European Banking Authority

2023

EU-wide Transparency exercise and Risk Assessment Report

The EU banking sector remains resilient despite pockets of risk stemming from the change in interest rates

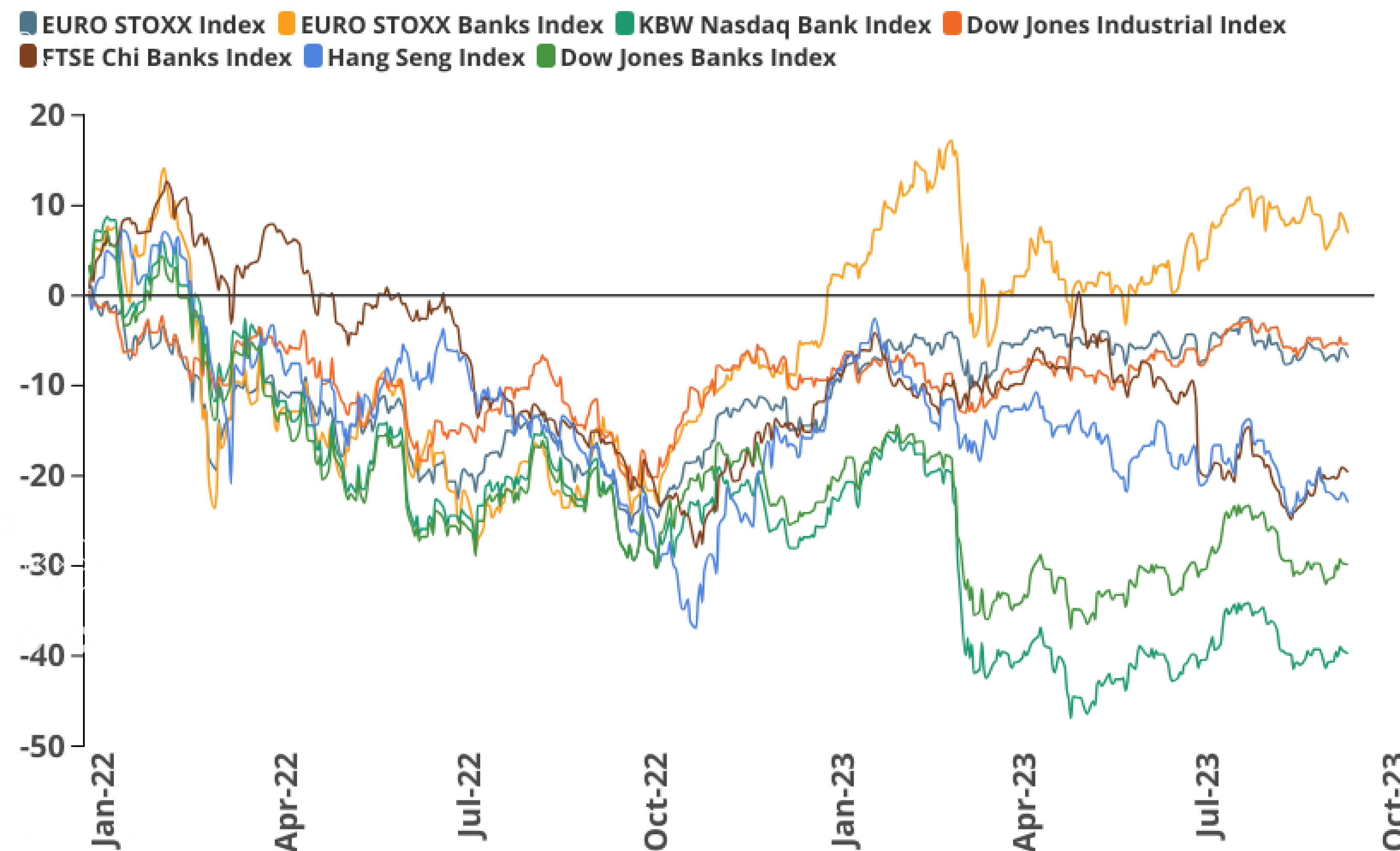
European Banking Authority

- The EU/EEA banking sector has proven to be resilient in the aftermath of the banking turmoil in March.
- Capitalisation remains high with an average common equity tier 1 (CET1) ratio, at its highest reported point (16%). Underlying profitability has supported banks’ payouts.
- Elevated interest rate levels have so far supported widening interest margins, but this might have reached its turning point.
- Asset quality remains robust, yet subdued economic growth and elevated interest rate levels create pockets of risks.
- Liquidity remains high, but it started normalising from its pandemic highest levels.
- Market funding costs have increased in line with interest rates, yet deposits rates have remained comparatively low but might rise going forward.

Macroeconomic uncertainty creates bouts of volatility

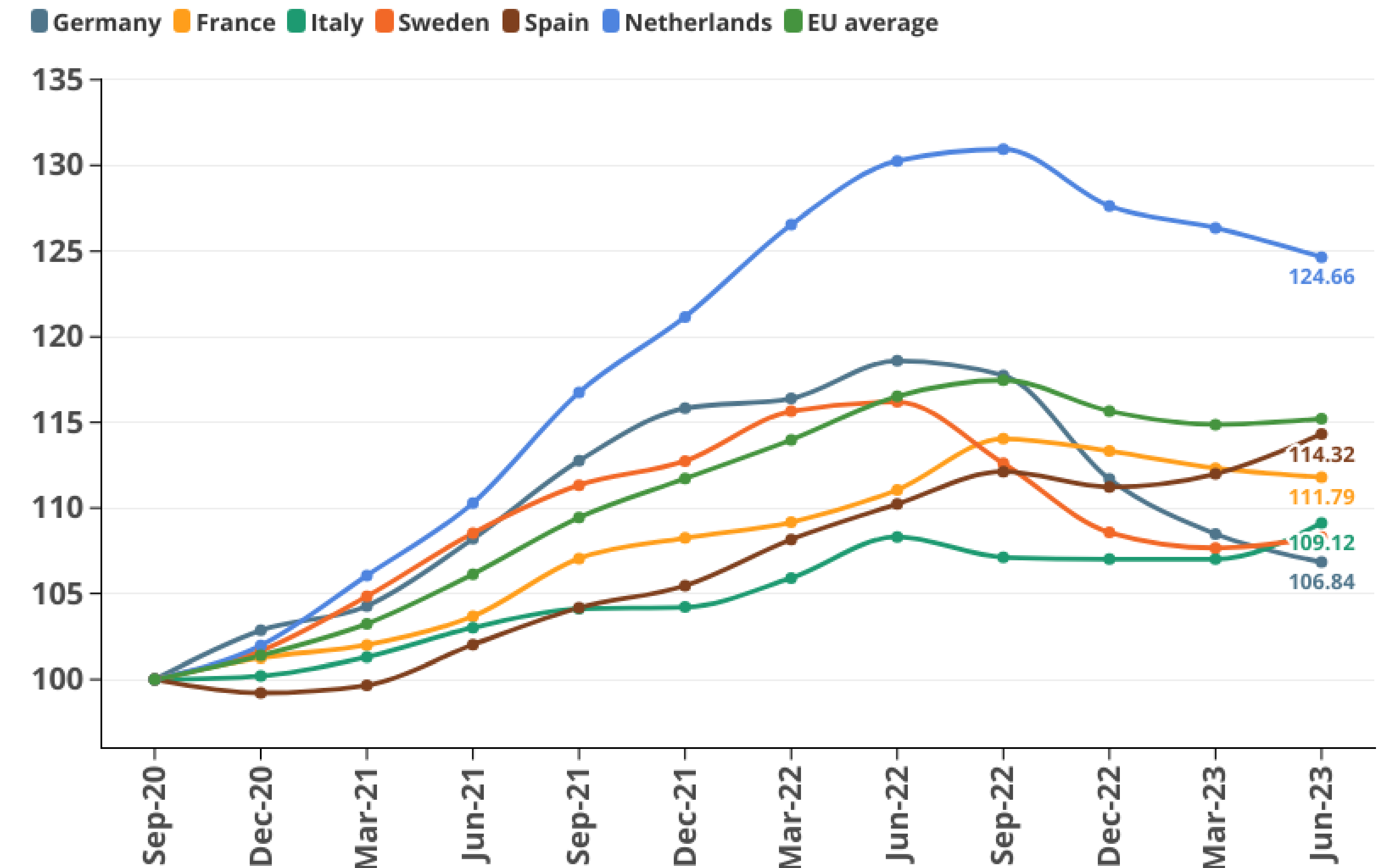
European Banking Authority

Selected share price indices (relative increase since 4 January 2022)



Source: S&P Capital IQ

House price indices for selected countries (Q3 2020 = 100)



Source: Eurostat

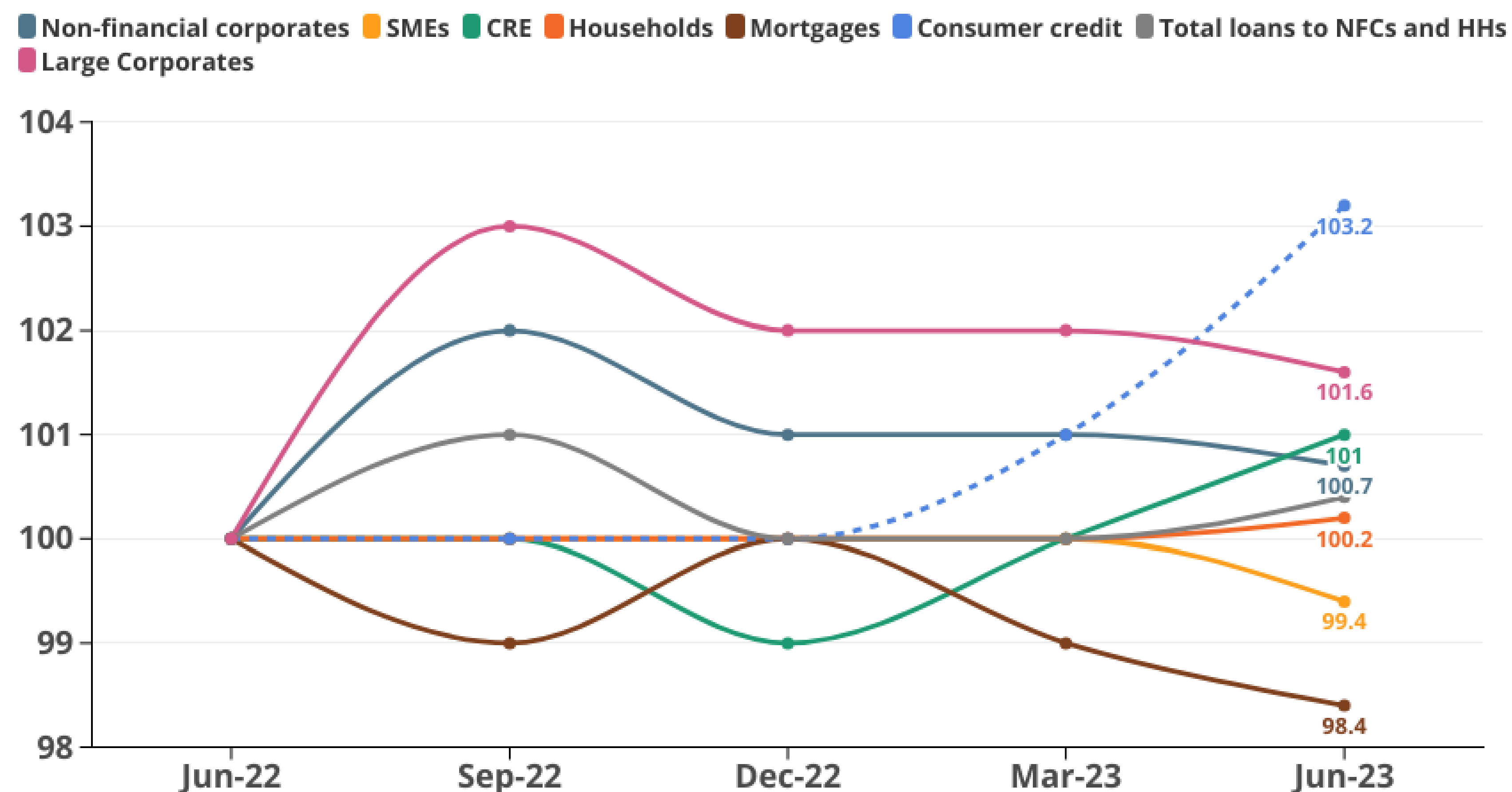
- Subdued economic growth, inflationary pressures, elevated interest rate levels and heightened uncertainty not least due to geopolitical tensions, have created an uncertain macroeconomic environment.
- High interest rate levels have weighed on consumers’ and businesses’ confidence affecting consumption and investment spending.
- Real estate prices stopped increasing. In some regions certain corrections have been seen.

