

Public hearing with Andrea Enria, Chair of the Single Supervisory Mechanism (SSM)

ECON on 21 March 2023



This briefing has been prepared for the public hearing with the Chair of the ECB Supervisory Board, Andrea Enria, in ECON on 21 March 2023, covering:

- *A European perspective on recent US bank failures, in particular Silicon Valley Bank*
- *SREP results for 2022*
- *Supervisory Banking Statistics*
- *EBF-commissioned study on the cost of regulation for EU banks*
- *EBA 2023 EU-wide stress test scenario*
- *ECB sanction for failing to report cyber incident within deadline*
- *Enhanced Code of Conduct for high-level ECB officials*
- *New MoU with EU national supervisors not part of the Banking Union*

A European perspective on recent US bank failures

*Please note that we cover only information available up to 16 March in this section.
The [ESRB](#) and this SSM hearing briefings entail identical sections on this topic, as it has both micro- and macroprudential relevance.*

The week of March 6, two banks in United States (US) have been closed by the authorities, the largest of which was Silicon Valley Bank, at the time the sixteenth-largest US bank. When the failure of Silicon Valley Bank unfolded, the **US authorities took quick action to stave off contagion** of the second-largest bank failure in US history. On Sunday, 12 March, US authorities [jointly stated](#) that US Treasury Secretary Janet Yellen authorised, in consultation with the US President, that **all depositors of the failed bank, insured and uninsured, will be repaid in full**. They also emphasised that there will be no losses for taxpayers.

At the same time, the statement also makes clear who might have “to pick up the bill”, as **shareholders** and certain unsecured **debtholders will not be protected**, and if there are any **losses** to the Deposit Insurance Fund, they will be **recovered by a special levy** on the rest of the banking system. Many press articles appreciate the quick action to resolve the bank but voiced **criticism that banking supervisors missed out on early warning signals**.



From a European perspective, there are at least the following questions that may deserve particular attention:

1. Are there direct links with the EU financial system?
2. To what extent are there comparable vulnerabilities in European banks?
3. Are there lessons to be drawn for regulation and supervision of EU banks?
4. Are there lessons to be drawn for EU bank crisis management and deposit insurance reform?

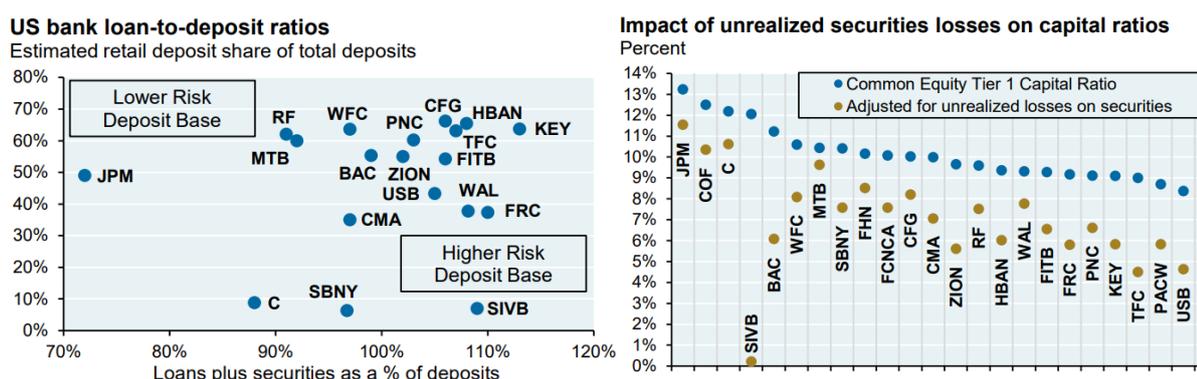
Are there direct links with the EU financial system?

[Press](#) quotes Commissioner McGuinness saying that the **direct impact on the EU seems to be limited** and that the market reaction was initially negative, but seems to have calmed down. Indeed, so far, we have not come across hints to particular linkages between Silicon Valley Bank and European banks.

The fact that Silicon Valley Bank attracted large deposits¹ and invested them in marketable securities suggests that it probably did not need much funding from other banks, let alone from European banks. This does not preclude, however, that individual banks turn out to be exposed to Silicon Valley Bank directly because they have invested in its debt (bonds) or equity (shares). The US authorities have announced that the deposits in Silicon Valley Bank are safe, but that does not extend to shareholders nor certain unsecured creditors. **Banks’ investments in debt and equity securities are therefore likely to be exposed to losses, and the status of unsecured interbank deposits is somewhat ambiguous.**²

It should also be noted that share prices of a number of other US banks came under pressure at the beginning of this week, reflecting concerns over similar vulnerabilities. However, it seems that among larger US banks, Silicon Valley Bank stood out with its combination of **hidden losses** on marketable securities and reliance on uninsured deposits that are likely to be withdrawn under stress. This is at least what **Figure 1** visually suggests. On the left hand side, it shows the share of (relatively stable, mostly insured) retail deposits at different banks relative to longer-term assets. On the right hand side, it shows the importance of unrealised losses relative to banks’ capital ratios (SIVB Silicon Valley Bank). **Overall, it will be important for the SSM to establish any direct or indirect exposures to US banks in difficulty or potential difficulty.**

Figure 1: Funding structures and unrealised securities losses of selected US banks



Source: *The JP Morgan research note mentioned above*. See there for additional explanations of the abbreviations and on the methodology. SIVB refers to Silicon Valley Bank, SBNY to the also-defunct Signature Bank and C stands for Citibank. The left-hand chart uses Q3, the right-hand chart Q4 2022 data.

¹ Silicon Valley Bank had total assets of USD 212 bn, classifying as a mid-sized bank, which in the US are exempt from some supervisory measures. The other bank was Signature Bank, with total assets of 110 bn USD. A third bank, Silvergate Bank, with around USD 16 bn total assets, is in voluntary liquidation.

