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Deloitte Banking Alert

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Chair of the Supervisory Board of the ECB speaks on 2023 SREP results and supervisory priorities for 2024-2026

The European Central Bank (ECB) published on 19th of December the results of its Supervisory Review and Evaluation Process (SREP) for 2023 and its supervisory priorities for the years 2024-2026. Based on the results of the SREP, the ECB specifies capital requirements and issues qualitative measures to remediate deficiencies for each bank. The SREP outcome also feeds into the ECB's supervisory priorities for the next three years.

The ECB continues to be concerned about governance, as some banks have failed to adequately address significant weaknesses in their management bodies' functioning and steering capabilities, and in risk data aggregation and reporting capabilities, which are essential for banks' overall assessment and steering of their risk exposures. From 2024 on, the **ECB will increasingly apply escalation mechanisms and tools, possibly including enforcement measures and sanctions**, to ensure that banks address these shortcomings.

SREP results: how did banks perform in 2023?

In 2023 European banks have proven resilient to the macroeconomic challenges arising from higher inflation and the accompanying rise in interest rates, the low growth of real GDP, the Russian invasion of Ukraine and the long-term effects of the COVID-19 pandemic. Overall, SREP results can be summarized as follows:

- Banks have solid capital and liquidity positions and increased profitability driven by the steady and rapid transition from a prolonged period of low interest rates to a consistent fast-paced increase over the past 18 months.
- Internal governance, risk management and capital planning remain key areas for supervisory action in light of deteriorating risk outlook.
- The average SREP score remained broadly stable at 2.6.
- **Pillar 2 requirements for CET1 capital set at 1.2% on average, compared with 1.1% in 2023.**
- Overall **CET1 capital requirements** and guidance **increased from 10.7% to 11.1%,** reflecting impact of macroprudential policies.

- Supervisory priorities adjusted to focus on building resilience to short-term risk outlook, strengthening governance and climate and environmental risk management, and making further progress in digital transformation and operational resilience.

Banks need to keep paying particular attention to internal governance, as three out of four have received measures to address deficiencies in that area. There was a substantial rise in measures issued to address liquidity risk and interest rate risk in the banking book, triggered by the changing macro-financial landscape. In this context, the ECB has slightly refocused its supervisory priorities for the next three years.

Supervisory priorities for 2024-2026

While the risk landscape has evolved since last year, the supervisory priorities and corresponding activities set out in 2022 remain valid overall. They still address the main vulnerabilities in the banking sector, both from a cyclical and structural perspective. The three overarching priorities for the next three years focus both on the near-term risks to the banking sector and the need to tackle more structural medium-term challenges.

Source: https://www.bankingsupervision.europa.eu/press/speeches/date/2023/html/ssm.sp231219~421bbae836.en.html

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Conclusions

Over and above the outcome of the 2023 SREP cycle, this key annual supervisory process has matured sufficiently to allow reflection on how to make it fit for the challenges ahead.

Following a public consultation, the Guide on effective risk data aggregation and risk reporting will be published in 2024 to reinforce supervisory expectations. This will be supported by **targeted reviews, on-site inspections, and engagement with banks showing persistent shortcomings.**

For further questions regarding the aspects mentioned in this alert, please don't hesitate to contact us:

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