Macroeconomic uncertainty and interest rate levels weigh on loan growth

eba European Banking Authority

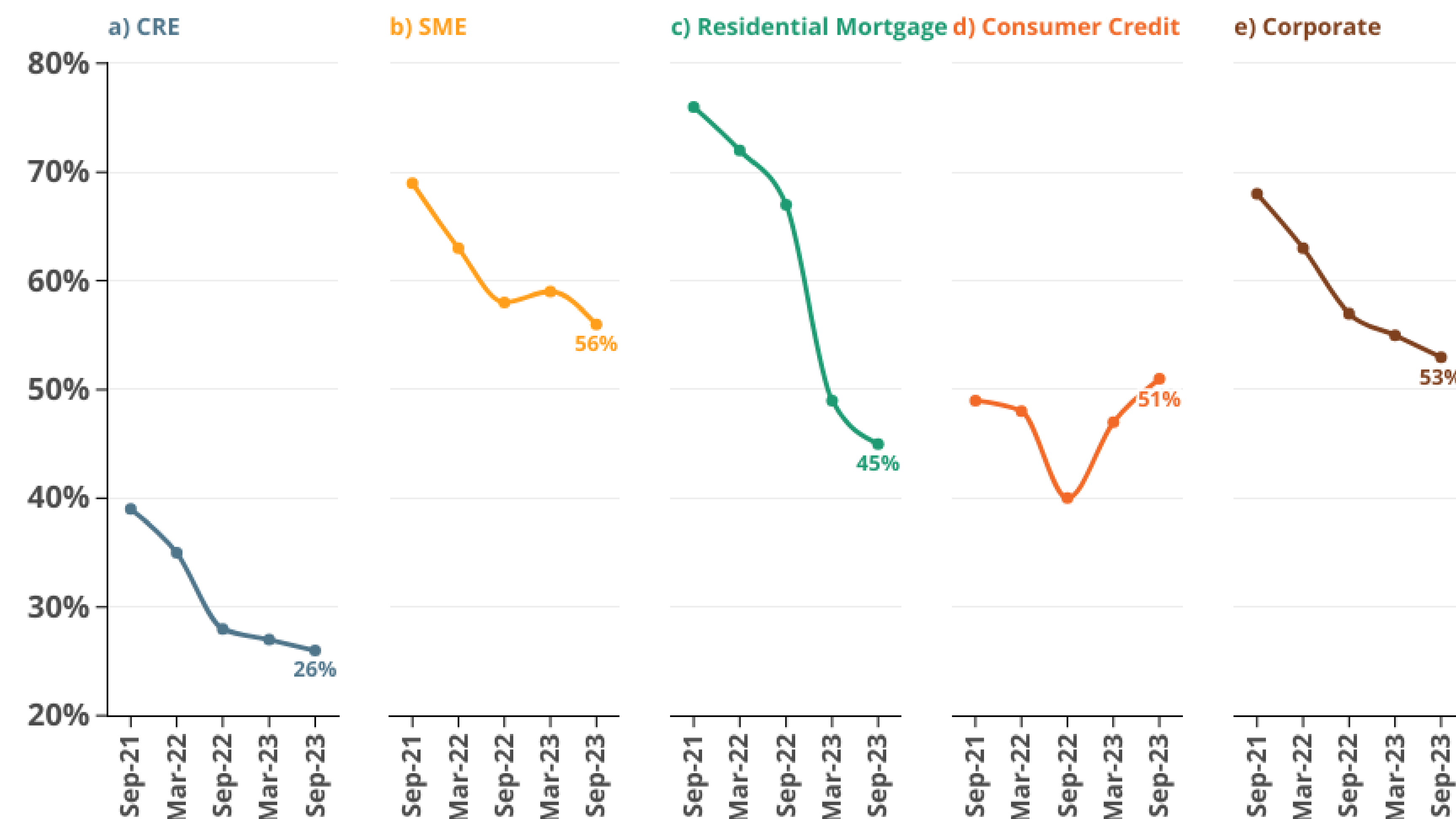
- EU/EEA banks reported total assets of EUR 27.6tn, (-1.9% YoY), mainly a result of a reduction of close to EUR 540bn in cash balances (-12.7% YoY).
- Outstanding total loans reported by EU/EEA banks as of June 2023 were just above EUR 17.1tn (+1% YoY). During the first two quarters of 2023, banks reported negative loan growth of close to 0.4%.
- Demand for loans (both retail and corporate) has markedly slowed down and banks' risk appetite to grow their lending portfolio is limited. Less banks aim to increase their exposures in core portfolios.

Growth in loans and advances by segment, June 2022 to June 2023 (June 2022 = 100)



Source: EBA supervisory reporting data

Portfolios which banks expect to increase in volumes in the next 12 months

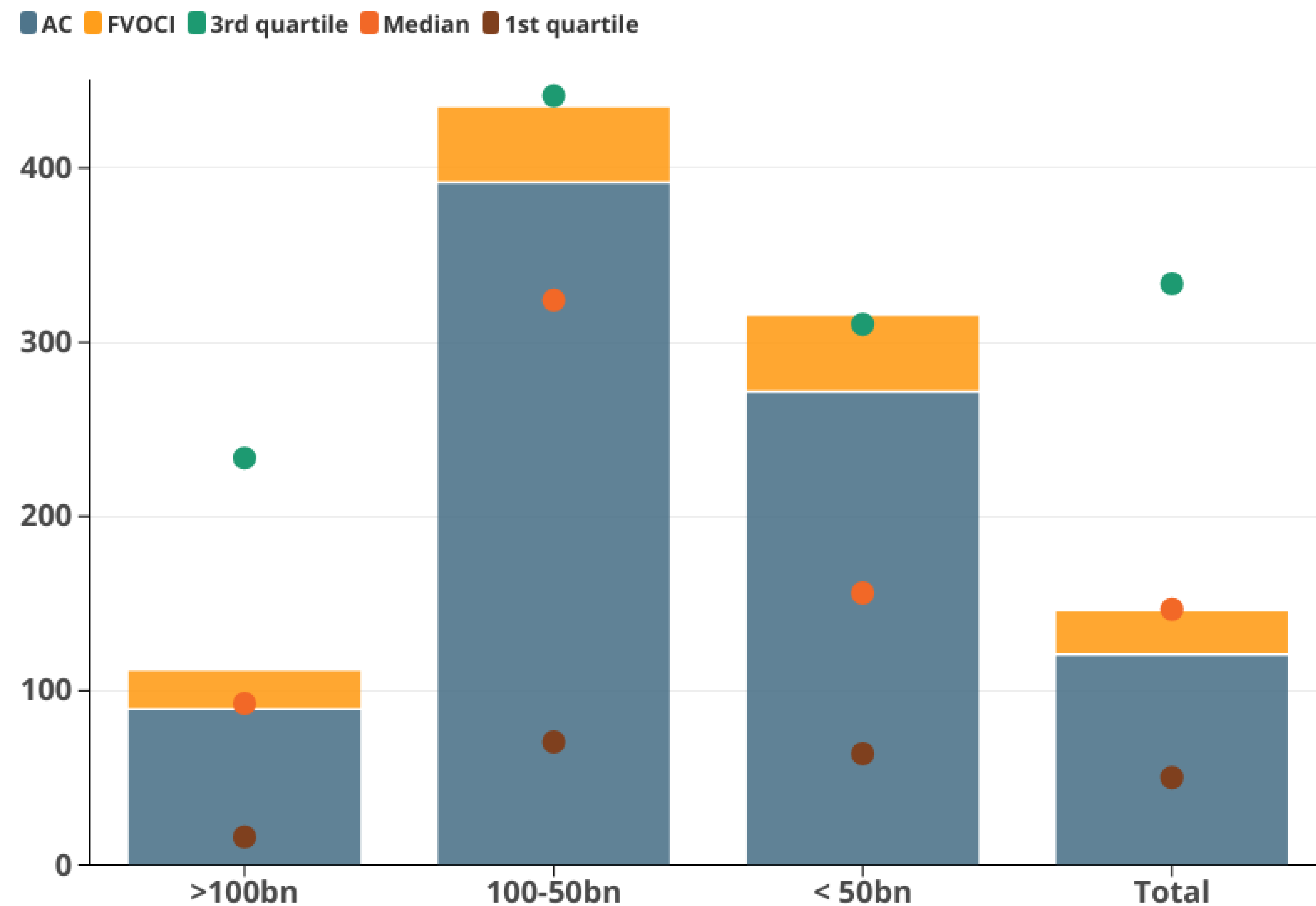


Source: EBA Risk Assessment Questionnaire (RAQ) (% of respondents)

The increase in interest rate levels create several pockets of risks

Unrealised losses from debt securities at amortised cost in bps of CET1 and dispersion by size of bank - Dec-22

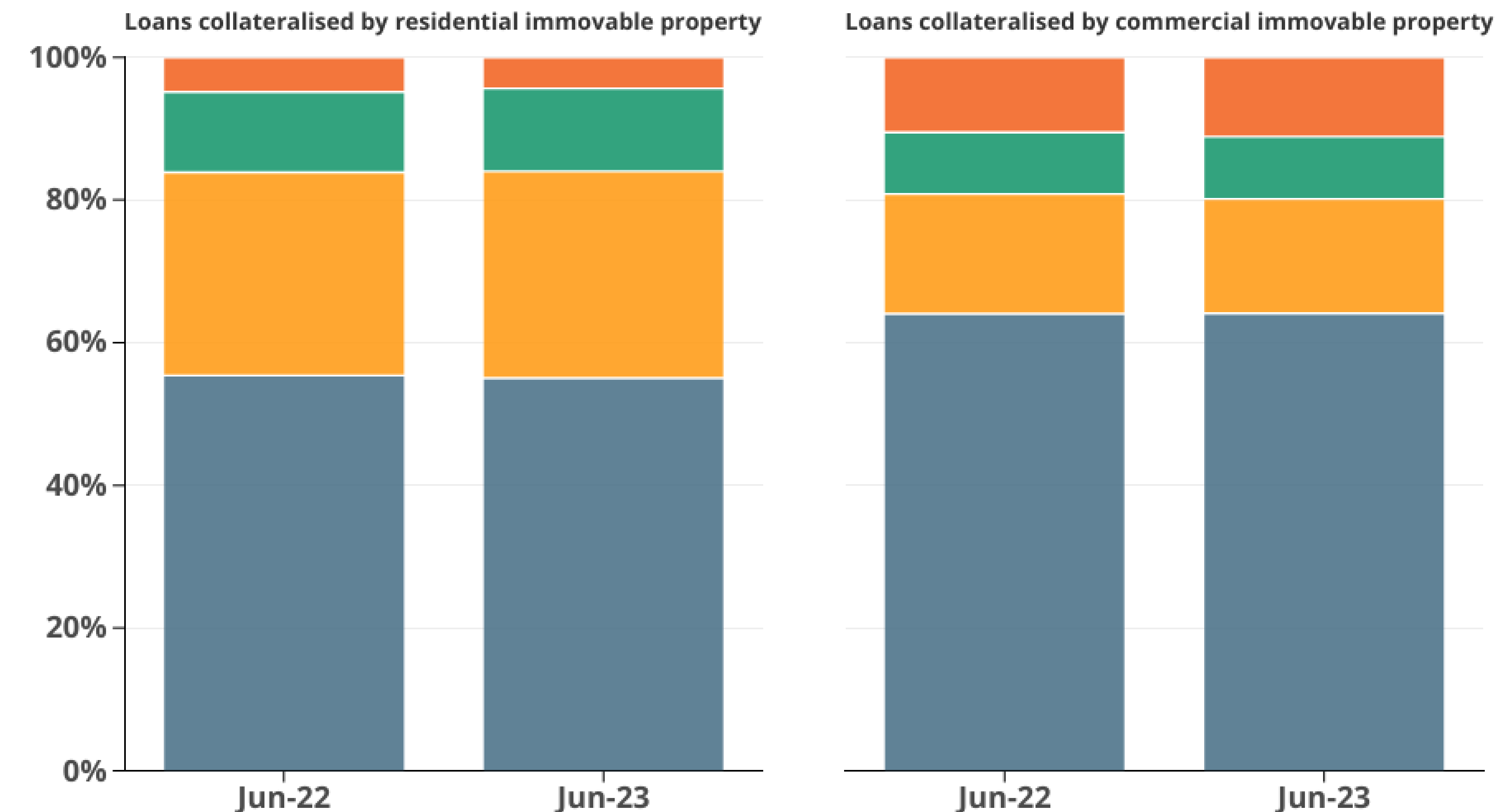
Source: EBA supervisory reporting data



Distribution of loans collateralised by RRE and CRE by loan to value – Jun-22 and Jun-23

Source: EBA supervisory reporting data

Of which: loans with LTV ratio lower than 60%
Of which: loans with LTV ratio higher than 60% and less than or equal to 80%
Of which: loans with LTV ratio higher than 80% and less than or equal to 100%
Of which: loans with LTV ratio higher than 100%

