European Banking Authority

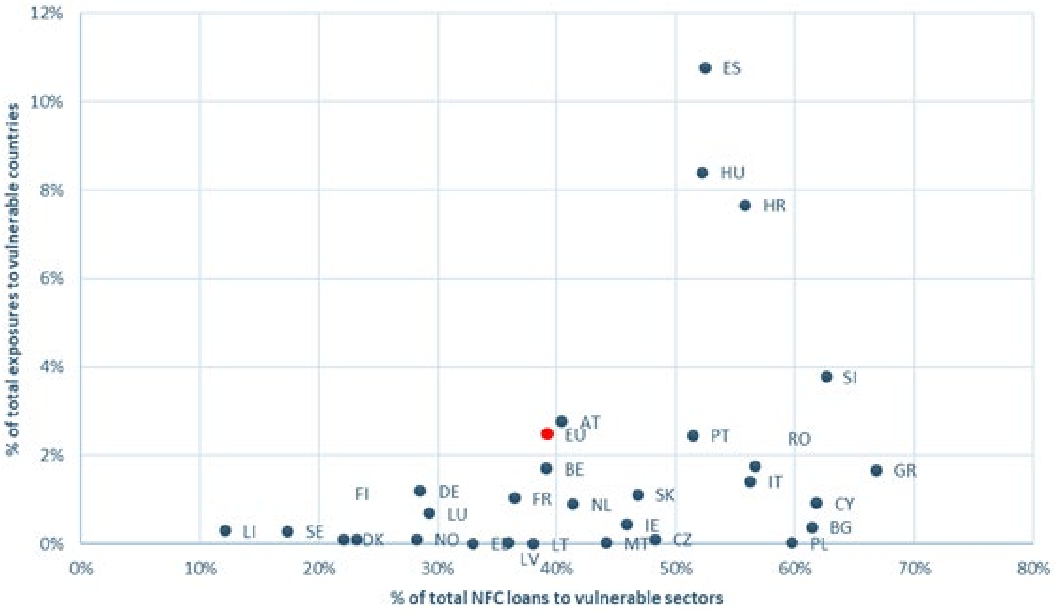
Autumn EBA's Risk Assessment Report and Transparency exercise 2024

EBA | November 2024

Slow economic growth and inflationary pressures create macroeconomic uncertainty

- Macroeconomic uncertainty remains high fuelled by geopolitical risks, including political developments.
- Around 2.5% of EU/EEA banks' total assets (EUR 500bn) are direct exposures to 'high-risk' countries. Banks face downside risks from second round effects, through geopolitically vulnerable sectors. Other risks include market, liquidity, and operational risks.
- High volatility, caused by economic instability, political uncertainties, or monetary policy changes, leads to greater risks in lending and investments, creating concerns over potential impact on banks' valuations.

Percentage of total exposures towards countries and sectors vulnerable to geopolitical risks, by country, June 2024 (%)



Source: Source: Caldare and Iacoviello, Refinitiv Workspace, S&P Capital IQ, EBA supervisory data and calculations

Risks may materialise from exposures to NBFIs

- EU/EEA banks' exposures to non-banking financial institution (NBFIs) represent almost 10% of their total assets and are highly concentrated in larger banks.
- NBFI activity has increased considerably over the last 10 years, partly due to banks refining their business strategies to adapt to regulatory changes, such as CRR3/CRD6.
- Financial intermediation channels can be exposed to unforeseen linkages and shared asset holdings.
- Were banks' liquidity facilities for NBFIs be abruptly activated, or banks were required to bring failing off-balance sheet entities onto their own balance sheets, banks' capital and liquidity ratios could be adversely impacted.

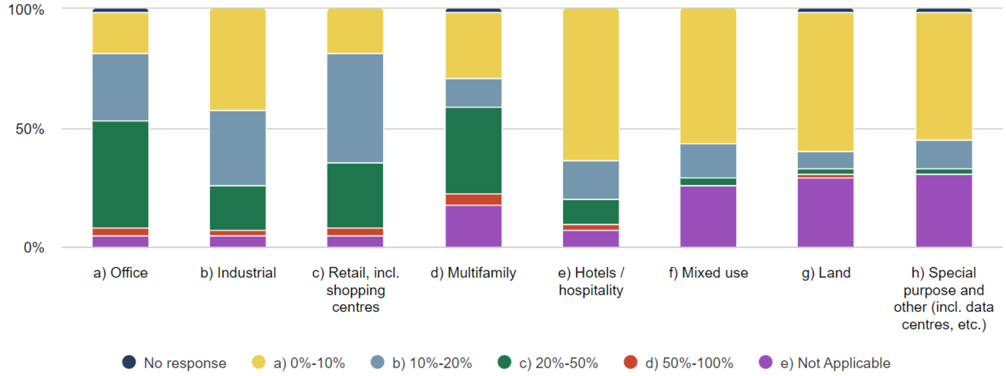
EU/EEA banks' asset exposures to NBFIs, as a share of total assets by country, June 2024

