

SPEECH

Welcome address

Remarks by Christine Lagarde, President of the ECB, at the ECB Forum on Banking Supervision, 9 November 2021

Frankfurt am Main, 9 November 2021

It's a pleasure to welcome you to the fourth ECB Forum on Banking Supervision.^[1]

The coronavirus pandemic has been a most unusual crisis. We saw the sharpest contraction in output ever recorded and one of the steepest recoveries ever observed. The response from policymakers was bold, in terms of both the support provided and the alignment between policies.

But an often underestimated, yet exceptional feature of this response has been the role played by the banking sector. Unlike in past crises, banks were not part of the problem – they were part of the solution. Banks were not only in a strong financial position to withstand the pandemic shock, but could help strengthen the common response to the crisis.

This role reversal is partly attributable to the contribution of European banking supervision. Back in 1999, Tommaso Padoa-Schioppa, one of the fathers of the euro, said:

“I am convinced that in the future [...] the banking industry will need a true and effective collective euro area supervisor. And it will have to be enhanced to the full extent required for banking supervision in the euro area to be as prompt and effective as it is within a single nation.”^[2]

The pandemic was the first real test of whether European supervision could act as effectively as a national authority. And it was the crisis that proved Tommaso right.

Looking beyond the crisis, it is crucial that banks adapt to the challenges of the future to ensure that they remain fit to support the economy.

The contribution of European supervision to the crisis response

European banking supervision proved valuable to the crisis response in three ways.

First of all, European supervision ensured that the entire banking system built resilience in the run-up to the pandemic crisis.

Having a common European rulebook enabled European supervision to hold the entire banking sector to a higher common standard. Since 2014, core equity ratios have increased from around 12% to more than 15%. And the stock of non-performing loans has decreased by around 50%. This focus on resilience meant the sector entered the pandemic in a robust position.

Second, European supervision leveraged banks' strong financial positions to unlock lending across the banking union when the economy urgently needed it.

Supervisors removed prudential barriers preventing banks from maintaining the credit flow to the economy, allowing them to maximise the funding made available via the ECB's targeted longer-term refinancing operations (TLTRO III).^[3] The combined response allowed banks to rapidly funnel liquidity to the economy. Between March and May 2020, bank lending to companies in the euro area rose by almost €250 billion, the largest jump on record in a three-month period.

At the same time, European supervision recommended suspending dividend payments to ensure that capital was not flowing out of the banking sector, but was instead used to support the economy and absorb losses. Banks that did not distribute dividends increased their lending by around 2.4% and their provisions by around 5.5%.^[4]

The third way in which European supervision was successful was by ensuring the consistency of these measures across the banking sector.

Having a single supervisor meant that bold collective action could be taken to reduce banks' natural incentives to retrench and cut lending to the economy during a recession. And crucially, that action could happen in all countries simultaneously and with breakneck speed. In many ways, this would have been unthinkable before the banking union, however incomplete it remains today. And it helped ensure that the ECB's monetary policy, which is largely transmitted through banks, could be delivered more evenly across all parts of the euro area.

Through these actions, European supervision was decisive in averting a much worse outcome for the economy. But its actions also showed that the post-financial crisis reforms are working as intended, combining resilience with flexibility. Higher capital and liquidity buffers did not constrain credit – they allowed banks to act as shock absorbers. And we saw that the prudential stance across the banking union can be adjusted, when needed, to support economy-wide stabilisation.

Making the banking sector resilient for the future

Thanks to this exceptional crisis response, banks are now playing their role in supporting the economic recovery. They have started releasing loan loss provisions, which is creating welcome leeway for maintaining credit supply as the recovery matures. And the ECB's most recent bank lending survey^[5] showed that credit conditions were being supported by a reduction in banks' risk perceptions, for the first time since 2018.

However, as successful as this crisis response has been, we now need to prepare for the post-crisis challenges, which have two components.

The first is addressing the long-run consequences of the pandemic for asset quality.

The full impact of the pandemic will become visible only gradually, which poses challenges for the management of credit risk. Public support and regulatory measures may have blurred the underlying creditworthiness of borrowers. As those measures are lifted and the true financial health of companies comes to light, asset quality could be affected.