² The same consideration applies for the smaller Signature Bank.

To what extent are there comparable vulnerabilities in European banks?

Figure 1 above shows that Silicon Valley Bank stands out among US banks with a large reliance on less stable deposits and a particular sensitivity of its capital position to **unrealised losses** on marketable securities. Based on public information, we **did not find comparable information about European banks**, but the rather unique business model is probably without exact parallels in Europe.

Nevertheless, abstracting from the concrete case, **instances of a relatively higher degree of reliance on less stable deposits** can probably also be found among European banks - even if, as discussed below, the regulation of liquidity risk is more robust in Europe. **Unrealised losses in European banks' securities portfolios** depend on the share of longer-dated securities and the accounting standards and practices banks apply. Following the recent increase in market yields, also European banks are likely to also have some exposure to unrealised losses. There might also be some resulting from widened issuer spreads.

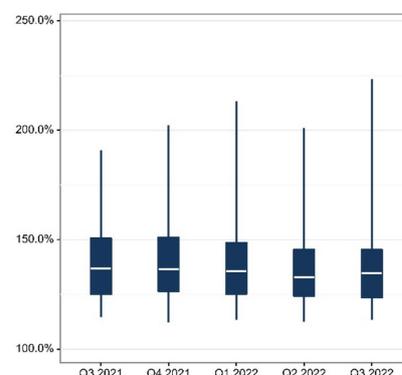
One needs to keep in mind, however, that the problems in Silicon Valley Bank chiefly resulted from the **combination of both problems**. A bank can operate for a long time with unrealised losses if it does not have to sell the securities and realise the losses to obtain liquidity.³ A bank can also afford a less stable funding position if it can withstand even sustained liquidity outflows by liquidating securities held at market values. Liquidity regulation for European banks recognises this fact by setting reduced stable funding requirements for investments in marketable securities; however, these reduced requirements do not consider possible unrealised losses. On the funding side, the Net Stable Funding Ratio tries to capture the stability of funding sources in a standardised fashion. **Figure 2** illustrates that directly ECB-supervised banks solidly exceed minimum requirements for net stable funding.⁴ **Against this background, it would be interesting to obtain the SSM's views about relevant risk factors in a European context.**

We note that the Supervisory Banking Statistics (see separate section in this briefing) provide **welcome and up-to-date transparency** about the health of Significant Institutions. However, as this episode in the US illustrates, existing problems may "stay under the radar" if one focusses only on average indicators for the sector or only at large banks. While there are box plots that illustrate the distribution of Significant Institutions for key ratios in the full package of graphs, the press releases of the ECB comments only on the averages and some relevant information, for instance on the composition of deposits and on unrealised losses is absent.

Are there lessons to be drawn for regulation and supervision of EU banks?

After the Global Financial Crisis, the European legislator introduced, in line with international standards, harmonised liquidity requirements for all banks. These consist of the Liquidity Coverage Ratio and the Net Stable Funding Ratio. The former ratio makes a standardised assessment of a bank's liquidity outflows under stress over a 30 days horizon and requires those outflows to be matched by a buffer of very liquid assets. The latter ratio requires banks to fund less liquid assets to covered by funding that is considered stable at an on-year horizon. Again, this is a standardised assessment that makes uniform

Figure 2: Net Stable Funding Ratios of Significant Institutions



Source: ECB

³ It is also worth recalling that in the case of fixed income securities with long durations, market valuations can go down quite steeply when interest rates rise, but eventually go up again mechanically when the maturity of the security approaches and if markets expect the issuer to repay the security in full.

⁴ We note however that the ECB seems to exclude some outlier banks from these graphs, which reduces the transparency they provide; see the discussion about solvency ratios in the section on banking statistics in this briefing.

assumptions about the stability of funding sources and the liquidity of assets. On top of these standardised ratios, European banks are subject to qualitative requirements on their liquidity risk management, which must be regularly reviewed by competent authorities under the SREP framework (also see following section of this briefing).

In principle, **these requirements aim at preventing a situation like that of Silicon Valley Bank**. Unfortunately, the two standardised ratios did not apply to that US bank, even though they are part of the international Basel III standards, because the **US authorities apply a tiered approach to banking regulation**, under which only a limited number of banks are fully subject to international standards. International standards entail an agreement to apply them to large, internationally active banks. However, it is left to national authorities to decide which banks fall into that category. Although Silicon Valley Bank was the 16th largest bank in the US and had some international business, it was not considered large, internationally active.

It is fair to say that the incident would have been less likely if Silicon Valley Bank had been subject to international standards. In a [public disclosure](#), the banks says that hypothetically being subject to the international standards would have required it to obtain more liquid assets and more long-term funding. Commissioner McGuinness is going a step further according to [press](#), clearly stating that the bank's mismanagement can be explained by the US' non-application of Basel III to small and mid-sized banks. In any case, one can consider this case as a **resounding confirmation of the EU's regulatory approach** which applies international standards to all banks.⁵

Nevertheless, one has to reserve judgement as to how much more safety standardised ratios would have offered, and as to what European supervisors would hypothetically have done to a business model like that of Silicon Valley Bank under the SREP framework. Apparently, the bank was subject to large withdrawals of uninsured deposits. Such deposits would have probably not been considered stable under neither of the two liquidity ratios. Less clear, though, is the treatment of the bank's apparently large securities portfolio. For instance, marketable securities are generally subject to reduced requirements for stable funding. This is so even when the marketable securities have long durations and have incurred unrealised losses. **Consequently, the question arises if lessons should be drawn for liquidity risk supervision and the interaction with the accounting treatment of marketable securities.**

[Are there lessons to be drawn for bank crisis management and deposit insurance?](#)