Source: EBA Supervisory data

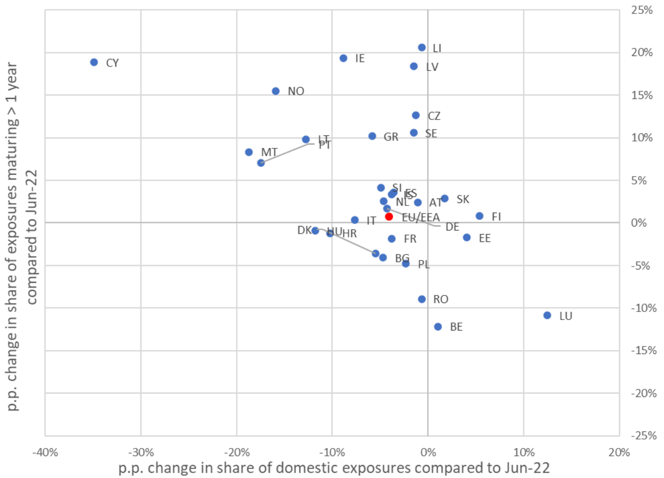
Lending is picking up slowly. Concerns over CRE have not abated fully

- Lending to NFCs and households showed a modest recovery. Factors like the level of interest rates and weak fixed investment by corporates affected demand. At the same time banks' credit standards remained stringent.
- Although real estate markets valuations stabilised, downside risks remain for the banking sector. The commercial real estate (CRE) sector saw notable loan increases due to restructuring support. Office and multifamily CRE dominate this portfolio. Banks' collateral valuations should reflect current market conditions.
- Despite concerns over the sustainability of sovereign debt, banks increased their investment in sovereign debt holdings, with a preference to longer maturities. The latter may prove helpful to banks' profitability in the medium term.

Distribution of banks' CRE portfolio by type, autumn 2024



p.p. change in domestic and long-term sovereign exposures, comparison with Jun-2022

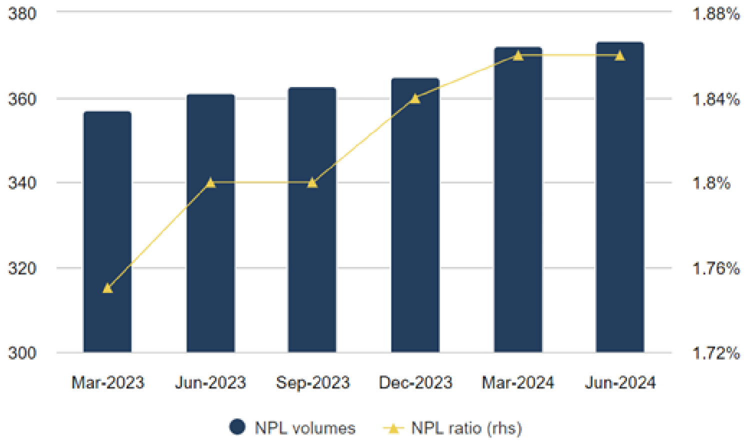


Source: EBA Supervisory data and Risk Assessment Questionnaire

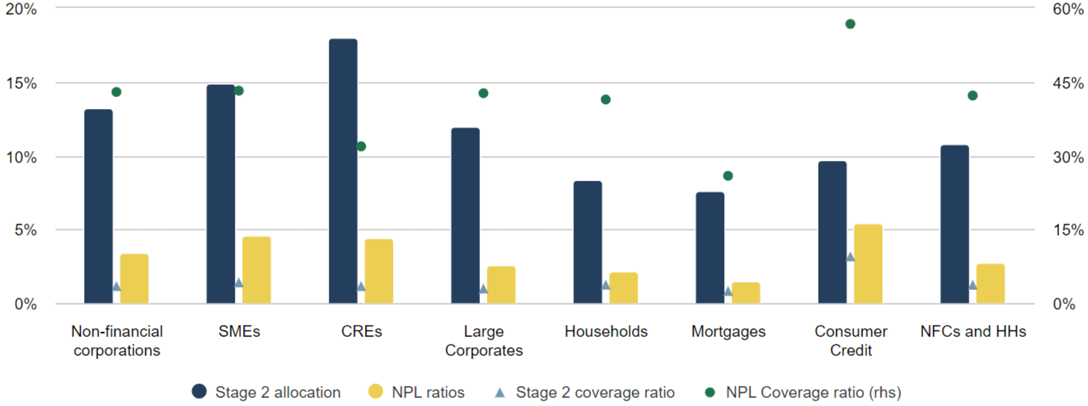
Asset Quality worsens, yet marginally and at slow pace

