and stability in the sector. In that respect, she added that: "[*The ECB's*] ***role is limited, from a supervision point of view – and that's the job of the SSM – to determine*** *(sic), on the basis of this qualifying holding, whether the rules are respected and whether the criteria are satisfied.*"

So far, SSM has not made a public statement. In an interview on 5 November, Claudia Buch was asked about the position of the CEO of Commerzbank, Bettina Orlopp, who had argued - implicitly pushing back against a combination of interests with UniCredit - that before cross-border mergers, a completed Banking Union and EDIS are needed. In response, Buch supported the idea of cross-border mergers to enhance the banking sector's stability in the euro area and its competitiveness in general terms. While **avoiding to comment on specific mergers or the situation of UniCredit and Commerzbank**, she simply pointed out that the **SSM's role in such situations is to maintain a neutral approach, focusing on specific criteria** to ensure regulatory and prudential standards are met, rather than interfering or opposing based on nationality. She reiterated moreover that any (domestic or cross-border) merger must align with prudential requirements, meet risk assessment standards and present a sustainable business plan. In another speech in April this year, Buch said that "*cross-border risk sharing is especially important in a currency union like the euro area, where a common monetary policy is implemented across different countries with different economic conditions*".

Despite the ECB's (generally) supportive stance for cross-border business combinations (i.e. mergers, acquisitions), the German government has shown resistance to the concrete possibility in the UniCredit/Commerzbank case. German officials, along with labour unions, worry about potential job losses and a reduction in lending to local firms if a foreign entity takes control. According to another FT piece an unnamed German finance ministry official noted the importance of how lending to the *Mittelstand* (i.e. German SMEs) "can be safeguarded in a crisis". This hints at the question, which would need to be studied empirically, about whether or not large banks headquartered in one Member State and firms in another would actually restrict local lending in a crisis due to a "home bias".

Some argue that stopping intra-EU mergers and acquisitions would go against EU principles of free movement of people, capital and goods and conflicts with **Member State's declared support for Banking Union, Capital Markets Union and overall European integration.** Others argue that the **EU's banking**

[4] ECB approval is only needed for UniCredit to assume control of the voting rights linked to Commerzbank shares. However, the rules don't prevent the Italian bank from gaining economic exposure to Commerzbank stock beforehand or from signing contracts now to receive the shares once approved by the central bank.

[5] For more details see *Bank mergers and acquisitions in the euro area: drivers and implications for bank performance, Financial Stability Review 2021* (link).

sector is already weakened by fragmentation and that such mergers would do little to change this reality. Furthermore, those who oppose a cross-border merger may argue that the regulatory and structural barriers within Europe might prevent such mergers from achieving the same benefits of scale and integration that US banks enjoy. So, while a merger could help address some of these issues, it also faces significant challenges inherent to the EU's regulatory and operational framework incomplete Banking Union framework in particular. In contrast to Europe, US banks benefit from a large, more integrated regulatory framework and market environment which allows them to operate more efficiently, leverage economies of scale, and diversify risks more effectively.

Is having large banks desirable? The argument that **growing larger to compete with US counterparts is the best approach**, and that **larger banks are more profitable and better for the firms they serve**, is not clear-cut. Note for instance this ECB analysis which suggests that size is not the main reason for the difference in returns between EU and US banks - in this paper authors find two reasons for the profitability gap. First, the higher income from fees and commissions and trading of US global systematically important banks (G-SIBs) explains the bulk of the difference in ROE. Second, euro area (EA) G-SIBs are still dealing with a legacy of non-performing exposures since the global financial crisis, which have driven up the associated impairments and provisions expenses beyond that of US peers. The authors conclude that differences in profitability can be explained by different business models in place, which are linked to differences prudential regulations, risk-appetite and macroeconomic environment. Another paper by the Federal Reserve of Kansas City argues that although small banks benefit from economies of scale as they grow, the marginal benefits of further growth decrease until they are insignificant beyond a certain point. The paper also finds that there is a correlation between higher returns and size, which however does not prove causality. Finally, a study from London School of Economics authors analysed the effect of bank size on the real economy in post-war West Germany, and came to the conclusion that firms did not benefit when their banks became larger, nor did the banks lend more to them or achieve lower cost efficiency ratios. In addition, the authors find that their evidence suggests that large banks are less effective at processing soft information and tend to take on more risks.