At this stage, it is too early to predict the trajectory of asset quality. Fast-moving indicators, such as the change in the share of forborne loans and Stage 2 loans, are already showing signs of deterioration. But the ultimate impact on non-performing loans will only occur with a delay of several years and will crucially depend on the strength of the recovery. Banks should have robust risk controls in place to be alert to these risks and address them early on.

Second, the pandemic has triggered more fundamental changes to the environment in which banks operate. It has accelerated the digital transformation and underlined the urgency of tackling climate change – both of which inevitably have an impact on banks.

In terms of digitalisation, consumer preferences are changing rapidly. New players – from fintechs to large technology companies – are increasingly driving competition in the financial services market. This creates an opportunity for euro area banks, which have struggled with low profitability and cost efficiency, to refocus their business models. The banking sector has seen a 23% increase in first-time digital users since the start of the pandemic.^[6]

Maintaining this focus on digitalisation could allow banks to reach customers without having a dense branch network. New products and services could be introduced at very low marginal cost. And pricing could be improved using advanced data techniques. In Europe, a number of digital-only banks are already leading the way in showing how digitalisation can generate higher returns and help improve cost efficiency.

The impending risks associated with climate change and environmental degradation also call for banks to adapt how they do business. The ECB's economy-wide stress test revealed that the default probabilities of the corporate loan portfolios of the most vulnerable banks could increase by 30% in a scenario in which climate change is not addressed.

Currently, few banks have integrated such risks into their existing strategies or risk management processes. They are all still a long way off meeting the supervisory expectations we have laid out in our Guide on climate-related and environmental risks^[7].

We all know that time is running out. So banks need to act now to be fit for a carbon-neutral economy by 2050. They need to adapt their strategies and risk management practices to ensure their business models are resilient in the short, medium and long run.

Conclusion

Let me conclude.

The pandemic has been an exceptional crisis. But the combined response of policymakers was just as exceptional. European supervision has ensured that – unlike in the last crisis – banks acted as shock absorbers, rather than amplifiers.

This common response reflected the realisation that all policy areas needed to act together to combat this unprecedented shock. Even more fundamentally, it reflected some core lessons from the great financial crisis. First, a systemic perspective is needed in situations of stress to avoid excessive procyclicality in the financial system. And second, common rules are needed to prevent regulatory arbitrage.

Now that the recovery is under way, European supervision is keeping a close eye on the build-up of risks. However, for banks to thrive in the post-pandemic world, they must also embrace the changes that the pandemic has triggered.

I am confident that this is possible. Just as the banking sector has contributed to a successful solution to this crisis, it can also provide one to our next challenge: facilitating the transformation of our economies towards a greener and more digital future.

As Winston Churchill once said, “Success is not final [...] It is the courage to continue that counts”.

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1. [ECB Forum on Banking Supervision, “Tomorrow’s banking: navigating change”, 9 and 10 November 2021](#)
 2. Padoa-Schioppa, T. (1999), “[EMU and banking supervision](#)”, lecture at the London School of Economics, Financial Markets Group, 24 February.
 3. Capital relief measures are estimated to have made €1.8 trillion available for lending and loss absorption (see ECB Banking Supervision (2020), “[ECB Banking Supervision provides further flexibility to banks in reaction to coronavirus](#)”, 20 March.
 4. Dautovic, E. et al. (2021), “[Evaluating the benefits of euro area dividend distribution recommendations on lending and provisioning](#)”, *Macprudential Bulletin*, Issue 13, ECB, June.
 5. ECB (2021), [The euro area bank lending survey – Third quarter of 2021](#), 26 October.
 6. Fernandez, S., Jenkins, P. and Vieira, B. (2020), “[Europe’s digital migration during COVID-19: Getting past the broad trends and averages](#)”, *McKinsey Digital*, 24 July.
 7. ECB Banking Supervision (2020), [Guide on climate-related and environmental risks: Supervisory expectations relating to risk management and disclosure](#), November.

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