2019 EU-WIDE TRANSPARENCY EXERCISE AND RISK ASSESSMENT REPORT

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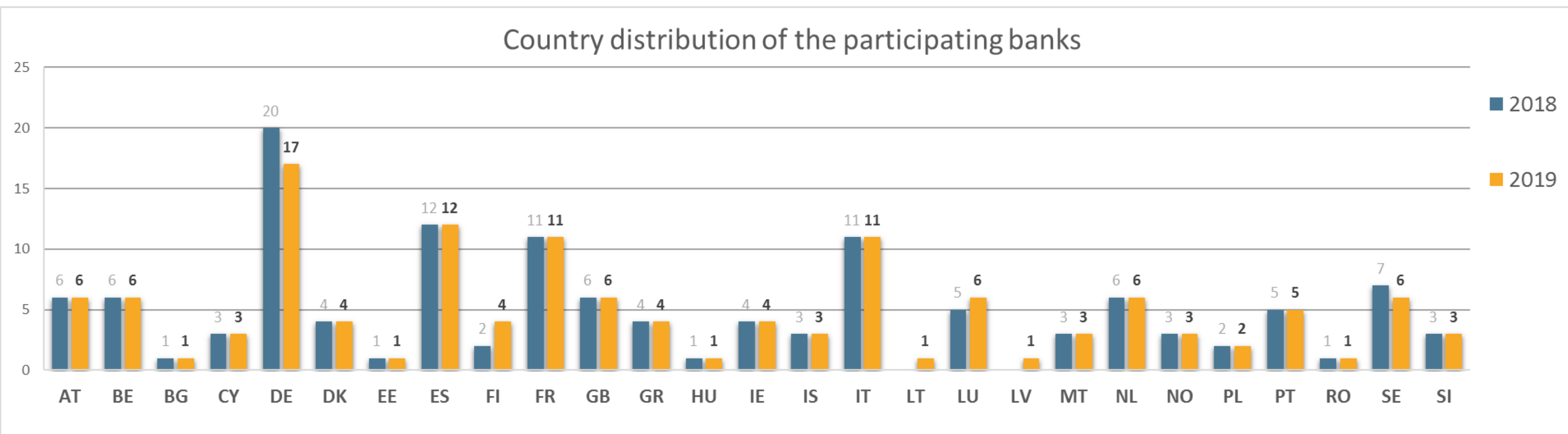
Background briefing with analysts and journalists | 29 November 2019

Outline of the presentation

- **Transparency exercise – what we publish today**
- Risk Assessment Report: main findings, outlook and policy implications

Sixth Transparency Exercise covering 131 banks

- Sixth EU-wide Transparency exercise (2019, 2018, 2017, 2016, 2015, 2013) excluding the transparency data provided in the Stress Tests.
- Up to 16,450 data points per bank, 131 banks from 27 EEA countries.
- Reference dates: **September 2018**, **December 2018**, **March 2019** and **June 2019** (quarterly data disclosure introduced in this year's exercise).
- Exclusively based on supervisory reporting data (FINREP, COREP). Information mostly in line with previous exercises to ensure continuity in the time series, and
    - new templates on financial assets and key metrics introduced,
    - RWA OV1 template revised to include Pillar 3 disclosures.