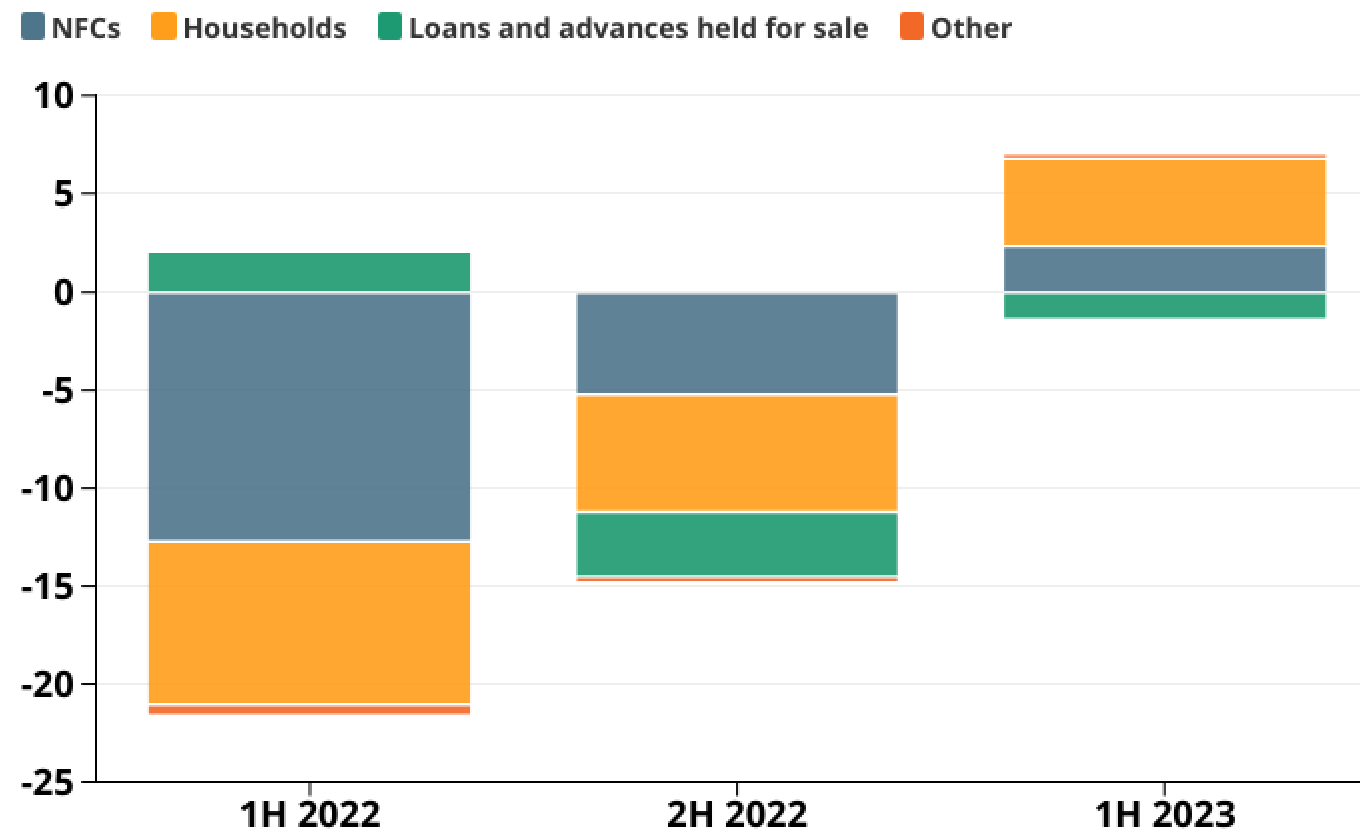


- EU/EEA banks reported EUR 3.45tn of debt securities, of which more than 50% were at amortised cost.
- Within these portfolios, small and medium sized banks reported higher unrealised losses compared to their larger peers, due to a higher share of debt securities accounted at amortised cost.
- High interest rates also create pockets of risks in real estate portfolios (both CRE and RRE). CRE related exposures accounted for EUR 1.4tn, of which EUR 200bn were towards non-EEA counterparties.

Asset quality remains robust, yet with some early warning signs

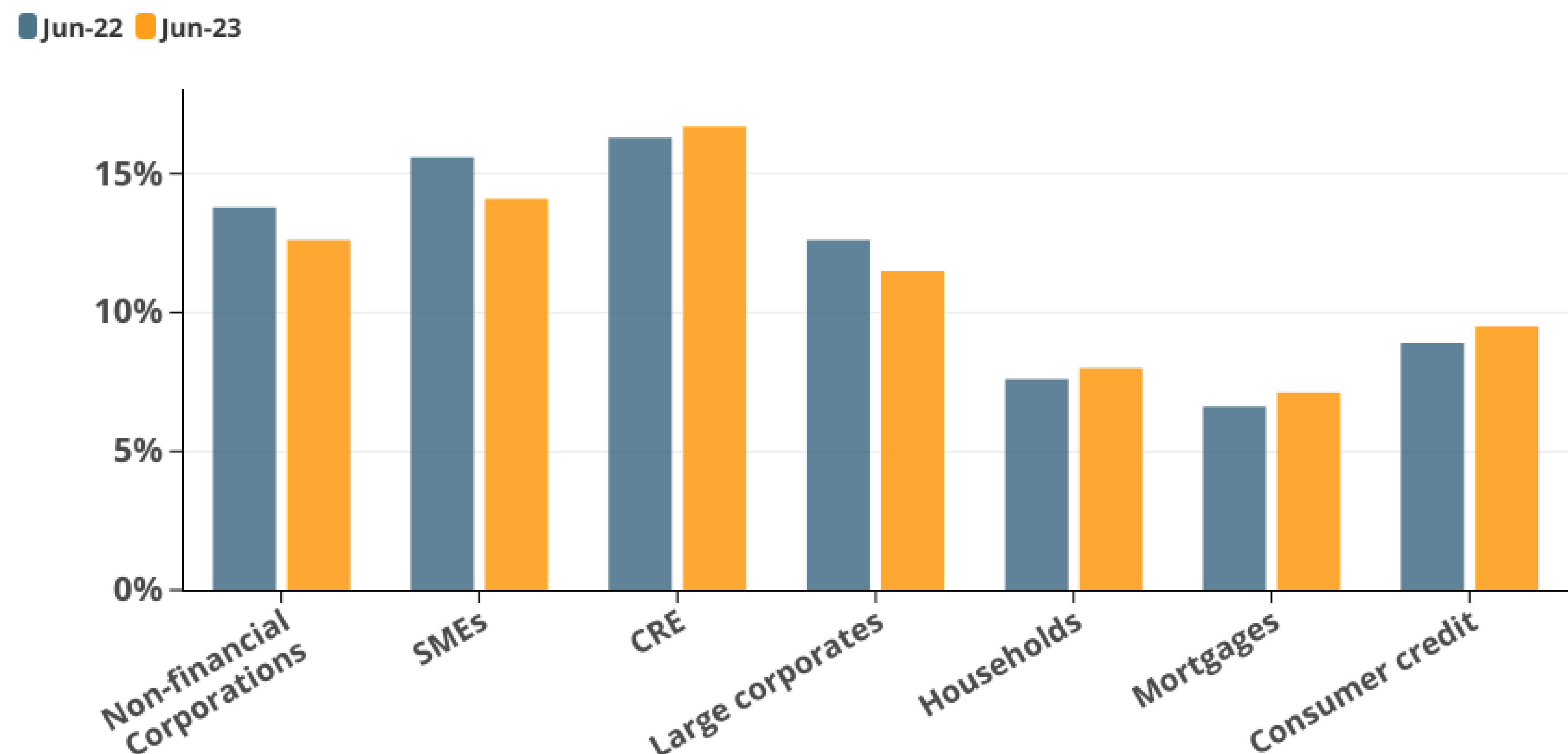
- NPL ratio remained steady at 1.8% of total loans, however NPL inflows were larger than outflows in the first half of 2023. Cost of risk for banks was steady at 45bps.
- Previous years' robust loan origination standards should cushion the impact. Unemployment rates are still near multi-year lows and accumulated liquidity during the pandemic help borrowers to maintain their repayment capacity.
- The overall slowdown in real estate markets, could potentially manifest in higher impairments for banks, albeit from a low level.

NPL cumulative net flows by segment, June 2022 to June 2023 (EUR bn)



Source: EBA supervisory reporting data

Share of Stage 2 loans by segment, June 2022 to June 2023 (%)



