EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Press release

19 December 2023

ECB keeps capital requirements steady in 2024, refocuses supervisory priorities

- SREP results show banks have solid capital and liquidity positions and increased profitability
- Internal governance, risk management and capital planning remain key areas for supervisory action in light of deteriorating risk outlook
- Overall average SREP score broadly unchanged; 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

The European Central Bank (ECB) today published the results of its Supervisory Review and Evaluation Process (SREP) for 2023 and its supervisory priorities for the years 2024-26.

The SREP is a core activity of European banking supervisors, enabling them to assess the risks banks face and how well banks are managing them. 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 euro area banking sector continued to be strong and resilient in 2023. On average, banks maintained solid capital and liquidity positions, well above regulatory requirements. Banks' profitability returned to levels not seen in over a decade, strengthening their ability to withstand external shocks, as the results of the 2023 EU-wide stress test showed.

The weak macroeconomic outlook, however, and tighter financing conditions remain a source of risk for European banks. The rapid increase in interest rates has helped boost banks' overall profitability,

European Central Bank
Directorate General Communications
Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany
Tel.: +49 69 1344 7455, email: media@ecb.europa.eu, website: www.bankingsupervision.europa.eu

but this effect will diminish as they pass higher interest rates on to depositors. At the same time, higher rates have contributed to credit, valuation and liquidity risks. The March 2023 market turmoil highlighted just how important it is for the banking sector to manage interest rate risk effectively.

In this context, the average SREP score remained broadly stable at 2.6 (in a range of 1 to 4), with 70% of banks scoring the same as in 2022, 14% scoring worse and 15% scoring better.

The ECB stepped up efforts to ensure banks took overdue action to address outstanding findings and measures imposed on them. It issued qualitative measures, a key component of its supervisory toolkit, primarily to address deficiencies related to internal governance, credit risk management and capital planning. 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.

During the 2023 cycle, supervisors worked to gain a better understanding of the factors underlying weak business models. They noted that recurring structural weaknesses are attributable to poor strategic planning and insufficient diversification, further exacerbated by shortcomings in internal governance.

After this assessment, the bank-specific Pillar 2 requirement (P2R) for Common Equity Tier 1 (CET1) capital slightly increased on average from 1.1% to around 1.2% of risk-weighted assets (RWAs). The P2R includes add-ons for risky leveraged finance for eight banks, and add-ons for non-performing exposures for 20 banks.

The overall requirements and non-binding Pillar 2 guidance in terms of CET1 capital increased on average to 11.1%, compared with 10.7% in 2023. This was driven mainly by several countries re-introducing or increasing their countercyclical capital buffers and, to a lesser extent, by changes in risk profiles and in add-ons for non-performing exposures. The overall requirements and Pillar 2 guidance in terms of total capital increased slightly to 15.5% of RWAs, from 15.1% in the 2022 SREP cycle.

The ECB, for the first time, applied a leverage ratio Pillar 2 requirement to six banks with a particularly high risk of excessive leverage. This bank-specific mandatory requirement amounted on average to 10 basis points and is in addition to the minimum 3% leverage ratio binding requirement for all banks. The ECB also applied a leverage ratio Pillar 2 guidance to seven banks.

In addition, the ECB imposed quantitative liquidity measures on three banks, requiring minimum survival periods and a currency-specific liquidity buffer.

European Central Bank
Directorate General Communications
Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany
Tel.: +49 69 1344 7455, email: media@ecb.europa.eu, website: www.bankingsupervision.europa.eu

In this context, the ECB has slightly refocused its supervisory priorities for the next three years. To strengthen banks' resilience to immediate macro-financial and geopolitical shocks (Priority 1), the ECB will ask banks to address shortcomings in their asset and liability frameworks and credit and counterparty credit risk management. Banks must also accelerate the effective remediation of shortcomings in internal governance and the management of climate-related and environmental risks (Priority 2). Furthermore, they must make further progress in their digital transformation and in building robust operational resilience frameworks (Priority 3).

For media queries, please contact Andrea Zizola, tel.: +49 69 1344 6551.

Notes

- **The SREP is an annual exercise** in which supervisors examine banks' risks and produce capital requirements and guidance for each individual bank (which is in addition to legally required minimum capital). The SREP assesses four main elements: the viability and sustainability of business models, the adequacy of internal governance and risk management, risks to capital and risks to liquidity and funding. Each element is given a score ranging from 1 to 4 (with 1 being the best and 4 the worst). These scores are then combined to produce an overall score (which also ranges from 1 to 4).
- The 2023 SREP assessment cycle was generally based on year-end data for 2022. The decisions resulting from the 2023 SREP assessment are applicable in 2024.
- The capital that banks are expected to maintain as a result of the SREP consists of two parts. The first is **the Pillar 2 requirement (P2R)**, which covers risks that are underestimated or not covered by Pillar 1. The second is **the Pillar 2 guidance (P2G)**, which indicates the level of capital that a bank should maintain in order to have a buffer sufficient to withstand stressed conditions (as assessed, in particular, on the basis of the adverse scenario in the supervisory stress tests). While the P2R is binding and breaches can have direct legal consequences for banks, the P2G is not binding.
- The Pillar 2 requirement does not encompass the risk of excessive leverage, which is covered by the leverage ratio Pillar 2 requirement. **The leverage ratio Pillar 2 requirement** is expressed as a percentage of the leverage ratio exposure measure, which includes a bank's assets and off-balance-sheet items, irrespective of how risky they are. It is therefore a non-risk-based requirement.
- **Overall capital requirements and guidance** means Pillar 1 + Pillar 2 requirement + combined buffer requirement + Pillar 2 guidance. See the Supervisory Methodology for additional information on the composition of the capital stack. All figures are reported as percentages of risk-weighted assets.
- **Combined buffer requirements** comprise the capital conservation buffer, the countercyclical capital buffer and systemic buffers (whereby systemic buffers comprise buffers for global systemically important institutions, other systemically important institutions and systemic risk), which are legal requirements established by the EU's Capital Requirements Directive (CRD IV) or by national authorities.

European Central Bank
Directorate General Communications
Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany
Tel.: +49 69 1344 7455, email: media@ecb.europa.eu, website: www.bankingsupervision.europa.eu