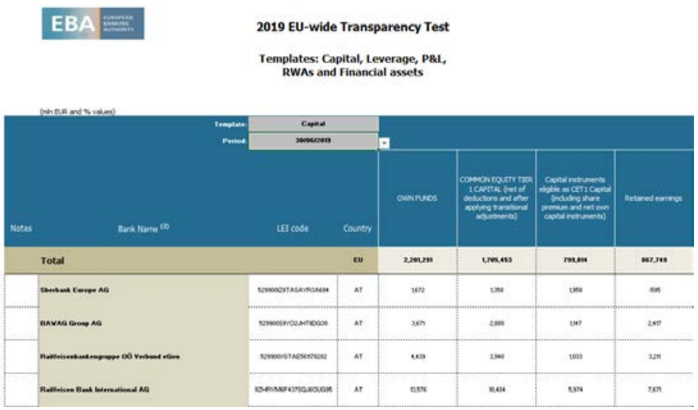


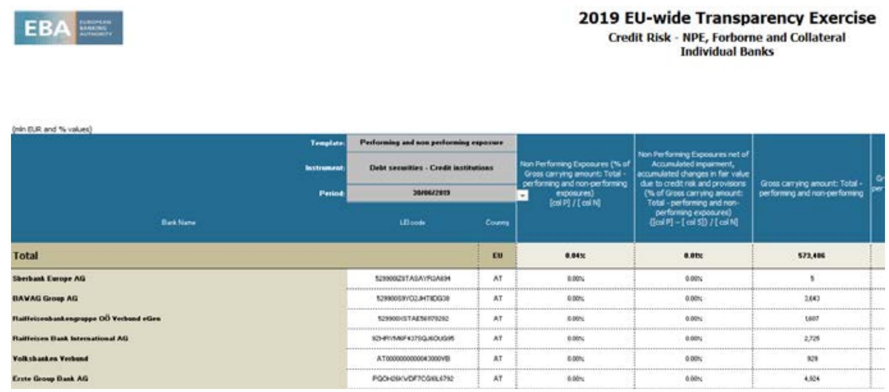
Detailed data is available on the EBA website

- **Database:**
  - ✓ **CSV Data** : Credit risk, Market risk, Sovereign debt exposures, Other templates
  - ✓ **Data dictionary**
  - ✓ **Metadata**
  - ✓ **Manual for using and managing data**
- **Single bank PDFs**
- **Interactive tools:**
  - ✓ **Excel tools**
    - Capital, Leverage, P&L, RWAs and Financial assets (1 file)
    - NPE and forborne exposures (2 files)
    - Credit Risk (3 files)
    - Sovereign (3 files)
    - Market risk (1 file)
  - ✓ **Map tool**

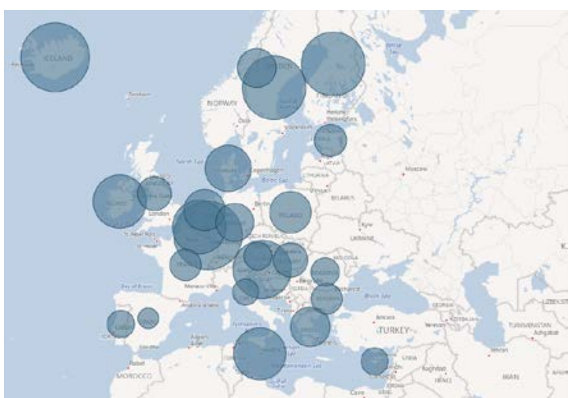
Exploiting data in an interactive way

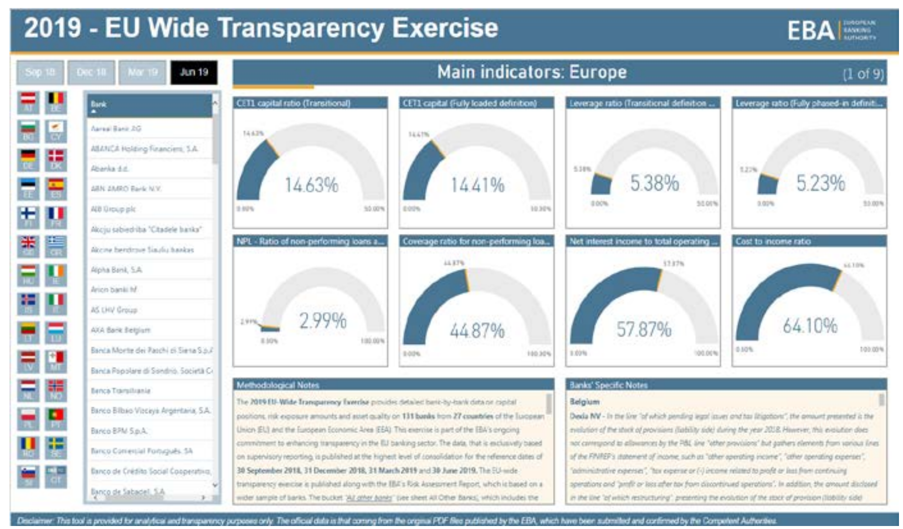
- **Excel interactive tools (downloadable)**: user friendly Excel tools for each template that allows analysing and retrieving data. Comparison by template at bank and country level.