Source: EBA supervisory reporting data

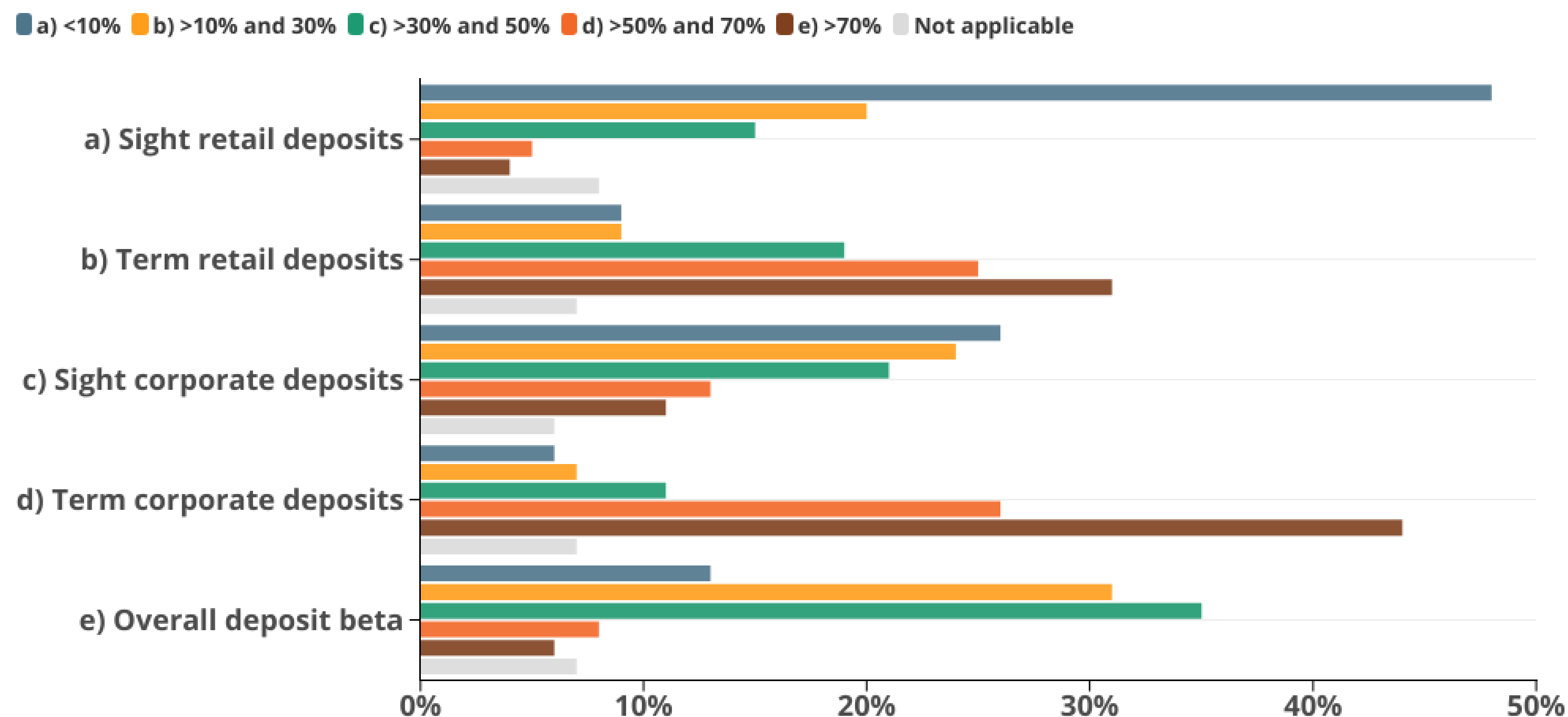
eba European Banking Authority

Funding focus shifting to deposits

European Banking Authority

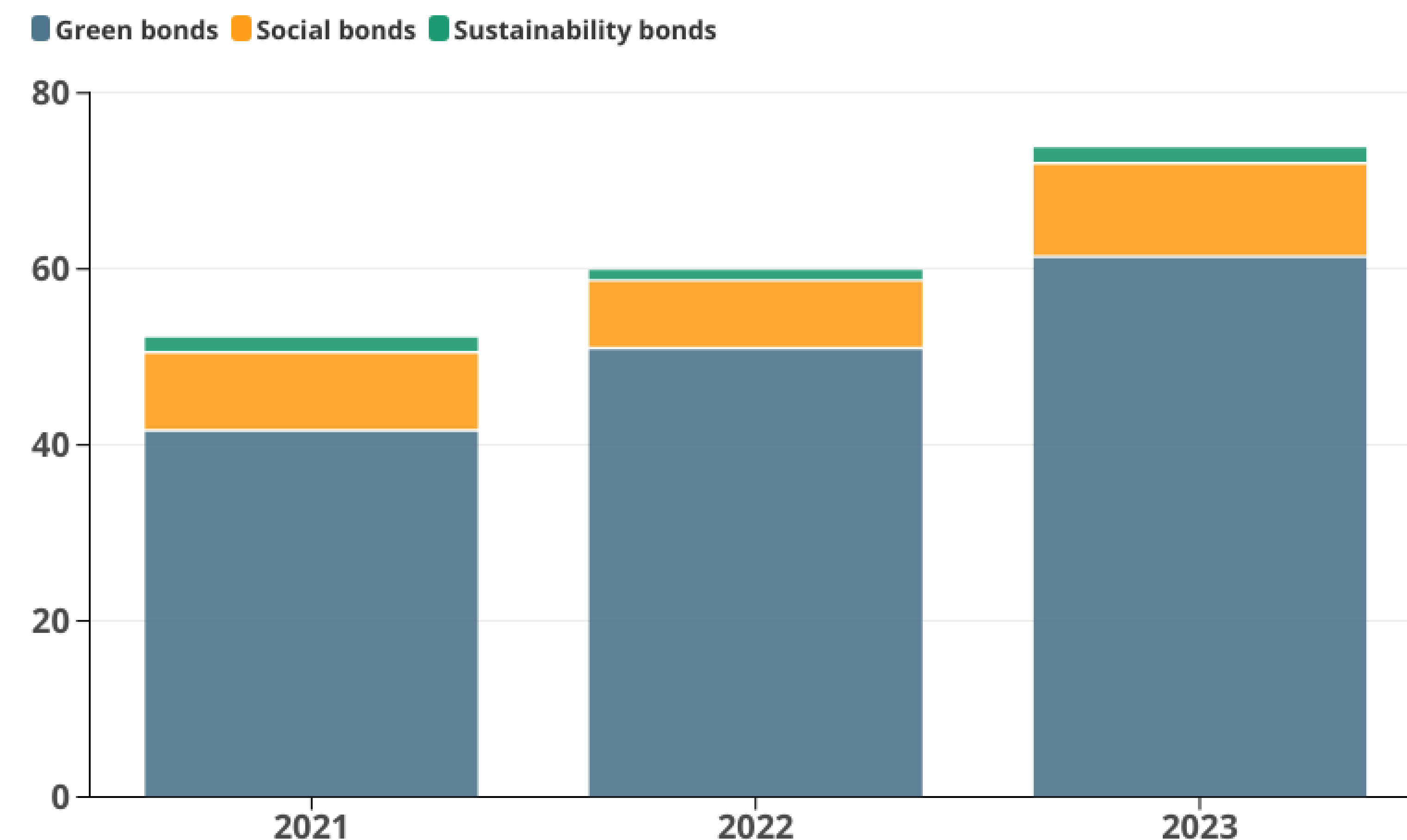
- Banks started to repay large amounts of long-term central bank funding. The share of debt securities issued has increased in EU/EEA banks' funding mix, amid high bond issuance volumes, with a growing focus on senior unsecured instruments.
- Deposit volumes stable with a move from sight to term. Going forward, more banks want to focus on wholesale and retail deposits and three quarters of banks aim to increase deposit rates. Still nearly 50% of the banks expect overall deposit betas to remain below 30% (in the next 6 to 12 months).
- Even though issuance volume of green bonds increased in 2023, their share in total bank debt issuance volumes declined. ESG bond issuance activity was also reduced at times of heightened volatility, when issuers still prefer to issue conventional debt instruments.

Banks' deposit beta expectations for the next 6 to 12 months



Source: EBA Risk Assessment Questionnaire (RAQ) (% of respondents)

Issuance volumes of green, social and sustainability bonds of EU/EEA banks, Q1 Q3 2021–2023 (EUR bn)



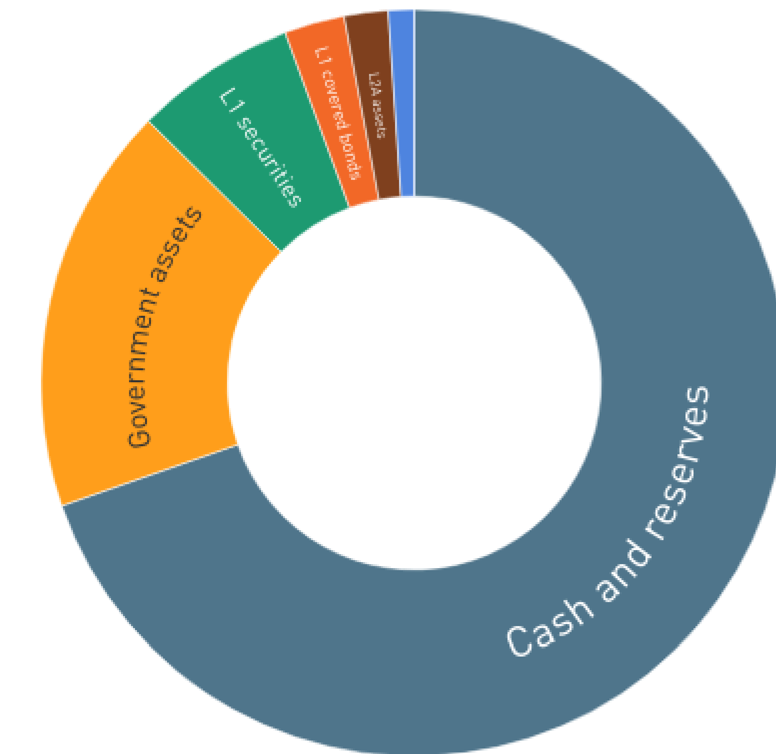
Source: Dealogic, EBA calculations

LCR ratios remain high, but pressure on liquidity buffers might increase

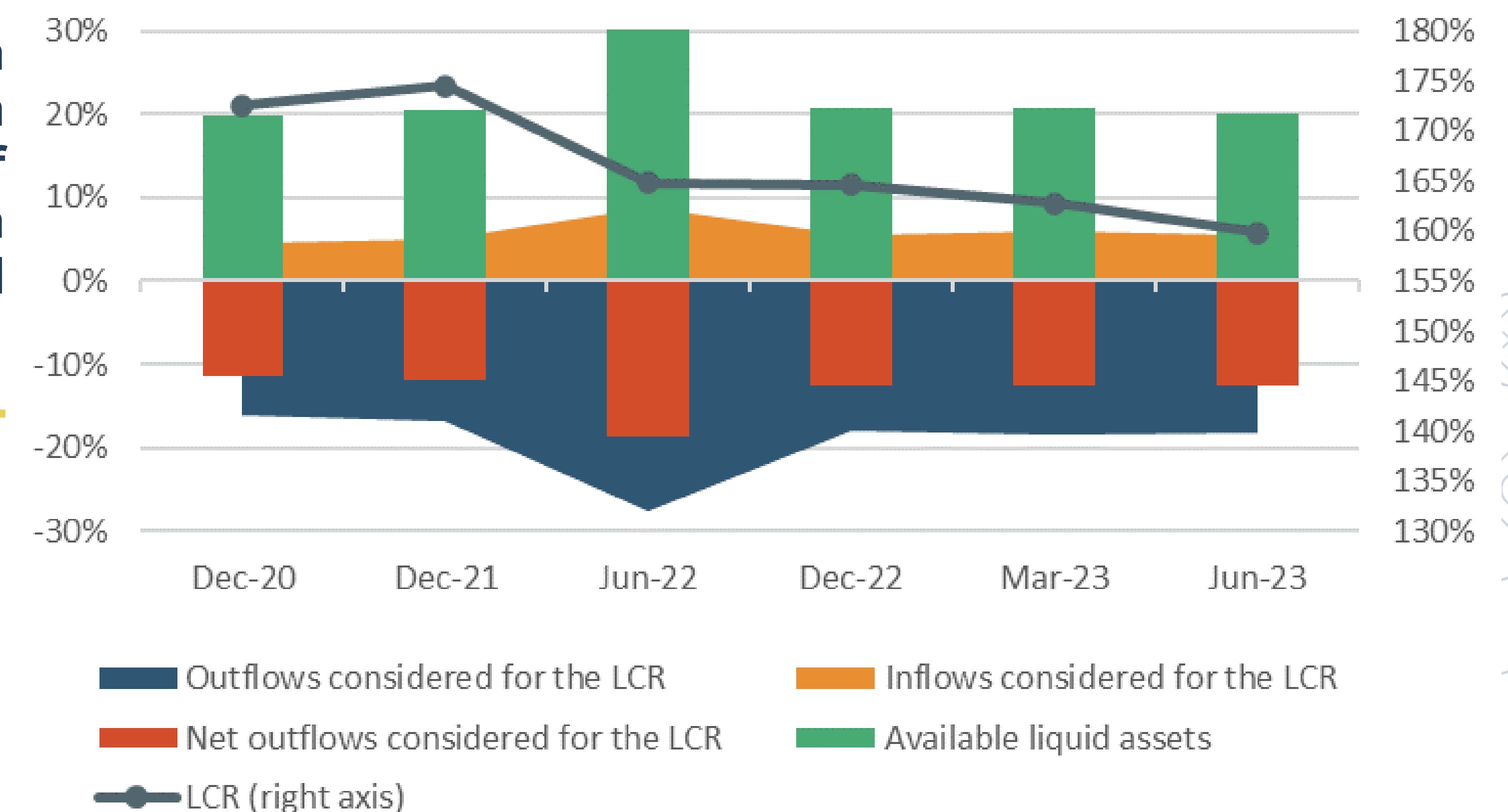
- Following the ca. 175% peak in December 2021, EU/EEA banks' average LCR declined to 161%, driven by a decline of liquid assets.
- Despite their YoY decline, cash and reserves remained the main part in liquidity buffers. They reached 60% of the liquidity buffer as of June 2023 (70% the year before). In parallel, the share of government assets and level 1 securities increased.
- Amid central banks' QT, banks might need to modify their liquidity strategies, implying changes in their liquidity buffers. Potential changes in minimum reserve requirement (MRR) ratios also affect LCRs.

Composition of liquid assets as of June 2022 and June 2023

Source: EBA supervisory reporting data



LCR evolution and main components of the LCR as a share of total assets



Source: EBA supervisory reporting data

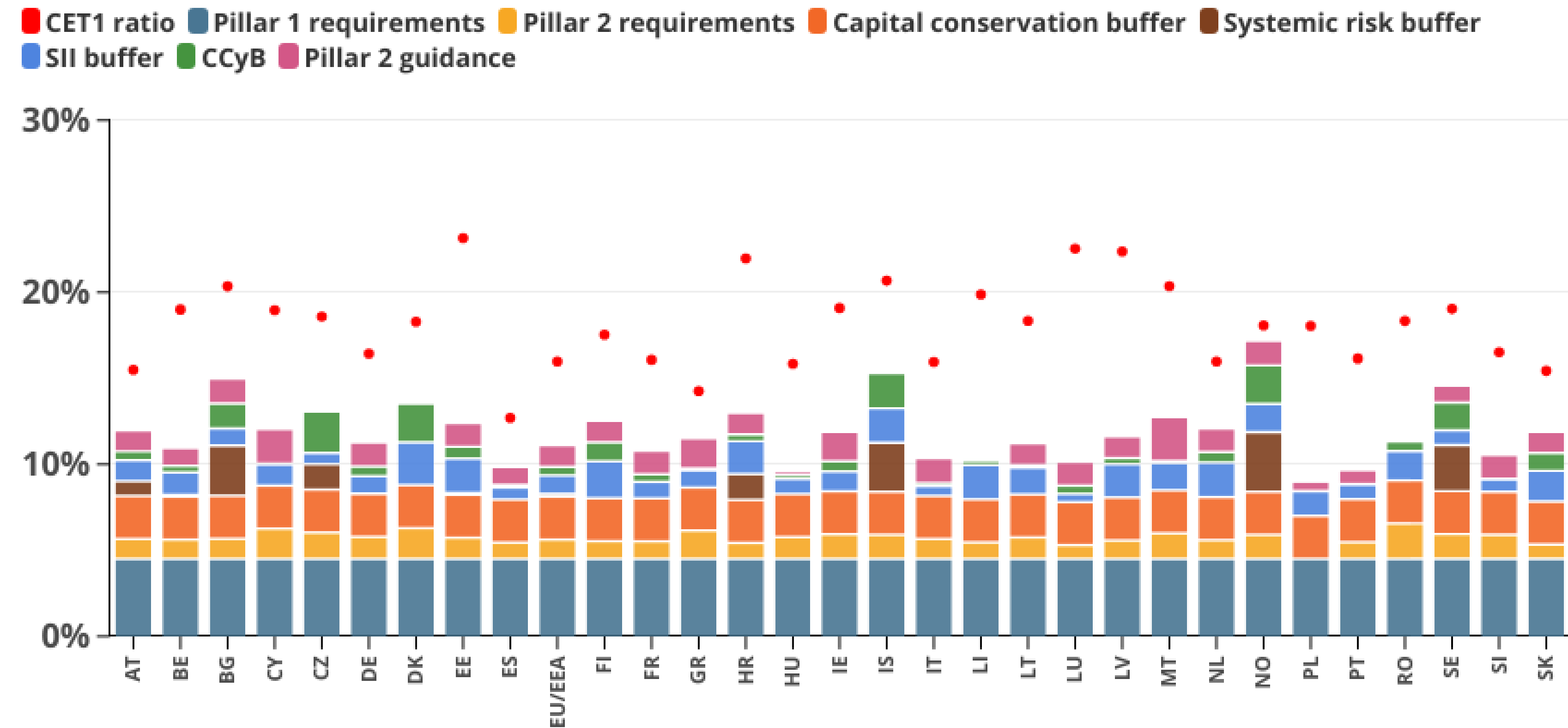
High capital levels; AT1 markets more persistently affected by March events

- Banks continued to increase their capital positions with capital ratios reaching new highs (CET1 ratio up by 76 bps to 16.0% in June 2023). This was despite record pay-outs to shareholders.
- Banks’ headroom over capital requirements and P2G was 492 bps in June 2023 (464 bps June 2022). Macroprudential buffers have led to an increase of capital requirements.
- Following the March events, average spread differentials for AT1 to senior unsecured bonds widened from around 504 bps to around 565 bps, and to T2s from around 409 bps to 466 bps. It shows that AT1 markets are considered riskier than other funding markets.