The Federal Deposit Insurance Corporation, which is the US resolution authority, [announced](#) that it transferred all deposits and substantially all assets of Silicon Valley Bank to a new entity. It also promised that **all deposits, insured and uninsured, will be "made whole"** (i.e. repaid in full), while shareholders and "certain" unsecured debt holders will not be protected. The insurance of uninsured depositors will be paid out of the deposit insurance fund, which also serves as resolution fund, and recovered through contributions from banks. The Federal Deposit Insurance Corporation emphasised that taxpayers will not bear losses.⁶

We understand that deposit insurance is extended to uninsured depositors under a so-called [systemic risk exception](#) agreed by the US Treasury, Federal Reserve and Federal Deposit Insurance Corporation. The published decision does not entail a specific motivation other than suggesting that it serves to *"protect the US economy by strengthening public confidence in the [US] banking system"*. Accordingly, the authorities considered *public* confidence insufficiently protected by insuring people's deposits up to 250.000 USD,

⁵ Nevertheless, as discussed in a previous briefing ("joint call to stick to Basel commitments"), A. Enria had raised concerns about potentially uncovered risks in the EU implementation of Basel III.

⁶ All the same also applies to the smaller Signature Bank; see the related [press release](#).

which is the statutory guarantee limit in the US - the comparable limit in Europe is 100.000 EUR. Moreover, that decision was taken in an overall rather benign financial environment, despite the ongoing but well-known interest rate developments. On the one hand, it is true that some banks' share prices reacted strongly to the events (despite the authorities' actions), but on the other hand, evidence like in **Figure 1** suggests that the situation of Silicon Valley Bank was rather special among larger US banks. **Overall, this raises the question under what circumstances the US authorities would have found it acceptable to keep the insurance limited to the statutory limit of 250.000 USD.**

Ostensibly, protecting uninsured depositors did not require the unpopular measure of using *general* taxpayers' money. **Nevertheless, such measure to protect confidence is not without cost.** Other banks may have to pay up for the imprudent behaviour of one bank and of its "sophisticated" depositors, and possibly also for gaps in the authorities' regulatory and supervisory framework. Beyond the direct cost for banks, the broad bail-out of uninsured depositors in a relatively benign financial environment may establish expectations among uninsured depositors and among banks and, by consequence, may instil less prudent behaviour going forward.⁷ Finally, if a bail-out of uninsured deposits is expected for some, but not for all banks, competitive distortions may result.

The underlying reflection is of relevance also for European policy makers. **There are at least two questions at stake: (1) are there circumstances when the bail-out of uninsured depositors is desirable and if those circumstances are fulfilled, (2) how is such bail-out of uninsured deposits feasible, notably in terms of funding.** The EU crisis management framework allows resolution authorities to exempt certain liabilities from bail-in to achieve certain objectives. One such objective in law is to avoid contagion to other banks that would severely disrupt the financial system. **The US case illustrates that this decision involves important judgement and political responsibility:** On the one hand, there may be the potential for destabilising the wider banking system, on the other hand, there are important direct and indirect cost from shielding uninsured depositors from losses.

EU resolution authorities have to take additional constraints into account if they feel compelled to avoid uninsured depositor bail-in. First, there is the no-creditor-worse-off principle, which requires that other creditors must not receive less in resolution than they would in insolvency - however, other unsecured creditors could receive less if a larger share of the bank's assets is used to repay depositors.⁸ Second, the Single Resolution Board can use the Single Resolution Fund only if it can otherwise bail-in 8% of the bank's total liabilities. This may not be possible, in particular if uninsured deposits cannot contribute to bail-in. Finally, the funding for uninsured depositor bail-out may require State Aid authorisation.

The impending review of the crisis management and deposit guarantee framework ("CMDI review"), discussed in [an earlier EGOV briefing](#), is an opportunity to reflect the about the conditions, costs and benefits of protecting uninsured depositors. The reflection is all the more pressing since one objective of the review is to apply the resolution framework more broadly,⁹ as discussed in [another briefing](#).

⁷ It is however also worth reflecting how effective the discipline uninsured depositors provide for bank management actually is; in this case, they have been rather complacent to the last minute, when a massive run set in.

⁸ In principle, this problem could be avoided if unsecured depositor compensation was available from a resolution fund rather than at the expense of other creditors. A general depositor preference in insolvency could also mitigate the no-creditor-worse-off constraint. However, this latter measure alone will not suffice to avoid uninsured depositor losses if the bank's assets alone are insufficient to satisfy depositors in full. In that case, only a sufficiently large and accessible resolution fund or a broadened statutory deposit insurance could keep losses from uninsured depositors.

⁹ Instead of national insolvency procedures. In this context, national insolvency may well entail solutions that protect uninsured depositors, as discussed in the briefing under the link above. If protecting uninsured depositors is, be it under narrower or broader conditions, considered desirable, the resolution framework and funding options available within it, require careful reflection.

SREP results for 2022

On 8 February 2023, the ECB published aggregated [results](#) of its 2022 Supervisory Review and Evaluation Process (SREP) for the banks (“*Significant Institutions*”) that it directly supervises. The **SREP** can be considered the **core activity of the ECB’s** supervisory arm that aims to assess each bank’s individual risk profile. The SREP decisions summarise all supervisory findings, show where a bank stands in terms of capital requirements and risk management procedures, and in particular define what amount of **additional capital** banks – given their individual risk profile – must hold above the minimum requirement (the additional part is called “**Pillar 2 requirement**”, or P2R).

