Policy implications and measures

Banks need to be flexible and agile and have proper plans and processes in place to address unexpected manifold challenges within the short term. This includes in particular geopolitical risks, which can materialise through many channels, such as credit, market and operational risks. It also includes proper management of sanctions, which can pose challenges for banks.

Robust management of credit risk remains key, including up-to-date collateral valuation. Adequate and timely loan provisioning can protect banks from negative hits to profitability. The latter can happen if asset quality deterioration is addressed too late. Banks need to provide lending to the economy, but at the same time need to apply proper lending standards, including in the CRE segment when other lending providers step out from respective financing.

Funding and liquidity risks seem to be low for the moment, but they might suddenly again come to the fore. Banks are planning for heightened issuance volumes, not least driven by replacement of maturing MREL debt and presumably influenced by final TLTRO repayments. Banks need to use windows for their issuances and be flexible in this respect, not least amid elevated funding costs in times of higher yields. It is important that banks have sufficient central-bank-eligible collateral available if need be.

Even though capital headroom above requirements stands at comfortable levels, cautious management of payouts is important. This is to be prepared for potential major negative impacts on capital. Supervisors' case-by-case assessments of payouts remain a key means in this respect.

Banks' profitability might have peaked amid rising pressure on NIMs. Banks need to have an adequate revenue mix going forward. Despite potential pressure on profitability amid inflation and the rising cost of risk, investments connected with information and communication technology (ICT) should not be postponed. Banks also need to be prepared for different interest rate scenarios going forward. M&A might be one means to also address profitability-related challenges. Windfall taxes should avoid compromising banks' long-run viability.

Banks need to be prepared to address technology-related challenges. Banks need to address cyber risk, which might increase even further, in volume as well as sophistication. Technology-related challenges also include the rising usage of new technological solutions, such as AI, and products, such as CBDCs. Developments like the so-called T+1 settlement for securities, as it was introduced e.g. in the US, are also part of such challenges.

NBFIs and in particular non-bank lenders have increased in relevance recently. Transparency for NBFIs should be improved. The risk management and loan origination standards applied by some NBFIs might also require further scrutiny, to make sure that expected and unexpected losses are sufficiently covered and that credit allocation to the economy remains efficient. In addition, to detect potential contagion channels early on, supervisors and macroprudential authorities also need to have a particular focus on the direct and indirect linkages between banks and NBFIs. Better data that allows for identification of such linkages at different levels of aggregation is needed.

Risks related to ESG challenges should also stay high on banks', regulators' and supervisors' agenda. ESG risks are increasingly materialising and require diligent consideration as part of banks' risk management. Regulatory and supervisory initiatives, such as under the revised CRR/Capital Requirements Directive (CRD) package, are also going in this direction to ensure that banks take necessary steps to incorporate ESG risk considerations as drivers of traditional risk categories.