Latest supervisory banking statistics (Q2 2024)

The ECB published the latest supervisory data for the currently 110 directly supervised Significant Institutions (“SIs”) on September 23. The data refers to the second quarter of 2024.

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**. Visually, capital ratios seem to have slightly improved at the lower end of the distribution in particular, as they also appear to have for the median bank. The aggregate **core capital ratio is currently at 15.8%**, compared to 15.7% 12 months earlier. 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 aggregate **profitability has stabilised around 10%.** As illustrated in **Figure 2**, this stabilisation follows a visible deterioration in the first quarter. Profitability has notably stabilised also for **the least profitable** significant institutions, which had seen improving levels of profitability over the previous twelve months and a deterioration in the first quarter of 2024. Underlying these developments, the ECB recognises a sizeable increase in operating income (driven by higher net interest income, which rose by 6.5% year-on-year) that was partially offset by higher equity (owing to a 7.6% increase in reserves compared with one year ago).

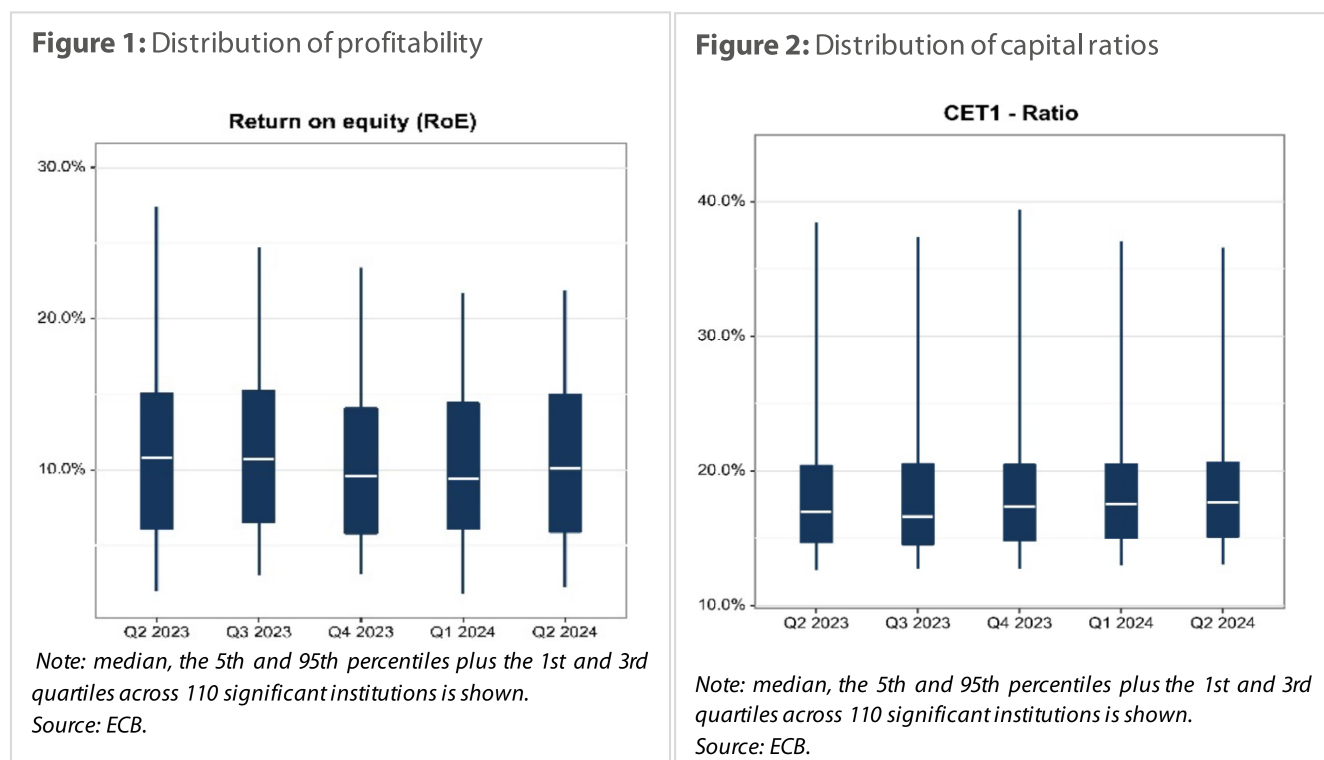


Figure 1: Distribution of profitability

Note: median, the 5th and 95th percentiles plus the 1st and 3rd quartiles across 110 significant institutions is shown.
Source: ECB.