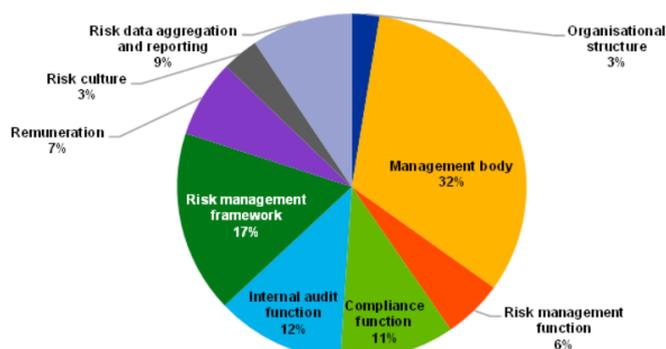
The weighted **average** of Pillar 2 requirements **remained close to the level set in previous years**, at 2.0% of risk-weighted assets (RWA), after 1.9% in 2022, despite deteriorating economic conditions and financial market dynamics following Russia’s invasion of Ukraine, as rising interest rates led to improved profitability and capital generation. The ECB publishes the [full list](#) of Pillar 2 requirements, per individual bank; 27 banks saw an increase of the P2R (ranging from plus 0,01% to 0,5% of total capital), 14 banks a decrease of their P2R (ranging from minus 0,03% to minus 0,25%).

Notable findings and changes to last year’s assessment, however, were as follows:

According to the 2022 SREP report, the ECB for the first time “took **concrete steps to tackle worrying developments in leveraged finance**, as the aggregate exposures of significant institutions to leveraged transactions continued to increase and underwriting standards deteriorated further”, considering that banks had not responded adequately to specific [guidance](#) issued in 2017. A **specific capital add-on** was hence included in the P2R decision for a few institutions with very high exposure to risks from leveraged transactions.

Internal governance and risk management remained an area of elevated concern. The ECB found that many banks had **insufficient resources across all their control functions** (risk management, compliance and internal audit), and that the banks’ management bodies paid insufficient attention to **compliance and internal audit functions**. In the ECB’s internal governance four-step rating, no bank obtained the best score of 1, while nearly three quarters of all banks had a score of 3, indicating that there is still plenty of room to improve internal governance and risk management procedures. That aspect hence dominated the **qualitative measures** in the 2022 SREP cycle (see **Figure 3**), addressing needs to improve the management body (32%), measures relating to the risk management framework (17%), internal audit (12%), or compliance function (11%), as well as risk data aggregation and reporting (9%).

Figure 3: Breakdown of qualitative measures relating to internal governance and risk management



Source: [ECB, results of the Supervisory Review and Evaluation Process in 2022](#)

Key observations from Q3 2022 Supervisory Banking Statistics

The ECB regularly publishes aggregate Supervisory Banking Statistics on the following aspects of directly supervised banks: general statistics, balance sheet composition and profitability, capital adequacy and leverage, asset quality, funding, liquidity, and data quality. The [latest release](#) reports on data for the 3rd quarter of 2022.

Key observations are:

As regards **capital adequacy**, the aggregate Common Equity Tier 1 (CET1) ratio continued a **moderate decrease** to 14.7% in the third quarter, compared with 15.0% in the previous quarter and 15.5% in same quarter of 2021. The boxplots in **Figure 4** suggest that the capital adequacy of banks at the lower end of the spectrum is broadly stable.¹⁰

While the absolute amount of CET1 has increased, the moderate decline of the ratio is driven by an increase in its **denominator**, the total risk exposure amounts. That increase in turn appears to mainly result from **volume growth**, since risk weights have barely changed over the period. This is true for both the standardised approach and the internal ratings-based approach, while the latter should be relatively more sensitive to an increase in credit risk if there was one.

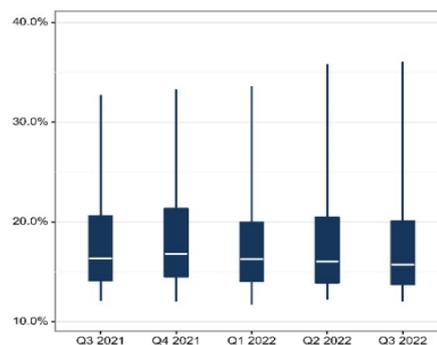
As regards **averages**, one may note that there are **large differences between CET1 ratios at country level**. The banks in the three Baltic states mark the upper end of the spectrum, and those in Greece, Portugal and Spain the lower end. The respective subaggregates range from 24.1% in Estonia to 12.5% in Spain.

As regards profitability, the average Return on Equity (RoE; annualised) was **stable**, compared to the previous quarter (7.6%), and only slightly lower than in same quarter of 2021 (7.2%).

However, we note that **the spread** between those banks that perform well and those that don't **has considerably increased** (see **Figure 5**): the upper and lower whiskers of the boxplot for the third quarter of 2022 are considerably longer, now **reaching deep into negative territory**. That development is important, as **supervisors need to keep track of outliers**, or groups of banks, that are clearly underperforming (or loss making).

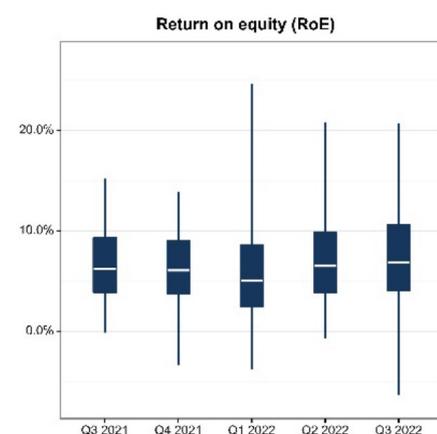
In the same vein, there are **large profitability differences at country level**: Significant institutions in Slovenia performed particularly well and achieved in the third quarter of 2022 the highest aggregated annualised RoE (18.8%), while the significant institutions in Malta that show the lowest RoE (-1.4%) were actually loss-making (see **Figure 6**).