- **Interactive dashboards:** allowing country/banks comparison through maps and advanced charts.





Outline of the presentation

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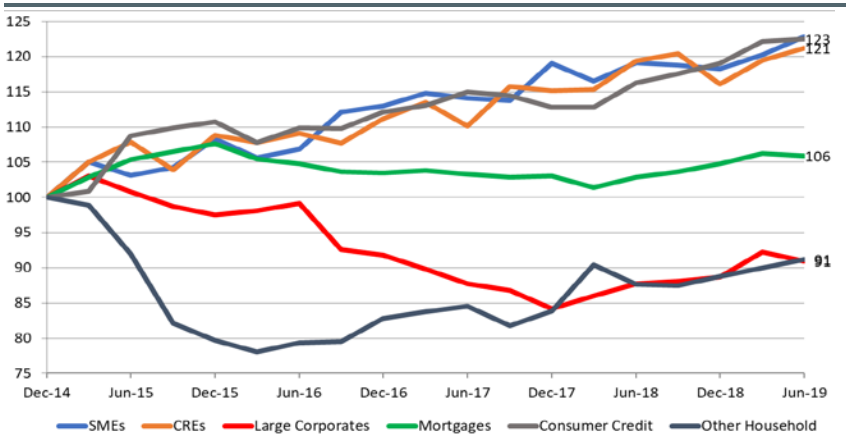
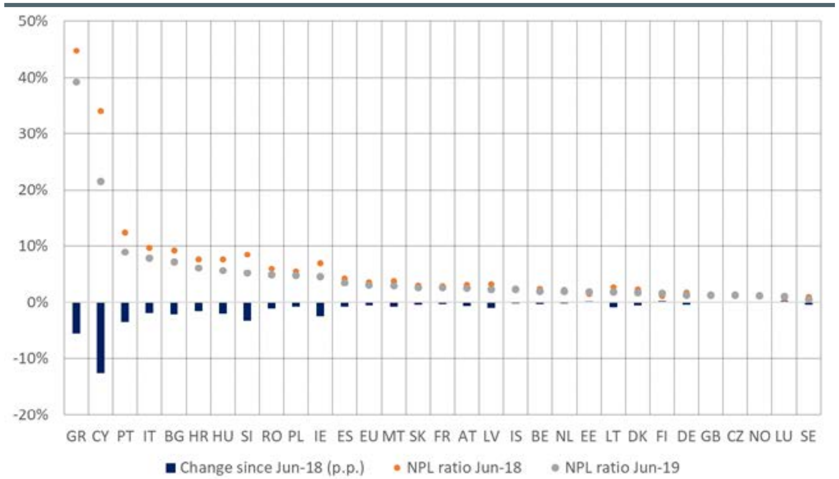
- **Risk Assessment Report: main findings, outlook and policy implications**

Banks have increased their riskier lending portfolios

Evolution of segments of loans and advances valued at amortised cost



NPL ratios by country in June 2018 and June 2019 (%) and p.p. change

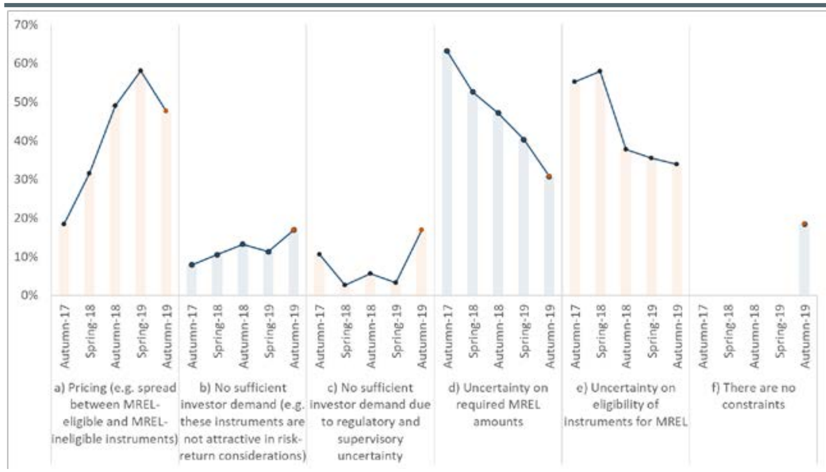


Source for all charts: Supervisory reporting.