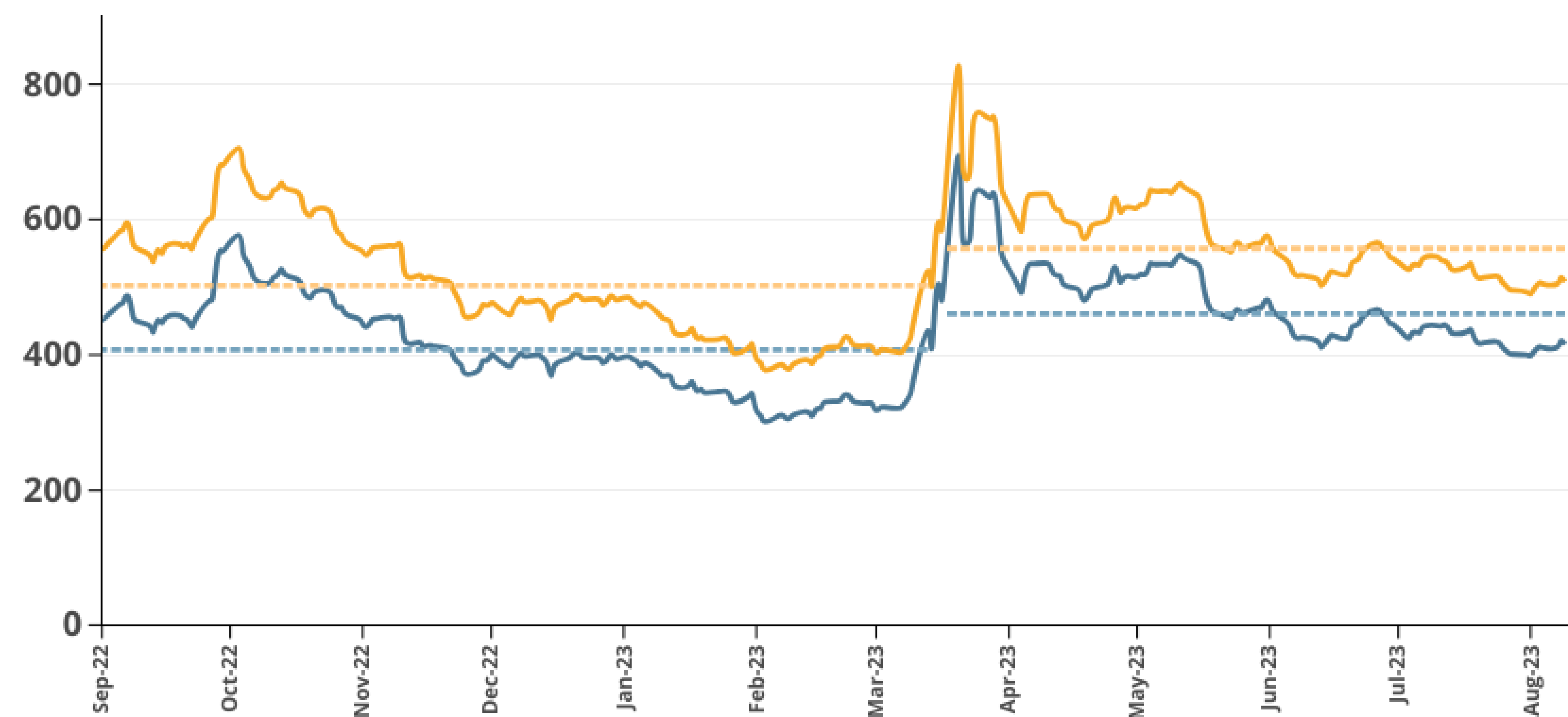
eba European Banking Authority

CET1 requirements plus Pillar 2 guidance, by country

Source: EBA supervisory reporting data



ASW spread differentials of EUR-denominated bonds – AT1 vs. senior unsecured funding and vs. T2 funding, in absolute terms (bps)



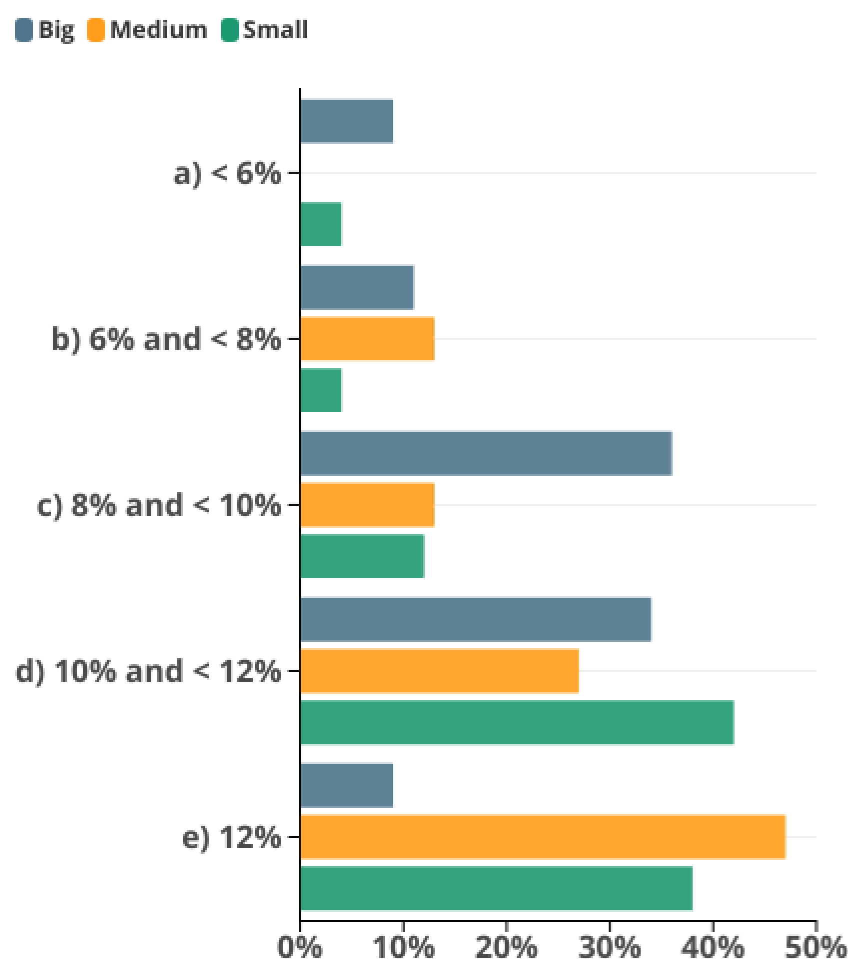
Source: IHS Markit, EBA calculations*

Profitability might have seen its peak, as the rise in net interest income flattens

European Banking Authority

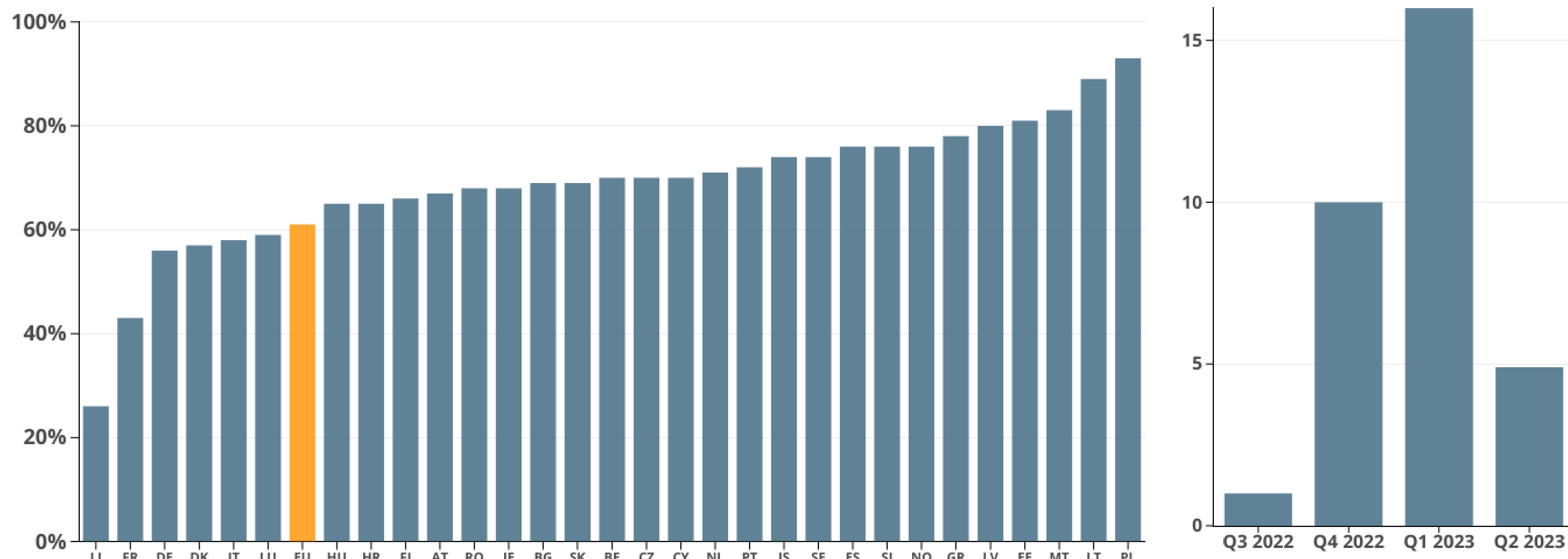
- EU/EEA banks’ RoE reached 11% in June 2023, compared to 7.9% a year earlier.
- RAQ results show that 40% of banks estimate their CoE below 10%, and 35% between 10% and 12%. Larger banks tend to report a lower CoE than small and medium-sized ones.
- EU/EEA banks’ profitability increased substantially, driven by a large rise of NII due to widening NIMs. Data indicates that the peak of NIMs might have been reached.

Estimated CoE by bank size



Source: EBA Risk Assessment Questionnaire (RAQ) (% of respondents)

Net interest income as share of net operating income by country, June 2023 (left) and Quarterly percentage point change in net interest margin in the last quarters (right)

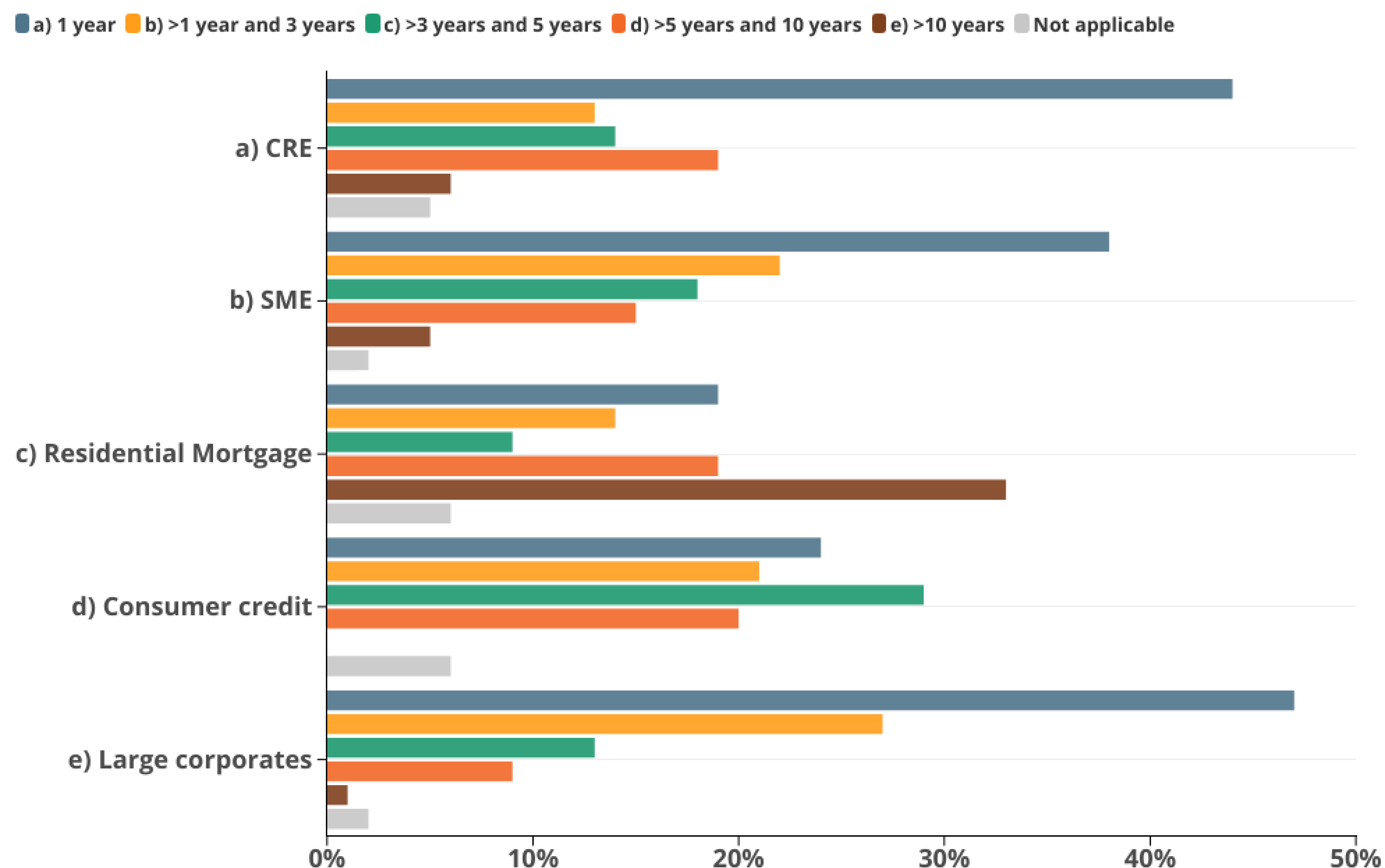


Source: EBA supervisory reporting data

Besides deposits repricing also asset repricing will further affect EU/EEA banks' NIMs