Figure 4: distribution of CET1 ratios



Source: ECB

Figure 5: profitability spread (RoE)



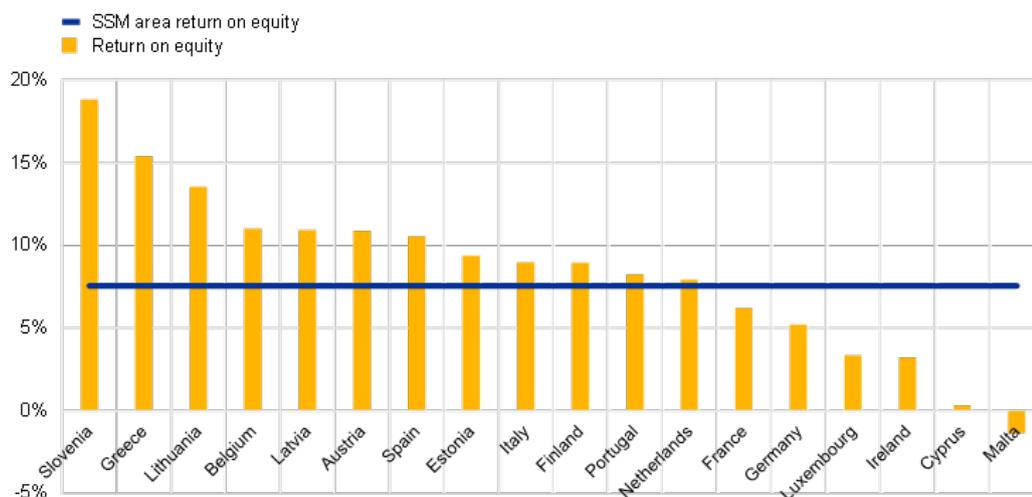
Source: [ECB Supervisory Banking Statistics](#), third quarter 2022, table T02.02.1

¹⁰ We note, however, that the lower end of the line of the ECB's boxplots does not appear to represent the lowest figures in the group; in fact, the ECB statistics report that in the third quarter of 2022, two banks held less than 10% of CET1, one in Portugal, the other in Italy (cp. the information in table T03.02.2).

An **analysis of the aggregated Profit and Loss figures** suggests that in a year-to-year comparison, net interest income has increased by 9%, which is plausible given the recent normalisation of the interest rates, commission income has increased by 5%, and provisioning for credit losses decreased by 1%, all of that contributing to an increase in net profits by more than 6% over one year. At the same time, we note that the aggregated statistics show considerable losses on financial assets held for trading and considerable gains on financial assets held at fair value; **those developments in the profit and loss results elude a simple explanation** and would merit a comment by the supervisor.

The aggregate **Non-performing Loans** ratio fell further to 2.3%, while the share of loans that have experienced a **significant increase in credit risk** (“stage 2 loans”) continued to slightly grow, reaching 9.8%.

Figure 6: Return on equity by home country in percent, 3rd quarter 2022



Source: ECB

Cost of banking regulation

Commissioned by the European Banking Federation (EBF), the consultancy Oliver Wyman produced a [report](#) on “The EU Banking Regulatory Framework and its Impact on Banks”. The report laments the **low profitability of European banks**, in particular when compared to US banks. This comes, according to the authors with detrimental consequences for the wider EU economy.

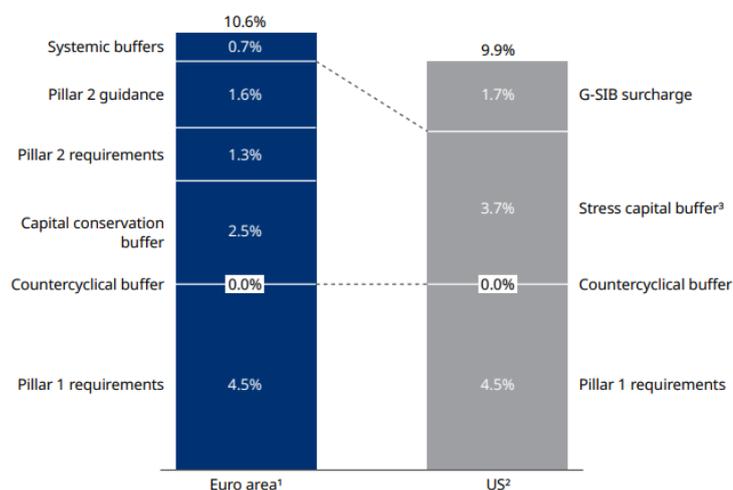
The authors point out that before the global financial crisis, EU and US banks showed similar profitability, while in the past two years, there was a difference of 2.3 and 4.3 percentage points in average return on equity, respectively. As to the underlying causes, their **key conclusion is that 0.8 to 1.0% percentage points of the lower profitability are caused by regulation.**¹¹ Since the authors base their analysis on the significant institutions directly supervised by the SSM, the Committee members may want to **seek the ECB’s views on the report.**

¹¹ The remainder of the difference would in the authors’ view be due to other factors, such as the macroeconomic environment in the EU vs. the US.

As regards capital, the report finds that EU banks hold 3.1 percentage points more CET1¹² capital than US peers, of which 1.3 percentage points are considered to directly result from higher regulatory requirements. The remainder of additional capital is in principle due to the bank's own decisions.

According to the report, the **1.3 percentage points CET1 capital due to higher regulatory requirements** chiefly result from comparing the so called "stress capital buffer requirement" in the US to the sum of capital conservation buffer, bank-specific Pillar 2 capital requirements and Pillar 2 guidance in the EU framework - see **Figure 7**. It is noteworthy that the authors treat **Pillar 2 guidance**, which in principle is a non-binding supervisory expectation, as part of the regulatory requirements. The authors suggest that the differences result from a simpler, more quantitatively deterministic model to accommodate bank specific requirements and expectations in the US. They also think that the SSM may turn to additional capital requirements more often where the US authorities would rather impose business limitations. In addition, they feel that the US process is more transparent to external parties.