- **Asset volumes increased by 3%** between June 2018 and June 2019, confirming the **end of the deleveraging trend**.
- Over the past few years, **riskier lending exposures** (consumer, CRE and SME financing) have **increased the most**.
- **The NPL ratio decreased from 3.6% to 3% YoY** (June 2019). The biggest contractions could be observed in countries with higher ratios. Despite this improvement in asset quality, **the NPL ratio declined at a slower pace** over the last quarters.
- Looking ahead, **banks expect a deterioration in asset quality** for most of their loan portfolios. At the same time, they plan to increase some of these portfolios in volume, like SME and consumer lending.

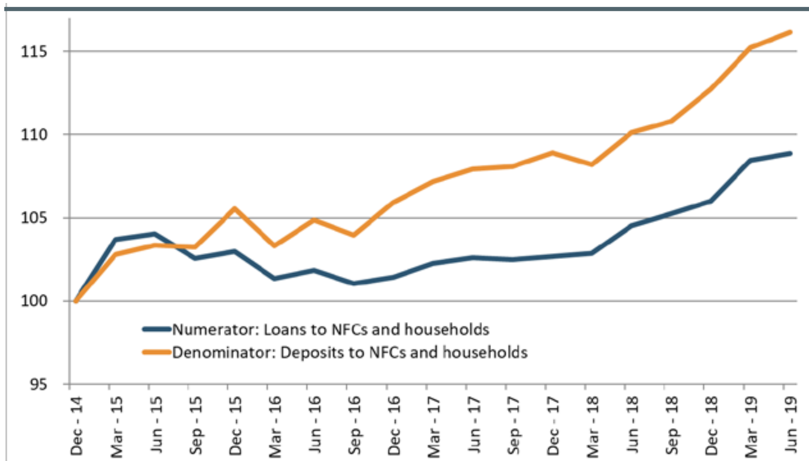
Funding conditions have improved in 2019

Constraints to issuing subordinated instruments eligible for MREL



Source: EBA Risk Assessment Questionnaire.

Loan-to-deposit ratio dynamics (trends of numerator and denominator)

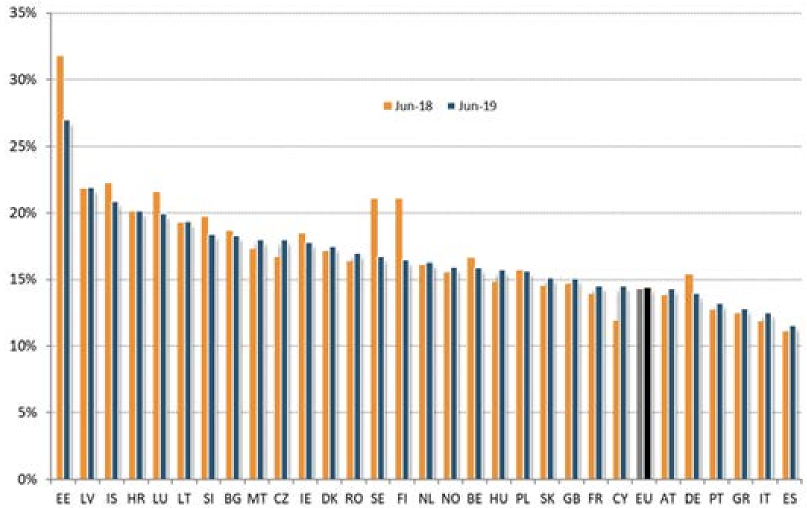


Source: Supervisory reporting.