Figure 2: Distribution of capital ratios

Note: median, the 5th and 95th percentiles plus the 1st and 3rd quartiles across 110 significant institutions is shown.
Source: ECB.

Please note that in all boxplots in the ECB's publications, 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 evolution of bank profitability (net interest margin[6]) is shown in Figure 3. Over the past decade, banks have improved their overall profitability. In 2024, banks have report a ROE of around 10%, up from 6% in 2015, with ROA rising from 0.4% to 0.7%. Profitability was much lower during periods of low interest rate environment and only recovered after interest rates have increased, highlighting the impact of the macroeconomic environment on bank profits. However, while bank profitability can be seen as a mirror of the past actions, profitability patterns may say little about the future (see Claudia's Buch speech from October). Different structural shifts, such as inflation dynamics, demographics, and geopolitical risks, could challenge the factors driving past profitability, so going forward banks will need strategic responses to adapt to these changes.

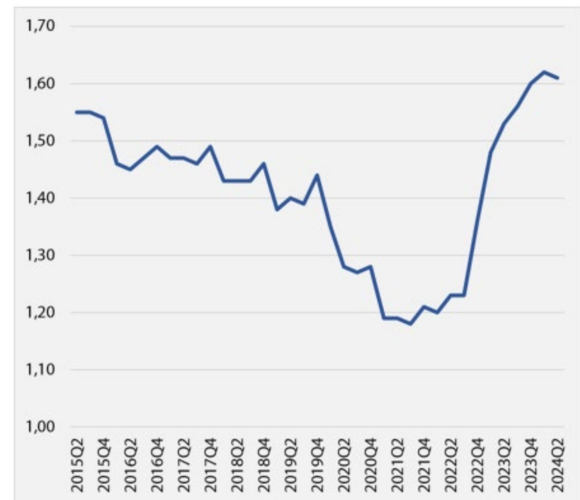
The state of significant institutions' loan books remains stable. The share of so-called **"Stage 2" loans** – that are loans that have experienced a significant increase in risk since they were granted and require particular provisions – had exhibited a marked increase by the end of 2023. That ratio 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

[6] Net interest margin = interest income divided by interest expenses. It is calculated as an aggregate for all significant institutions in countries participating in European banking supervision. The composition of the sample has changed over time to reflect changes in the list of supervised entities.

objective evidence of credit impairment, has crept up slowly from quarter to quarter, standing at **2.27% in Q2 2024, compared to 2.18% one year earlier**.

For both groups of loans with a significant increase in credit risk, the **coverage of risky loans by provisions** stands somewhat lower today than it stood in early 2023, that is at 3.47% compared to 3.82% for stage 2 loans and 43.06% compared to 45.17% for stage 3 loans.

Figure 3: Net interest margin, in %

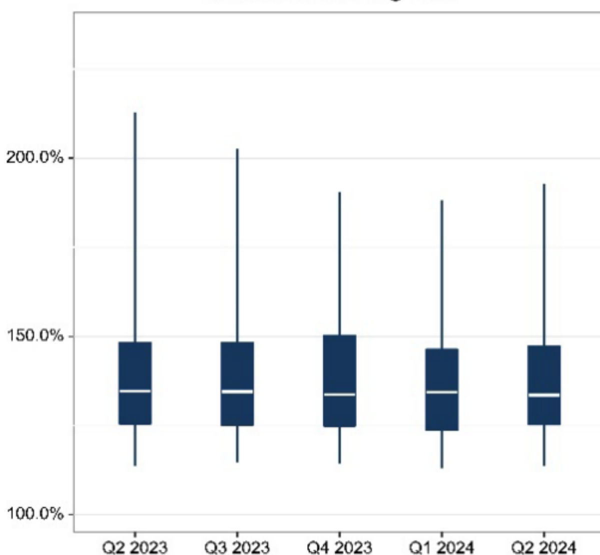


Note: SIs, EU countries participating in SSM (changing composition) is shown.
Source: EGOV's own elaboration based on data from ECB.

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 2.30% 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%.