Figure 7: EU vs. US Breakdown of CET1 capital requirements



Source: Oliver Wyman using data from ECB 2021 SREP results, Federal Reserve Dodd-Frank Act Stress Test 2022

The **remainder of additional capital** - in jargon referred to as "**management buffer**" - held by EU banks, compared to US banks, is in principle due to the bank's own decisions. However, the **authors suggest that it is also driven by SSM actions and expectations**:

- banks supposedly hold these "management buffers" in order to pay stable dividends when the SSM is more likely to impose dividend restrictions than US authorities and expects the Pillar 2 guidance mentioned above to be followed at all times;
- banks supposedly prepare with these buffers for future discretionary capital requirements when "supervisors place less importance on predictability" (sic), also in light of more difficult equity funding from markets for EU compared to US banks.

These claims are not corroborated with concrete evidence in the report, but it would nevertheless be interesting to obtain the SSM's take on them.

The **report does not discuss the impact of differences in the implementation of Basel III** on the EU-US comparison. As discussed in a [previous EGOV briefing](#) ("*joint call to stick to Basel commitments*"), A. Enria had raised concerns about potentially uncovered risks in the EU implementation of Basel III. Both the EU and the US deviate from the Basel III calculation of risk weighted exposure amounts in order to reflect specificities of their banks and economies, but the Basel Committee [considered](#) the impact of the EU's deviations to be greater. This might imply that the **higher capital ratios of EU banks under EU legislation may also be to an extent the result of EU specificities in their calculation**.

Finally, the authors see **further cost disadvantages** for EU compared to US banks resulting from the European framework for deposit guarantees and resolution funding, the requirements for loss-absorbing

¹² "Common equity tier 1", the highest quality category of regulatory requirements which chiefly results from issuing shares and retaining earnings

liabilities and a range of compliance issues like anti-money laundering. Since these are not in the SSM's remit, we will not discuss them in this briefing. What is however in the SSM' remit is the **cost of supervision**. In this regard, the authors assert that EU supervision is more *“process heavy, resulting in higher operational costs for banks compared to the more streamlined approach of the Federal Reserve”*. To corroborate that assertion, the authors list supervisory actions and processes on either side of the Atlantic; the list is longer for the EU context. However, this does in itself not support the conclusion that one approach is more costly than the other in terms of the resources that get tied up in banks for responding to supervisory requests. Moreover, the authors find the cost of supervisory work that supervisors invoice to banks to be lower in the EU than in the US. This observation does at least not lend obvious support to the view that the supervisory processes in the EU are more resource intensive, since one might expect that a more resource intensive supervision for banks goes together with higher cost for supervisors, which are subsequently charged to banks. It is of course conceivable that the cost incurred by the supervisor and subsequently charged to banks are higher in the US while those incurred at the banks are higher in the EU.

Box 1: Securitisation and EU vs US bank profitability

The [report](#) also points to the **role of securitisation** as an additional, structural, source of profitability differences in EU vs. US banks. In particular, the report presents a chart where additional securitisation activity increases CET1 capital ratios by almost 3 percentage points. There is no doubt that securitisation could play a more constructive role in financing loans for the EU economy. However, the presentation in the report needs to be taken *cum grano salis*. The authors are correct to observe that taken risky assets off banks' balance sheets frees up CET1. However, their **headline figures do not reflect that banks tend to retain riskier tranches** of their securitisations that require proportionally more capital, reducing the improvement of CET1. In this regard, the **comparison with US banks is moreover biased** since the US banks are still allowed to apply the more lenient rules of Basel II to retained tranches, while the new securitisation framework has been due for implementation since 2018. As to profitability, it should also be borne in mind that while securitisation frees up capital, it also requires sharing interest income with investors. By consequence, the headline improvements in CET1 ratios do not translate fully into improved profitability, either.

2023 EU-wide stress test - adverse scenario

Approximately every two years, the largest European banks¹³ undergo a stress test exercise led by the European Banking Authority (EBA); the ECB conducts its own stress test in parallel, for medium-sized banks that, due to their smaller size, are not included in the EBA-led stress test sample. The ECB applies the same stress test methodology and templates as EBA, and uses the same stress scenarios. The [adverse scenario](#) was provided by the European Systemic Risk Board (ESRB), the [baseline scenario](#) by national central banks. After the launch of the EBA 2023 EU-wide stress test exercise, the ESRB identified errors in certain values that had been transmitted to the EBA; those errors were subsequently corrected (see [letter](#) from the ESRB to EBA dated 1 March 2023).

The **adverse scenario** is in principle used **to assess the resilience of banks** to a hypothetical severe scenario of a significant deterioration in the overall outlook for the economy and financial markets in the next three years, and meant to ensure a significant level of severity across all EU countries.

For the 2023 stress test exercise, the EBA [press release](#) says that *“the narrative depicts an adverse scenario related to a hypothetical severe worsening of geopolitical developments, accompanied by an increase in commodity prices and resurgence of COVID-19 contagion. This results in high inflation and adverse effects on*

¹³ The scope of the EBA stress test [encompasses](#) 70 EU banks, covering roughly 75% of total banking sector assets in the EU and Norway, while the ECB [performs](#) stress test to 99 euro area banks, out of which 42 directly supervised banks that are outside the EBA stress testing sample. The previous stress testing exercise took place in [2021](#), during a time marked by pandemic confinement in most countries.