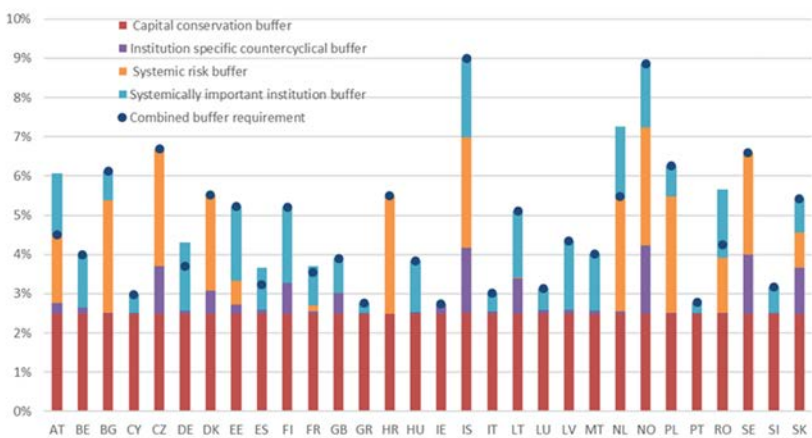
- Amidst further monetary easing and yields at low levels, **market funding conditions have improved** this year.
- Banks have taken advantage of these conditions to build their MREL buffers. In the last Risk Assessment Questionnaire (RAQ), **the percentage of banks indicating constraints to meet MREL requirements due to pricing decreased**.
- Similar to loans, also customer **deposits kept on growing** even though deposit rates are at historically low levels.
- Some banks charge **negative interest rates for corporate and household deposits above certain thresholds**. The effects of the latter measures on deposit stability remain to be seen.

Stable capital ratios amid growing capital and RWAs

CET1 ratio, by country, June 2019 vs. June 2018 (fully-loaded)



Capital buffer requirements and combined buffer, as % of RWA, by country, as of June 2019

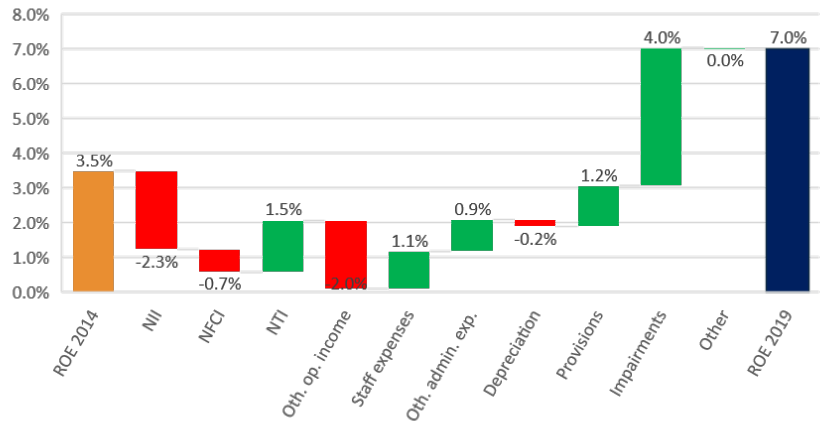


Source for all charts: Supervisory reporting.

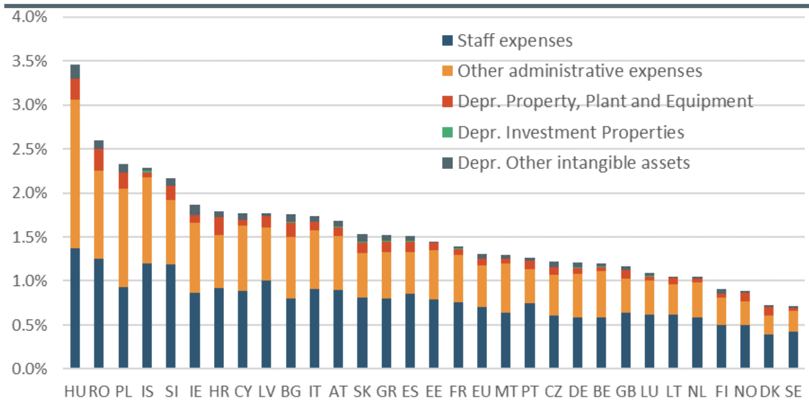
- **The CET1 ratio (fully loaded) was slightly up from** 14.3% to 14.4% YoY. Notwithstanding a still wide dispersion, **banks on the lower ends have increased their ratios** (from 11.5% to 11.8% for the 5th percentile and from 13.5% to 13.9% for the first quartile).
- **RWAs have grown less than total assets** (2.5% vs 3%). Moreover, credit risk, went up by 2.3% since June 2018, less than total loans (3.5%).
- There are significant differences in capital **buffers across countries**, reflecting differences in banks' risk profile and structures of national banking systems. For O-SII buffers, there are also indications for divergences in their application and setting.