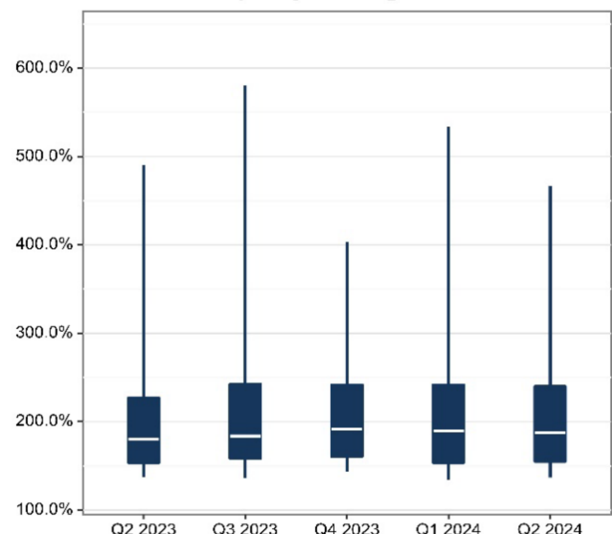
The **funding and liquidity positions remain broadly unchanged** across the distribution of significant banks. Considering the net stable funding ratios (NSFRs) **Figure 4** and the liquidity coverage ratios in **Figure 5** variation of funding and liquidity over time seems to have largely taken place 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



Note: median, the 5th and 95th percentiles plus the 1st and 3rd quartiles across 110 significant institutions is shown.
Source: ECB.

Figure 5: Distribution of LCRs



Note: median, the 5th and 95th percentiles plus the 1st and 3rd quartiles across 110 significant institutions is shown.
Source: ECB.

The statistics also contains 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 2'928 bn (up from 2'828 bn 6 months earlier), the largest aggregate exposures are those to France (EUR 614 bn), followed by those to Italy (EUR 406 bn) and Spain (EUR 362 bn). Conversely, the largest investor in general government debt is the French banking sector with holdings of EUR 924 bn, followed by Italian banks with EUR 513 bn and Spanish banks with EUR 493 bn.

ECB statistics break 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 6** 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 22% in Austria and Ireland to 75% in Lithuania and 62% in Greece.

Figure 6: significant institutions' exposures to their home general government, as percentage of their overall general government exposures by end Q2 2024

BE	BG	DE	EE	IE	GR	ES	FR	HR	IT	CY	LV	LT	LU	MT	NL	AT	PT	SL	SK	FI
48%	n/a	53%	31%	22%	62%	52%	59%	n/a	54%	n/a	36%	75%	n/a	n/a	42%	22%	37%	25%	n/a	49%

Source: EGOV own calculations based on ECB.

ECB consultation on its approach to options and discretions

While we generally enjoy a single rule book for banks in the EU in general and in the Banking Union in particular, the legislation contains a number of national options and discretions. While they may have benefits in terms of reflecting local specificities, they may also entail costs in terms of complexity for supervisors (and the SSM in particular) and for cross-border banks. In addition, they may have implications for competition among banks. That said, **a number of options and discretions are in the hands of competent authorities**. For the directly supervised **Significant Institutions**, the ECB takes a **harmonised approach** to these options and discretions, which consists of a directly applicable ECB Regulation for options of general applicability and of a Guidebook for the Joint Supervisory Teams as far as case-by-case options and discretions that can be exercised differently from one bank to the other are concerned. When it comes to **Less Significant Institutions** directly supervised by the SSM's national competent authorities, the SSM issues a Recommendation for some options and discretions and a binding Guideline for others in order to provide for harmonisation within the Banking Union.

On 8 November, the ECB has **launched a [consultation](#) on revised policies for applying options and discretions** available in EU law. It is open for feedback until end on 10 January 2025. **On substance, the changes of general applicability are limited are quite limited**. In the Regulation and the Guideline, respectively, they concern the possibility to continue to recognise until July 2026, under the Standardised approach for credit risk, external ratings that entail a notion of public support for a bank.[7] By contrast, there is a broad range of changes that reflect the profound and complex changes brought by the new EU banking package (the Capital Requirements Regulation III and the Capital Requirements Directive VI), which entail new

[7] Moreover, obsolete guidance regarding the use of a 180 days-past-due threshold is deleted since it is also deleted from the legal basis.

and amended margins of appreciation (or, if one so wishes, discretion) for competent authorities looking at the circumstances of individual banks, for instance regarding the scope of application and methods of consolidation, the definition of own funds and the various changes to the calculation of capital requirements.