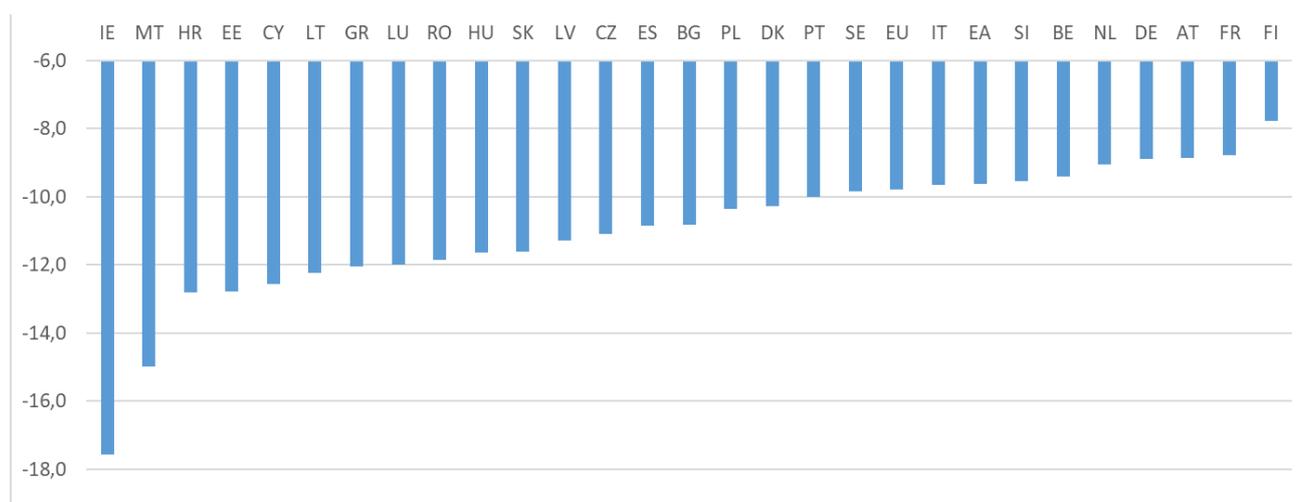
private consumption and investment coupled with a worldwide economic contraction. The worsening of economic prospects is reflected in a substantial global increase of long-term interest rates, a sustained drop in GDP and increased unemployment”.

The EBA writes that the adverse scenario for the 2023 exercise assumes for several macro-financial variables **more severe shocks than in previous stress tests**: In the adverse scenario, real GDP at the EU level is assumed to decline by 6% cumulatively over the three-year horizon, while the unemployment rate would increase by 6.1 percentage points, both relative to the starting point. The rate of inflation would also be well above the baseline over the whole horizon, by 3 ppts in 2023 and 1.5 ppts in 2025.

In comparison with stress test exercises in other relevant jurisdictions, the ESRB document sets out that the adverse scenario is “more severe than the 2022 scenarios of the Bank of England and the Federal Reserve System, which in part reflects the use of updated data”¹⁴.

A **key criticism** that has previously been made in relation to the EU-wide stress test exercise of 2018 seems still valid, though (see [R. Haselmann and M. Wahrenburg 2018](#)): “**The adverse scenario has a highly asymmetric impact on different European countries**”, affecting some countries considerably more than others. To illustrate that aspect with a concrete example representing a significant component in the calculation, see **Figure 8**, which shows the assumed differences in GDP deviation in 2025, as compared to the baseline level, sorted by the size of deviation (the table in the annex contains additional information on historical growth, assumed growth in the baseline and adverse scenario, and the cumulated effects).

Figure 8: Adverse scenario in the stress test - assumed GDP deviations in 2025 (%)



Sanction for failing to report cyber incident within deadline

The European Central Bank, on 7 December 2022, imposed a EUR 3.15 million [administrative penalty](#) on the Spanish bank ABANCA Corporación Bancaria, S.A. (ABANCA), for having knowingly **failed to report a significant cyber incident** to the ECB within a prescribed two-hour deadline. That amount is equivalent to approximately 1% of the bank’s profit before taxes in 2022 (see consolidated [financial statements](#) for 2022).

That was the first time that a directly supervised bank was sanctioned with a penalty (cp. [ECB list of sanctions](#)) for having breached the two-hour deadline prescribed by the cyber-incident **reporting**

¹⁴ The Federal Reserve released its 2022 stress test scenario before the Russian invasion of Ukraine, the Bank of England’s Annual Cyclical Scenario was prepared prior to the aggravation of geopolitical tensions and the gas supply cut from Russia.

framework that the ECB implemented in 2017 (see [Lautenschläger 2019](#)); the ECB's cyber-incident reporting framework as such is **not publicly available**.

Nowadays, cyber-attacks can be considered as one of the main threats to banks, and given the high level of interconnectedness within the financial sector, they can also pose a threat to the stability of the overall financial ecosystem (see [ECB on cyber-resilience](#); enhancing cyber resilience is also a key element of the [FSB's work programme](#) to promote financial stability; for more details, also see ESRB [briefing](#)).

The ECB placed cyber-risks among the supervision [priorities for the 2023-2025 period](#), paying particular attention to the risk stemming from the **outsourcing** of IT activities; in the case at hand, however, the ECB's press release does not give any indication as to whether outsourcing aspects have or have not played any role for the delayed reporting of ABANCA.

Enhanced Code of Conduct for high-level ECB officials

The ECB has [published](#) an enhanced Code of Conduct applicable for all high-level ECB officials.¹⁵ The revised rules aim at enhancing the ECB's accountability and transparency, and shall mitigate the risks of misuse of confidential information and possible conflicts of interest. The revised Code of Conduct (the first version had been introduced in January 2019) entered into force on 1 January 2023. It includes **three new key elements** and will apply to all serving high-level ECB officials and for six months beyond the end of their term in office.

First, additional restrictions apply to the private financial transactions of the high-level ECB officials. *"Under the enhanced rules, high-level ECB officials must **limit investments to publicly listed, broadly diversified collective investment schemes such as exchange-traded funds and mutual funds**".* This rule, however, does **not apply retroactively**. Hence, high-level ECB officials are allowed to maintain investments into the assets that became prohibited with the change of the Code of Conduct, if those assets had been purchased before the rules entered into force.