European Banking Authority

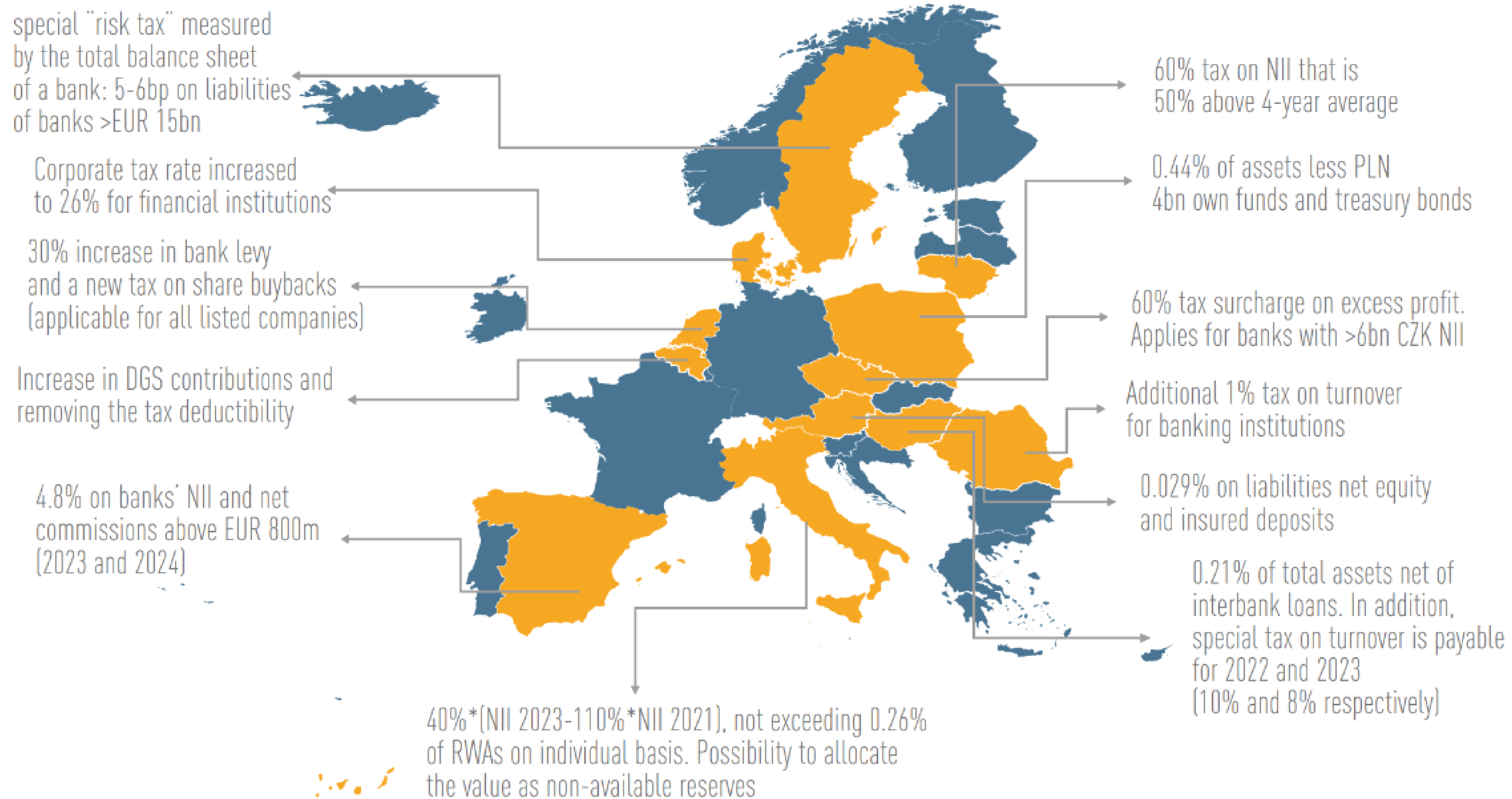
Average interest rate fixation periods for loans at origination



Source: EBA Risk Assessment Questionnaire (RAQ) (% of respondents)

- Besides liability repricing, EU/EEA banks' NIM dynamics are also defined by their asset mix.
- Certain portfolios, such as CRE, have shorter rate fixation periods than others.
- RRE portfolios have in contrast the longest rate fixation period. Such portfolios take longer to reprice, especially in a period of subdued loan growth, impairing banks' capacity to benefit from the higher interest rate environment.

Bank specific taxes more and more widely applied across the EU/EEA



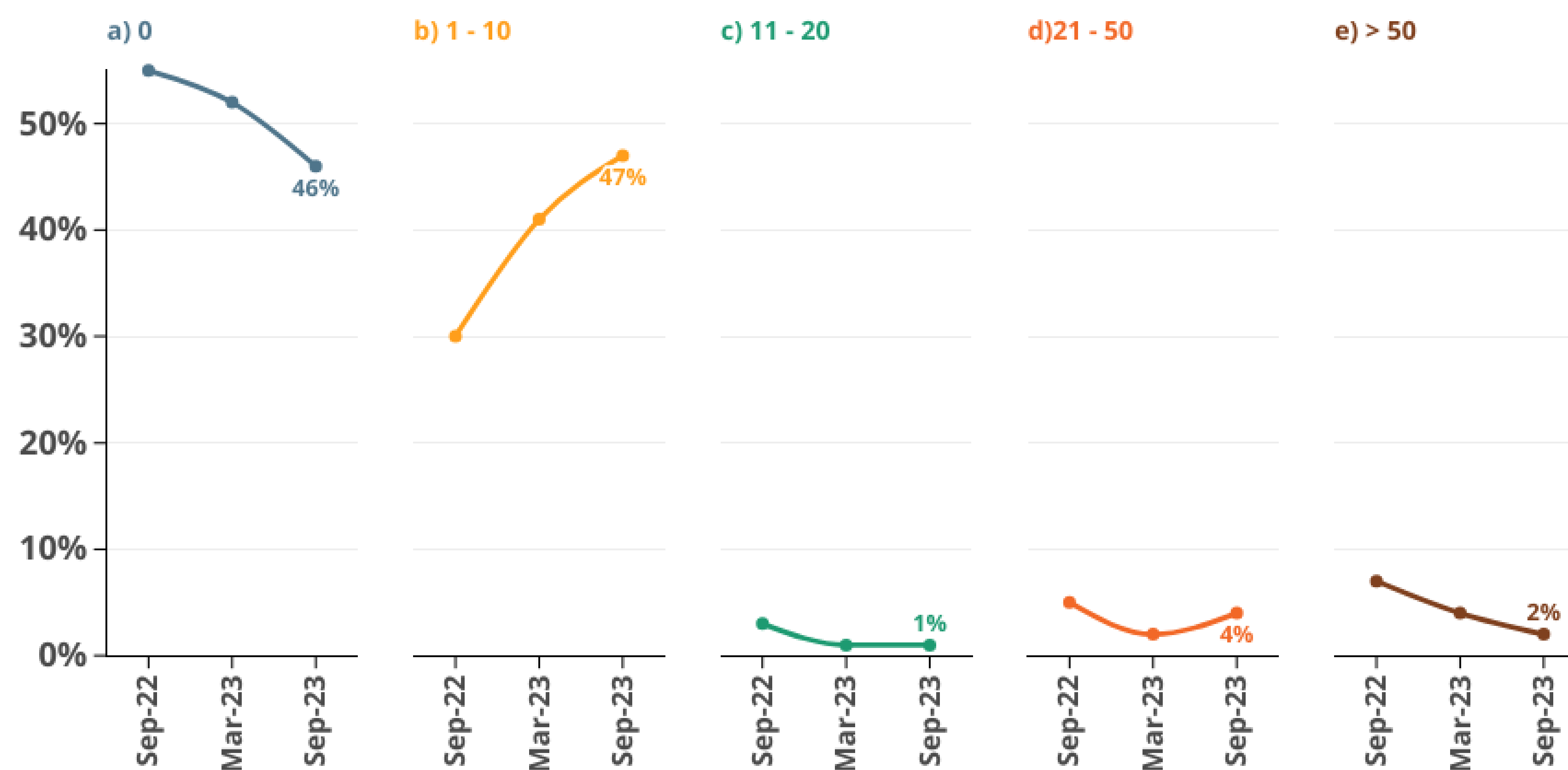
Implementation of a bank-specific tax and characteristics in selected countries
Main sources: finance and other ministries, tax and similar authorities and institutions, as well as central banks, EBA internal data collection among competent authorities, etc.

Operational risks remain high

eba European Banking Authority

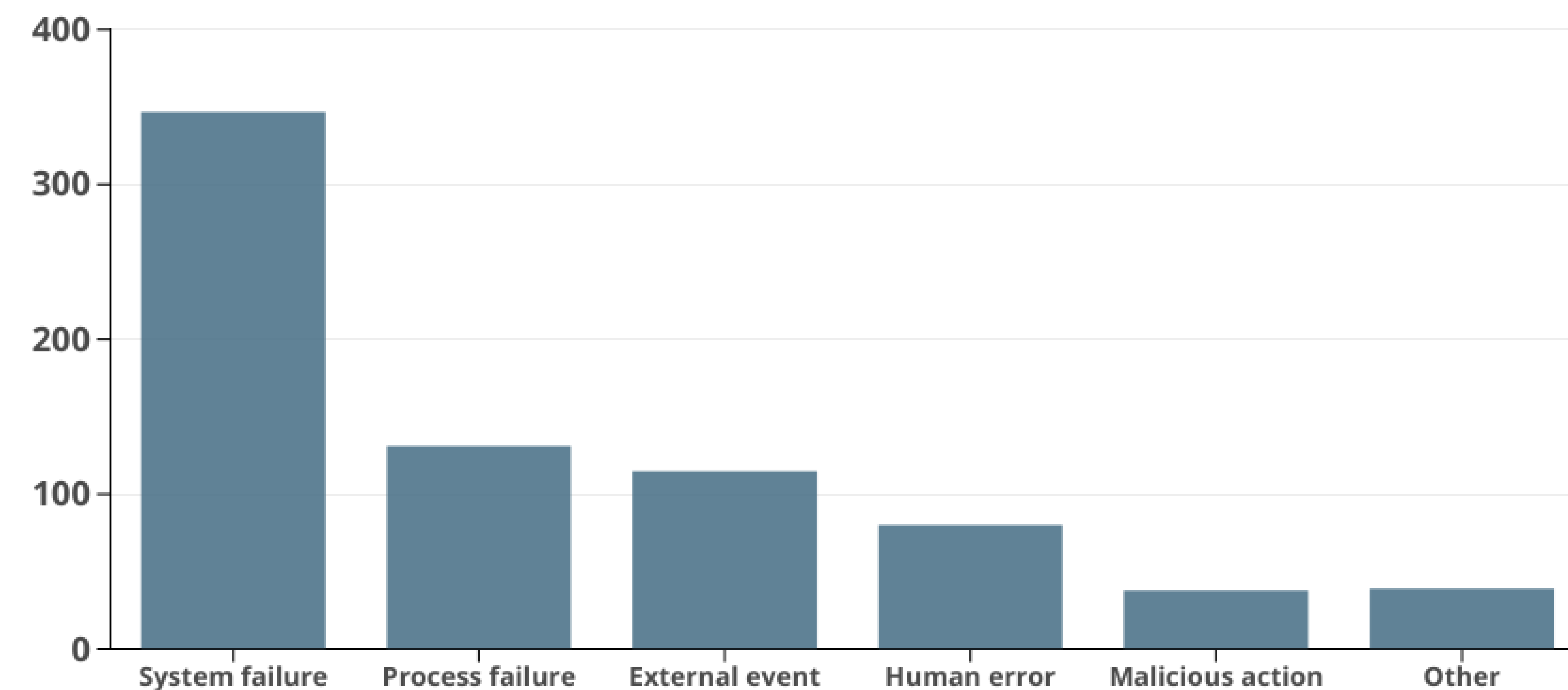
- According to the RAQ, main drivers for operational risks are cyber risk and data breaches, conduct and legal risks, as well fraud.
- On cyber risks, RAQ responses show that the volume and frequency of cyber-attacks as such were unabatedly high (see chart). However, a large majority of responding banks (81%) report that they actually did not face a successful attack which resulted in an actual major ICT-related incident.
- In the payment sector, incidents causing service unavailability were mainly due to system failures, followed by process failures and external events. Remarkably, only a small part of the major incidents (4%) was indicated as potentially cyber-related.