Costs remain a key challenge for banks

Contribution to the improvement in RoE of the main P&L items since 2014



Breakdown of operating expenses as a percentage of total assets, by country (June 2019)

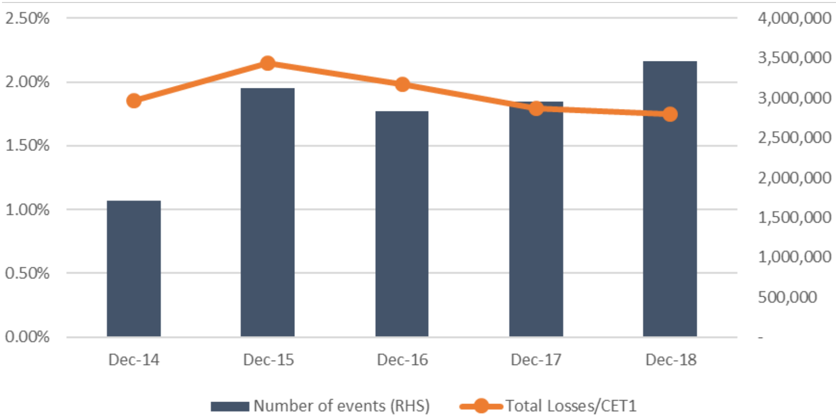


Source for all charts: Supervisory reporting.

- **Banks' ROE decreased slightly** from June 2018 (7.2%) to June 2019 (7%). Market valuations reflect **unattractive profitability prospects** since only 28% of listed EU banks trade with a PtB above 1 (81% in the US).
- Over the past few years, the increase in profitability has been driven by a decrease in impairments. However, **in 2019 impairments grew by 33%**.
- **The decreasing trend in net interest income was halted in 2019**. This improvement was driven by an increase in lending volumes, since the net interest margin remained low.
- Costs tend to be comparatively high for CEE countries, but rather **low in the Nordics**.
- This reflects the already high levels of **digitalisation and automatisation**, and low branch density.

Further increasing numbers of new operational risk events

Total losses from events in operational risk as a share of CET1 and number of new events



Source: Supervisory reporting.

Operational risk decomposition as seen by banks and analysts

Source: EBA Risk Assessment Questionnaire.

- The **number of new events** in operational risk **increased** YoY, continuing a trend from former years. However, total losses from OpRisk events slightly contracted.
- The reason for the latter is that these losses are only those incurred so far. **Additional losses**, like further provisioning, fines, payments for compensation etc. might be incurred in the **coming years**.
- Additionally, **reputational losses** (loss of clients, higher funding costs, costs to improve banks' governance etc.) are not included.
- **50% of banks and analysts expect operational risk to increase**, though they differ in the sources.
- The **sophistication of digitalised banking and competitive pressure from FinTech firms** have led banks to point at cyber risk as the main source of operational risk.
- **Analysts are more concerned about AML/CTF** and **conduct and legal risk**.

Conclusions and policy recommendations

- **The soundness of the EU banking system improved in 2019** thanks to a slight increase in capital ratios. Also asset quality continued to improve, though at a slower pace than in former years.
- There are challenges on the horizon that deserve close monitoring. **Banks have significantly increased their riskier lending portfolios** (consumer, CRE and SME financing) and, looking forward, they plan to keep increasing these exposures. Under a bleak economic outlook, banks should avoid an unduly easing of credit standards.
- **Weak macroeconomic conditions let more banks expect a deterioration in credit quality.** Timely and stringent provisioning policies might allow banks to continue to reduce their impaired assets.
- Banks should take advantage of the current low interest rate environment to **build up their MREL buffers**.
- Charging **negative rates** for NFCs and household deposits **might challenge the traditional stable behaviour of depositors** and, thus, the stability of banks' funding mix.
- There are indications of **differences in the application and setting of the O-SII buffer**. Some harmonisation might be needed.
- **Banks need to streamline their operating expenses** to weather a challenging environment for profitability. Measures to tackle the profitability and cost related challenges might include **M&As as well as orderly exits** of banks which do not reach sustainable profitability levels.
- It is essential that **both banks and third-party providers apply adequate means to deal with cyber risks**.
- **Banks need to properly identify and address their AML/CTF related operational weaknesses** and prudential supervisors should include AML/CTF risks in SREP and closely cooperate with AML/CTF supervisors.

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