Second, high-level ECB officials are obliged to **publicly disclose all financial transactions undertaken** during the last calendar year. It should be noted that this disclosure obligation also extends to the close family, i.e. spouses and minor children, if financial transactions exceed EUR 10.000 during the calendar year. That information will be published annually together with the Declarations of Interests.

Third, the focus on medium to long-term investments has been strengthened by the enhanced rules. To this end, the **minimum holding period has been extended from one month to at least one year** for all assets. Additionally, a requirement of at least 30 days' advance notice has been introduced for transactions exceeding EUR 50.000.

New MoU with EU national supervisors not part of the SSM

The European Central Bank has concluded a [multilateral Memorandum of Understanding \(MoU\)](#) with the national competent authorities (NCAs) of the six EU Member States that are not part the SSM. **The MoU will provide a framework for Czech Republic, Denmark, Hungary, Poland, Romania and Sweden to share information and coordinate supervisory activities.** The agreement aims to enhance supervisory cooperation. The MoU provides a framework for Member States to regularly exchange information on supervisory matters and issues concerning cross-border supervised institutions, as well as on supervisory methodologies, approaches and priorities. This is important as some banks supervised by the ECB have

¹⁵ Enhanced Code of Conduct covers the members of the Governing Council, the Executive Board, the Supervisory Board, the General Council, the Audit Committee, the Ethics Committee and the Administrative Board of Review.

subsidiaries in or sizeable credit exposures towards borrowers in those Member States. Conversely, some institutions based in non-participating Member States also have a significant presence in Member States participating in the SSM. The conclusion of the MoU goes back to a requirement in Article 3 of the SSM regulation, which entered into force in 2013.

The memorandum states that authorities **intend to inform** each other proactively of dangers, financial difficulties, material violations of law and impending license revocations concerning the banks of mutual interest. There is a similar statement of intent to cooperate in authorisation procedures, qualifying holdings assessments and fit and proper assessments. More binding language is used announcing that the authorities “*will endeavour*” to inform each other of supervisory measures in advance. The same language is used regarding mutual information and coordination in emergency situations, with regard to which [Article 114 CRD](#) requires the consolidating supervisor to inform the host supervisors of a group. The MoU also sets out that **regular meetings, training initiatives and staff exchanges may take place**. The [press release](#) of the ECB announces that the MoU “*boosts supervisory cooperation through shared information, and fosters common supervisory culture*”. It may hence be interesting to evaluate at future hearings how cooperation evolves in practice.

Annex

Assumed GDP level deviation in 2025 in the adverse scenario of the 2023 EU-wide stress exercise

	Historical growth (%)	Baseline growth (%)			Adverse growth (%)			Level of deviation in 2025 (%)
	2022	2023	2024	2025	2023	2024	2025	
Ireland	12,9	4,9	6,6	4,3	-1,3	-3,3	0,8	-17,6
Malta	6,8	3,7	3,6	3,5	-0,4	-5,4	0,4	-15,0
Croatia	6,3	1,4	3,0	2,3	-3,5	-5,1	1,8	-12,8
Estonia	-0,5	0,4	3,1	4,4	-4,0	-2,2	0,4	-12,8
Cyprus	5,8	2,5	3,1	3,1	-1,6	-4,6	1,4	-12,6
Lithuania	2,5	1,3	3,8	3,5	-1,8	-2,6	-0,2	-12,2
Greece	6,2	1,5	3,0	2,8	-1,9	-4,5	0,9	-12,1
Luxembourg	1,8	1,6	2,6	2,6	-2,6	-3,8	0,4	-12,0
Romania	7,2	2,0	2,1	3,4	-2,9	-5,5	3,6	-11,8
Hungary	3,5	1,0	4,0	3,5	-3,8	-4,0	4,0	-11,6
Slovakia	1,5	1,1	3,2	2,7	-3,9	-4,2	3,0	-11,6
Latvia	2,1	-0,3	4,4	3,5	-4,4	-3,1	3,1	-11,3
Czech Republic	2,2	-0,7	2,5	3,1	-4,7	-4,8	2,9	-11,1
Spain	4,6	1,3	2,7	2,1	-2,6	-2,9	0,1	-10,9
Bulgaria	2,8	0,1	3,4	3,5	-4,3	-2,3	2,1	-10,8
Poland	4,6	0,4	1,7	3,2	-3,0	-4,6	2,2	-10,4
Denmark	2,0	-0,1	1,2	1,6	-3,9	-4,6	0,5	-10,3
Portugal	6,8	1,5	2,0	1,9	-1,6	-3,1	-0,4	-10,0
Sweden	2,7	-0,7	1,1	1,9	-5,0	-3,7	0,8	-9,8
EU	3,4	0,4	1,8	1,9	-3,5	-4,2	1,6	-9,8
Italy	3,8	0,4	1,2	1,2	-2,6	-5,7	1,1	-9,7
Euro area	3,4	0,5	1,9	1,8	-3,4	-4,1	1,6	-9,6
Slovenia	5,0	0,8	2,4	2,3	-1,5	-2,8	-0,2	-9,5
Belgium	3,1	0,6	1,7	1,8	-2,7	-4,9	2,0	-9,4
Netherlands	4,2	0,8	1,6	1,6	-2,2	-3,6	0,3	-9,0
Germany	1,8	-0,5	1,7	1,4	-5,2	-4,3	3,1	-8,9
Austria	4,9	0,6	1,7	1,6	-3,4	-4,0	2,1	-8,9
France	2,6	0,3	1,2	1,8	-2,9	-3,9	1,1	-8,8
Finland	1,9	-0,5	1,1	1,5	-3,6	-3,3	1,0	-7,8

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