Number of cyber-attacks that resulted or could have potentially resulted in a "major ICT-related incident" in the last semi-annual assessment period



Source: EBA Risk Assessment Questionnaire (RAQ) (% of respondents)

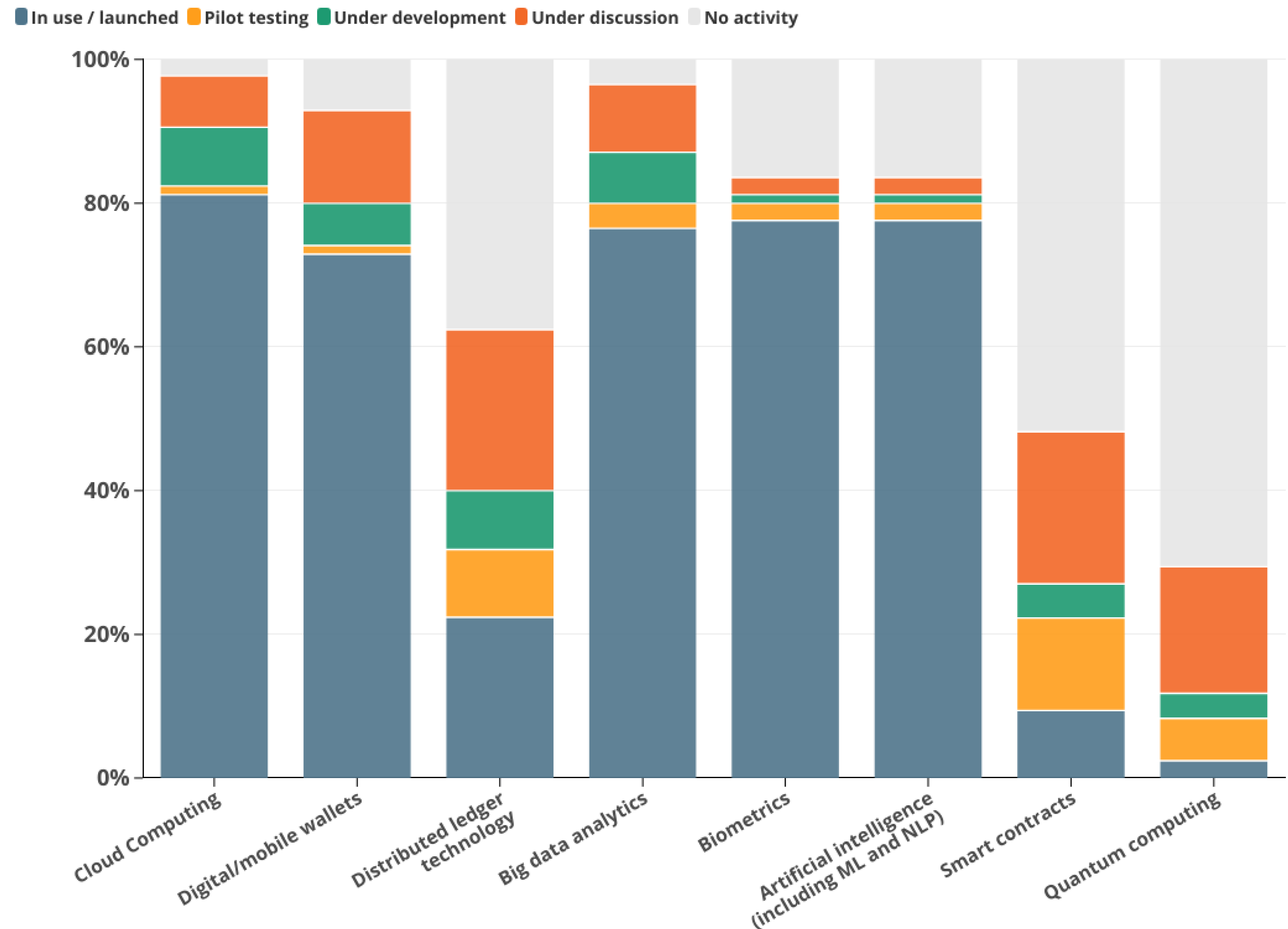
Incidence of the root causes indicated for the major incidents in the payment market



Source: EBA payment incident reporting

Not all innovative technologies are evenly wide-spread among banks

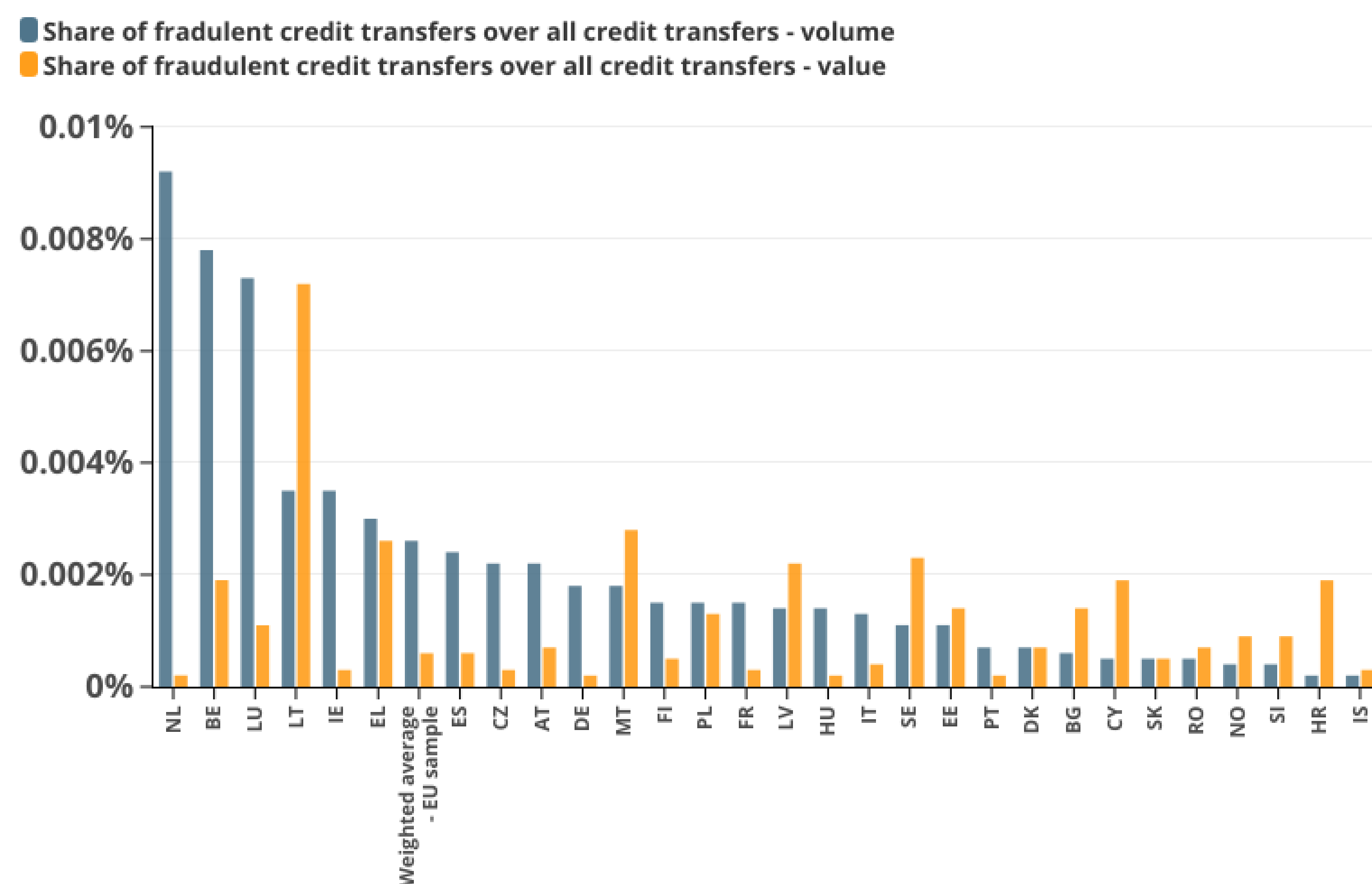
- RAQ results show that the use of certain innovative technologies has been well established within the banking sector.
- More than 80% of banks apply, test or develop solutions that use cloud computing, big data analytics, digital/mobile wallets, artificial intelligence (including machine learning and natural language processing) and biometrics.
- Meanwhile, usage of testing of and experimentation with DLT or smart contracts is still limited, with only 22% of banks using DLT.



Consumer protection aspects are covered for the first time in this edition of the Risk Assessment Report

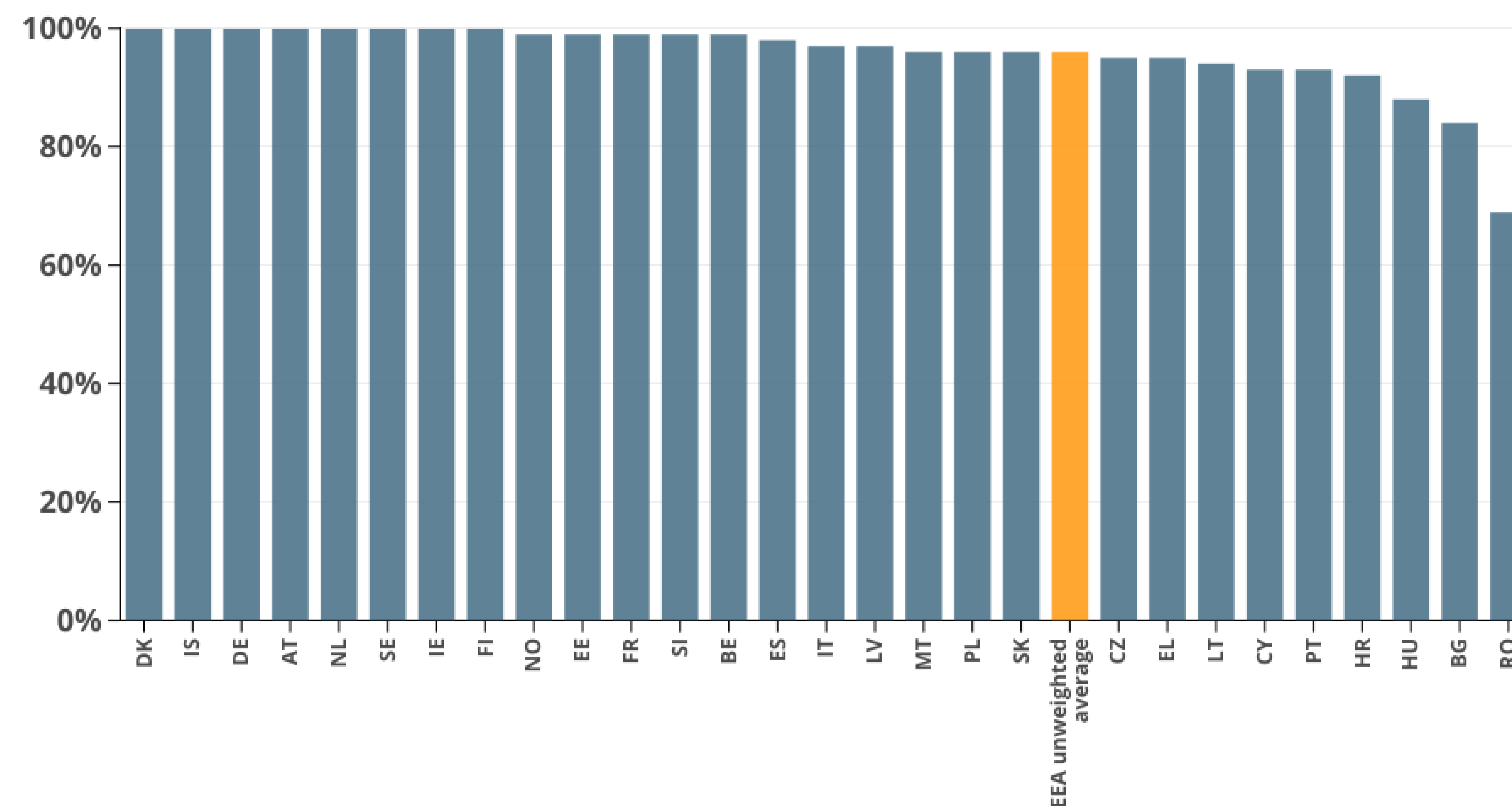
- One indicator is the share of fraudulent credit transfer transactions which is low. In 2022, 0.026% of credit transfers in the EU/EEA were fraudulent, with the proportion ranging from 0.009% to close to zero (volumes).
- While the volume of fraudulent payments is high in some Member States, the value of such fraudulent transactions is low. In others the value is significantly higher compared to the volume.
- Concerning access to financial services, 96% of people had a bank account in the EU/EEA , with very close to 100% in more than half of EU/EEA states, but with some countries being below 90%.

