Claudia Buch: Hearing at the European Parliament's Economic and Monetary Affairs Committee

Introductory statement by Prof Claudia Buch, Chair of the Supervisory Board of the European Central Bank, at the European Parliament's Economic and Monetary Affairs Committee, Brussels, 21 March 2024.

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I am delighted to be here for my first hearing as Chair of the Supervisory Board of the ECB and to report to you on the activities and priorities of ECB Banking Supervision.

Today, I will focus on three points concerning the banking outlook, our supervisory priorities and the completion of the banking union.

First, the European banking sector has coped well with the shocks of the recent past, but faces new risks in a changing external environment.

Second, ECB Banking Supervision will remain agile and proactive in addressing these risks.

And third, I would like to thank you for all the work you have done over the past parliamentary term to move the banking union forward. Efforts to complete it are needed now more than ever in order to further increase the resilience and integration of the banking system.

The European banking sector faces new risks in a changing external environment

Euro area banks have robust capital and liquidity positions. This is underscored in the ECB Annual Report on supervisory activities 2023, which was published today. The aggregate Common Equity Tier 1 capital ratio of significant institutions was 15.6% in the third quarter of 2023, which is higher than at the start of the banking union in 2015, when it was 12.7%. The leverage ratio has increased slightly to 5.6% (from 5.4% in 2016). The aggregate liquidity coverage ratio stood at 159%, which is higher than before the pandemic, when it was 140%. Non-performing loans accounted for less than 2% of total outstanding loans in 2023. Bank profitability and valuations have increased, also reflecting higher interest rates.

At the same time, the evolving economic and financial landscape, along with geopolitical risks, is challenging the resilience of European banks. The profit outlook for banks may deteriorate if funding costs increase, loan growth weakens or losses materialise. Losses from exposures to sectors particularly sensitive to interest rate changes may rise. In the first three quarters of 2023, non-performing loans were already increasing gradually, driven primarily by commercial real estate loans and consumer credit loans.

Bank are operating under a high degree of uncertainty, owing to geopolitical risk and a challenging macroeconomic environment. Broader structural shifts are under way relating to digitalisation, demographic change and climate change. This is why, in its supervisory priorities for 2024-2026, the Supervisory Board has taken into account heightened macroeconomic and geopolitical risks and the impact of digitalisation.

Preserving bank resilience and strengthening it further in a lasting manner remains our priority. European banks have coped well with yesterday's problems, and we need to make sure they can withstand tomorrow's challenges equally well.

Resilience is about the ability of banks to withstand external challenges. It requires sound capital positions, effective risk management and governance, and resilient IT systems.

First, the backbone of a resilient banking system is appropriate capitalisation, especially in an external environment characterised by increasingly frequent shocks. Well capitalised banks are not only more resilient, they can also better support the real economy and better compete internationally. Implementing Basel III faithfully and having the new rules in place in 2025 is therefore in Europe's best interest.

Second, new risks require robust governance structures and adequate provisioning. Our supervisors will therefore continue to address long-standing deficiencies in banks' credit risk management frameworks, the functioning of their management bodies, and their capacity to efficiently handle and use risk-related data. Banks must address climate-related risks by enhancing their assessment, management and disclosure of such risks.

Third, banks need to continue investing in their IT systems and their operational resilience. This is important not only to adapt to the digitalisation of the financial system, but also to ensure resilience against an increasing number of cyber incidents. ECB Banking Supervision will continue assessing deficiencies in banks' outsourcing arrangements and cybersecurity management, and we are currently conducting a system-wide cyber resilience stress test.

Supervision will be agile and proactive in addressing risks

European banking supervision is well positioned to address emerging risks. For a decade now, it has been a central pillar of the banking union, and it has established strong supervisory standards. In the decade to come, European banking supervision will adapt to the new environment by learning from the past and by being agile and proactive in dealing with emerging risks. We have to ensure that the problems we identify are addressed by the banks, and that the banks remain resilient to shocks.

I am therefore fully committed to concluding the reform of the Supervisory Review and Evaluation Process which the Supervisory Board initiated on the basis of independent expert advice.

Generally, if we identify weaknesses, we need to use the full range of supervisory tools in a timely and effective manner. This year, we will intensify the use of escalation mechanisms to ensure that supervisory findings are addressed and deficiencies are remedied by banks. For example, for climate-related and environmental risks, we have established clear supervisory guidance and follow-up procedures, setting deadlines for banks to progressively meet all supervisory expectations by the end of 2024. We also envisage the use of periodic penalty payments should supervised entities fail to comply with the requirements.

Moving forward, we need to continue our efforts to complete the banking union

Given the challenges and structural changes that lie ahead, completing the banking union is more important than ever. Europe needs a strong and resilient banking sector to withstand shocks and promote growth. A truly integrated single market for financial services, with a complete banking union at its heart, would ensure that businesses and households have access to sufficient and affordable funding.

As stress in the system may increase, we need to close the remaining gaps in our crisis management framework as soon as possible. Strong supervision and credible resolution are indeed closely connected and reinforce each other. The crisis management and deposit insurance review will give authorities a more flexible toolkit to ensure that failing banks are able to exit the market in an orderly fashion, making the European banking system more resilient to shocks. To be able to apply these tools in practice, it is crucial to have access to adequate funding, including from existing industry-funded pools such as deposit guarantee schemes.

In addition, we need further progress with regard to the third pillar, a European deposit insurance scheme that would ensure high and uniform levels of depositor protection. This would increase the resilience and integration of the European banking system.

Completing the banking union and building a genuine capital markets union should go hand-in-hand. Financing the green transition and innovation requires both bank and capital market finance. Moreover, well-functioning capital markets can foster cross-border activities by banks and ensure better risk sharing.

Conclusion

Let me conclude by underlining that accountability to European institutions is essential for us. Supervisors need to continuously and transparently connect with all stakeholders to explain what risks we see and how we are addressing them. Building on what we have achieved together, I look forward to working with the European Parliament over the next parliamentary term to complete the banking union and support your work to further strengthen the regulatory framework.