Climate Risk Scenario Analysis: One off Fit-for-55 package

In 2021, Commission, as part of its strategy to finance the transition to a sustainable economy, called upon key regulatory bodies (ESAs, ECB and ESRB) to **assess the financial system's preparedness for climate-related shocks**. This exercise aligns with the Fit-for-55 package launched recently in March 2023, which targets a 55% reduction in greenhouse gas emissions by 2030. The results are expected to be published by the end of 2024 or in Q1 2025 at the latest (more information available here).

The main goal of climate risk scenario exercise is to **evaluate potential shocks to the financial system analysing how climate related risks** (both transition and physical risks) could impact asset valuations, financial institutions, and the wider financial ecosystem. The findings of the report (*still to be published*) should guide policymakers and regulators in understanding potential vulnerabilities of the financial system. These insights should also feed into the discussion of how to strengthen monitoring practices across different sectors, ensuring that financial institutions are more resilient to climate-related disruptions. **ECB plans to provide individual feedback, including key findings, to banks** that participated in the data collection (credit risk, market risk, real estate risk and income data as well as climate-relevant data on transition risk and physical risk) which should enable supervisors to track progress in line with the ECB's 2022 climate risk stress test and to evaluate banks' climate risk data capabilities.

With regard to climate-related risks, in late 2023, the Basel Committee released a proposed framework for reporting climate-related financial risks, providing guidance to regulators worldwide. At the same time, **EBA announced that it is revising the framework governing capital requirements** for financial institutions (commonly referred to as Pillar 1) to include considerations of environmental and social risks. According to the SSM, **banks need to significantly enhance their management frameworks to handle climate-related risks**. Namely, the SSM noted elevated transition risk, urging banks to integrate climate risks into their risk management systems. Banks will also need to reassess the probabilities of defaults and losses, as well as risk weights used to determine the capital reserves allocated for their clients.

In recent years, the ECB has stepped up its supervisory efforts around climate and environmental (C&E) risks. Some of these efforts are related to the release of C&E risks in late 2020, the 2021 bank self-assessments, and the 2022 climate risk stress test and thematic review on C&E risks. Moreover, the ECB conducted an in-depth gap analysis on C&E risk disclosures and carried out initial on-site inspections at selected SSM banks. By end of 2024, the ECB expects all supervised banks to align fully with its supervisory expectations. Frank Elderson, in March 2024, said that the ECB will closely monitor each bank's progress toward final deadlines as the latest assessment revealed that, while all eligible banks disclose most of the required data, further work is needed to improve consistency and quality. Banks within the scope of EBA's technical standards on Pillar 3 disclosures for ESG risks will also need to report the alignment of their credit portfolios with a climate neutrality scenario.

Miscellaneous

Cyber risk resilience stress test

In July 2024, the ECB concluded a test how banks would recover from a severe but plausible cybersecurity incident. To date, **no public feedback from the ECB is available**; the ECB merely noted that the results will

feed into ECB's 2024 Supervisory Review and Evaluation Process. A short document by KPMG considers that the test "presented banks with major challenges". We understand from the document that banks in particular struggled with limited time to prepare (while a real incidence would presumably come without time for preparation) and with quantifying the economic impact of the hypothetical incident. See ECB's press release.

Governance and risk culture

The ECB had launched a consultation on draft Guide on governance and risk culture; a new "Guide" is supposed to replace the 2016 "supervisory statement", clarifying supervisory expectations and pointing out "good practices" for banks' internal governance. The **consultation ended on 16 October 2024**. See ECB's press release.

Market Risk capital requirements

On 24 July 2024, the Commission adopted a delegated act (DA) postponing the date of application of the market risk framework in CRR 3 by one year to 1 January 2026. While those rules form part of the final phase in the implementation of the internationally agreed Basel 3 standards, the legislators mandated the Commission to monitor possible differences in the international implementation of the Basel market risk framework and, in case of 'significant differences', empowered the Commission to postpone the application for up to two years. In her previous ECON hearing, and still during the scrutiny period for the delegated act, Claudia Buch noted that she understood the "political reasons" behind the delegated act but did not think the European banks concerned would significantly lose ground compared to their competitors absent such postponement. Meanwhile, the **postponement has entered into force**. See EP briefing and Commission delegated regulation.

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