Share of fraudulent payments over total payments (credit transfers)



Source: EBA supervisory reporting data

Percentage of people aged 15+ who have a bank account (2021)



Source: World Bank

Main policy conclusions

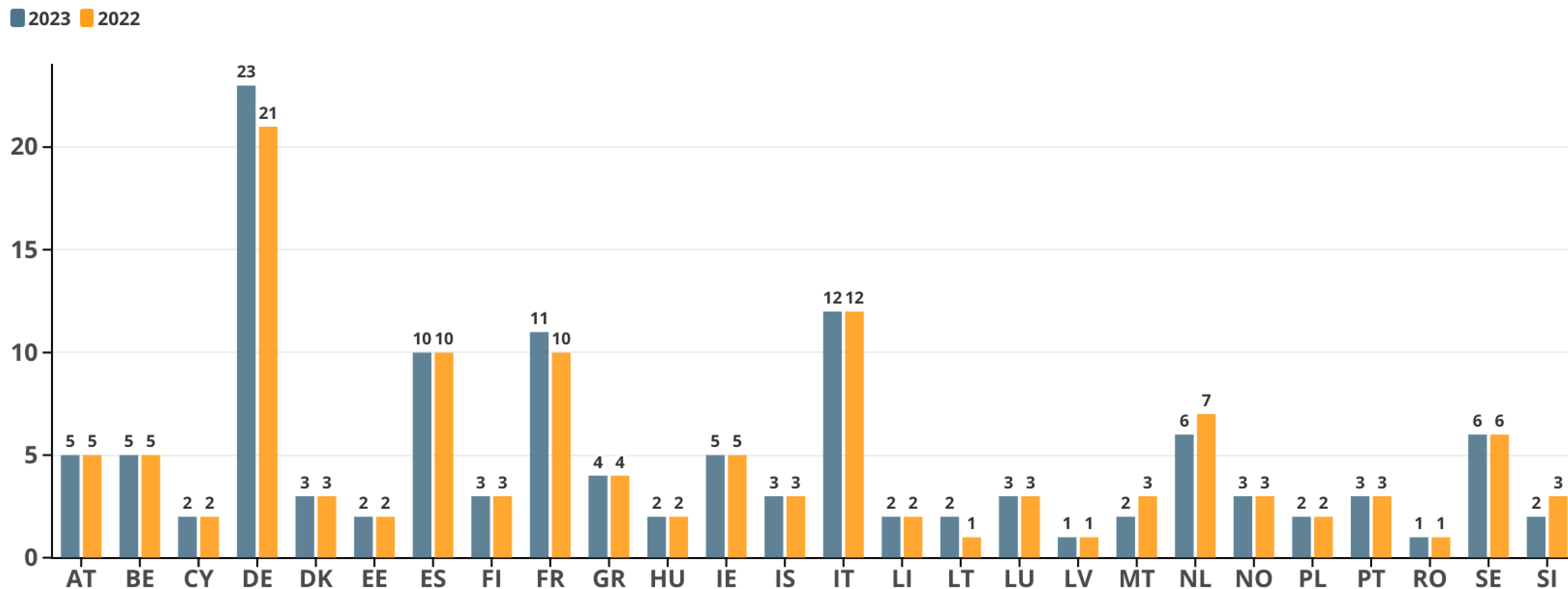
European Banking Authority

- **Uncertainty around the macroeconomic environment outlook and geopolitical risks remain elevated** Banks and supervisors need to remain vigilant and flexible to react quickly to a changing monetary and economic environment as well as geopolitical developments.
- **Slow loan growth can have long-term economic effects** Banks should continue providing credit to the economy also in times of elevated uncertainty, adequately assessing and pricing risk.
- **There is a rising probability of a deterioration in asset quality** Banks should evaluate credit risk prudently and ensure sufficient provisioning.
- **Banks are expected to continue their efforts to develop approaches to manage ESG risks.** Banks need to develop methodologies to assess how and to what extent ESG risks translate into financial risks.
- **Interest rate risk needs to be managed prudently.** Banks should validate the parameters used in their models to manage interest rate risk and hedging practices.
- **Banks aim to increasingly focus on deposit-based funding going forward.** Banks should ensure a healthy overall funding mix incl. capital market access. Close monitoring of deposit flows and their composition – in respect of counterparties and sectors – is warranted. Banks and supervisors should explore new ways with a more forward-looking perception to monitor liquidity, incl. through monitoring social media interactions.
- **Resolvability of institutions should be a priority.** Banks and supervisors have to make sure they can facilitate the execution of the optimal resolution plan. Banks also need to be prepared for crisis events and should have flexible recovery plans in place based on realistic assumptions.
- **ICT and cyber related risks should remain a focus area of banks.** Banks need to be prepared for any impact on their ICT systems as well as major cyber-attacks, including third-party providers.

EU-wide Transparency Exercise covering 123 banks

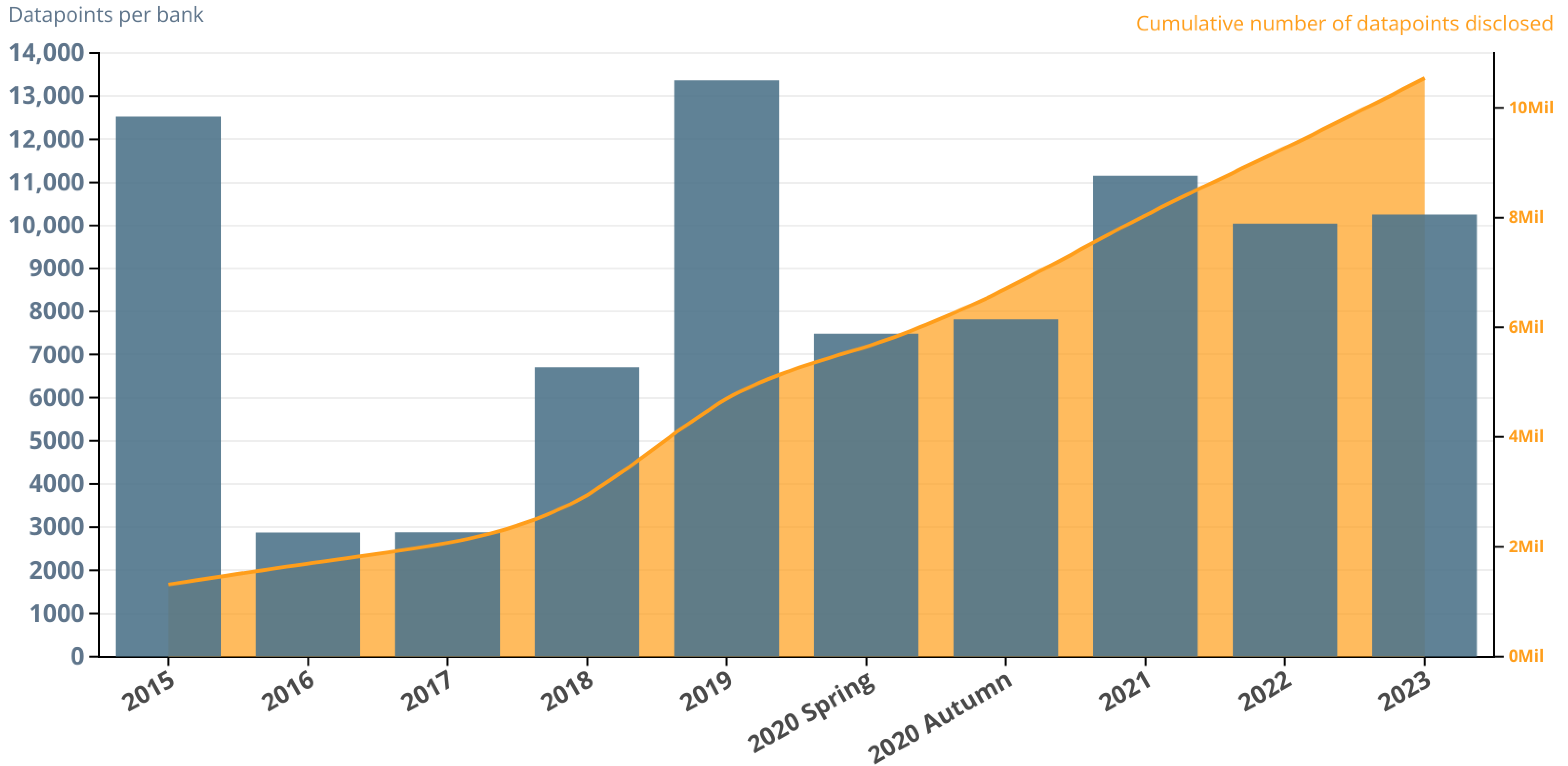
On average more than 10,000 data points per bank; 123 banks from 26 countries at the highest consolidation in the EU/EEA.

Reference dates: **September 2022, December 2022**, **March 2023** and **June 2023**



EBA's transparency exercises: data disclosed over the years

eba European Banking Authority



What's on the website: the full package

European Banking Authority

Database:

- CSV Data: Credit risk, Market risk, Sovereign debt exposures, Other templates
- Data dictionary
- Metadata
- Manual for using and managing data and tools
- Template mapped to supervisory reporting items

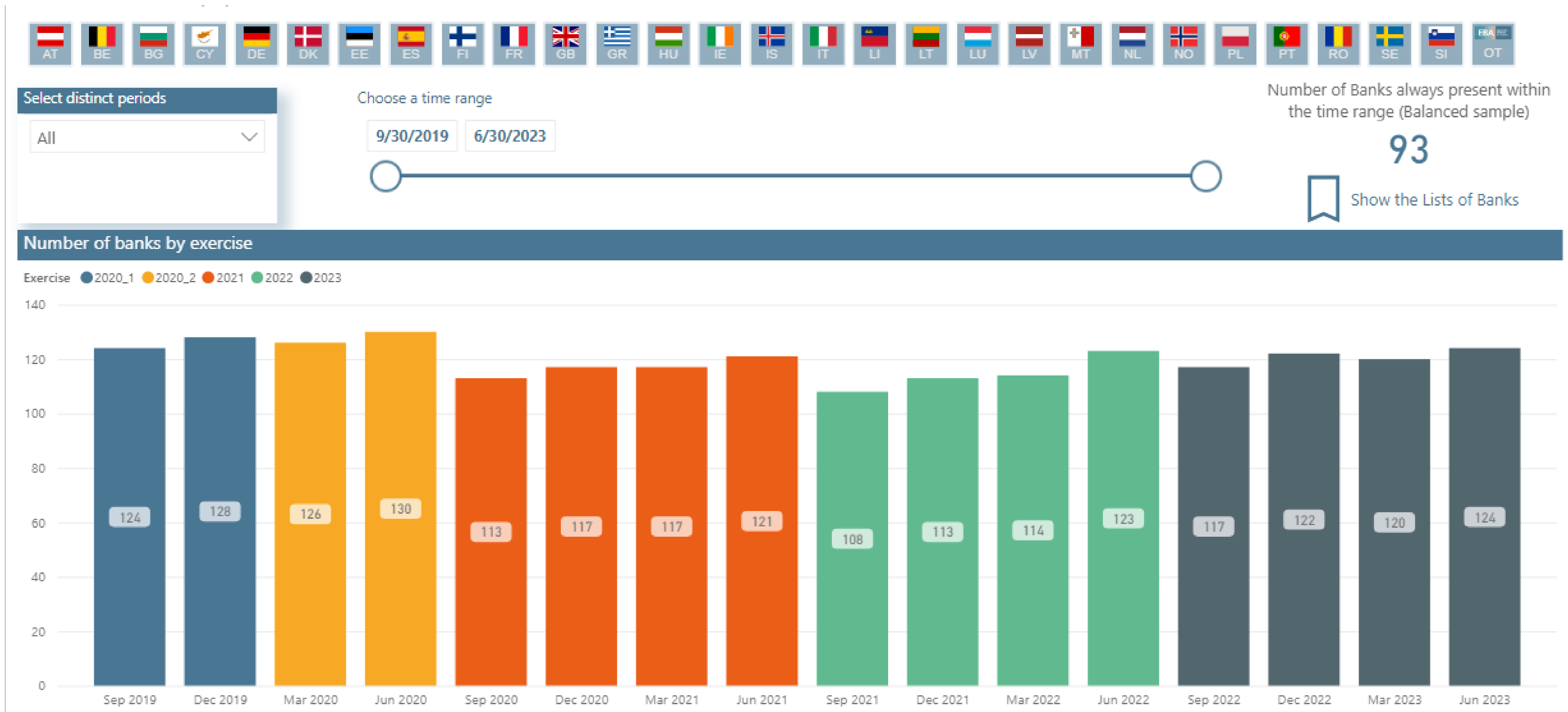
Online interactive dashboards:

- Key Metrics: Time series and data
- Catalogue of data asset
- Main indicators – visual exploration tool
- Key Metrics, Capital, Leverage, P&L, RWAs, Assets and Liabilities
- Credit risk
- NPE and forborne exposures
- NACE
- Sovereign

Single bank PDFs

Exploiting data via interactive dashboards

Online data exploration tools: allowing country/banks comparison through transparency template based tables, maps and advanced charts.



European Banking Authority

Disclaimer: * With regard to IHS Markit in the chart “ASW spread differentials of EUR-denominated bonds – AT1 vs. senior unsecured funding and vs. T2 funding, in absolute terms (bps)” and any further references to it in this report and related products, neither Markit Group Limited (“Markit”) nor its Affiliates nor any third-party data provider make(s) any warranty, express or implied, as to the accuracy, completeness or timeliness of the data contained herewith nor as to the results to be obtained by recipients of the data. Neither Markit nor its Affiliates nor any data provider shall in any way be liable to any recipient of the data for any inaccuracies, errors or omissions in the Markit data, regardless of cause, or for any damages (whether direct or indirect) resulting therefrom.