- Asset quality showed a slight decline. Non-performing loans (NPLs) increased by 3.4% compared to last year and stood at EUR 373bn, accounting for 1.9% of total loans.
- NPL inflows were driven by defaults in the non-financial corporates (NFC) sector, particularly among SMEs and CREs. Credit risk pose a greater threat to smaller institutions.
- Stage 2 loans increased by 4.5% YoY, and totalled nearly EUR 1.5 tn, representing 9.3% of all loans.
- Around 40% of banks anticipate a deterioration in asset quality over the next 6 to 12 months, particularly in the consumer credit, SME, and CRE sectors. However, the share is, lower than in previous surveys

Trend of EU/EEA NPL volumes (EUR bn) and ratio (%)



NPL ratios, Stage 2 allocation and coverage ratios by segment (June-2024)



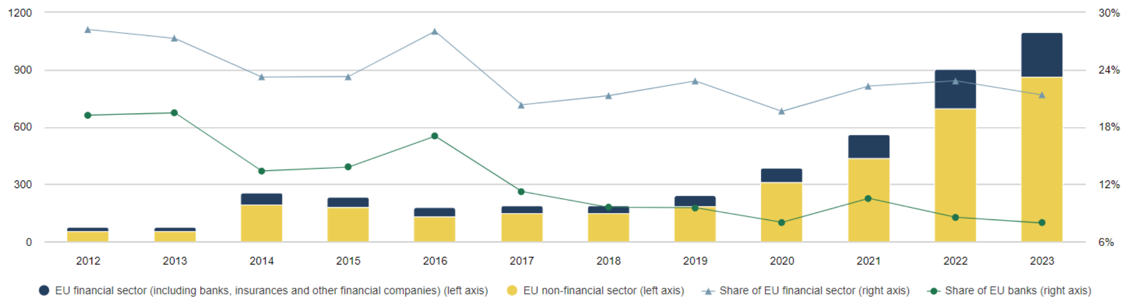
Source: EBA Supervisory data

Climate and physical risks call for a transition to a sustainable economy

- The increasing frequency and severity of extreme weather events in Europe also affect the financial sector.
- EU-wide climate risk results (‘Fit for 55’)* show a limited near-term financial impact but losses can potentially be significant under adverse macroeconomic conditions.
- The EU average weighted total GAR was under 3% at the end of 2023. Most banks report total green asset ratios (GARs) below 2%, though significant variability exists, with a number of banks indicating substantially higher GARs.
- The share of sustainable lending products offered by EU banks has been increasing slightly, mainly targeting large corporates through proceeds-based green loans.
- This shift to more use of sustainable products has also increased the risk of greenwashing, which can undermine investor confidence and necessary investments.

Total losses from climate risk stress test relative to total exposure

Number of alleged GW incidents in the EU financial and banking sector



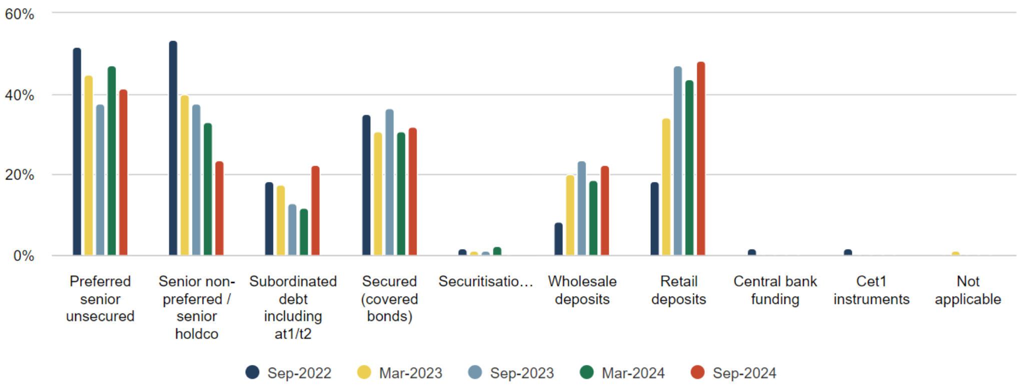
*EU-wide cross sectoral assessment of climate-related financial risks

Source: EU-wide cross-sectoral assessment of climate-related financial risks, RepRisk database

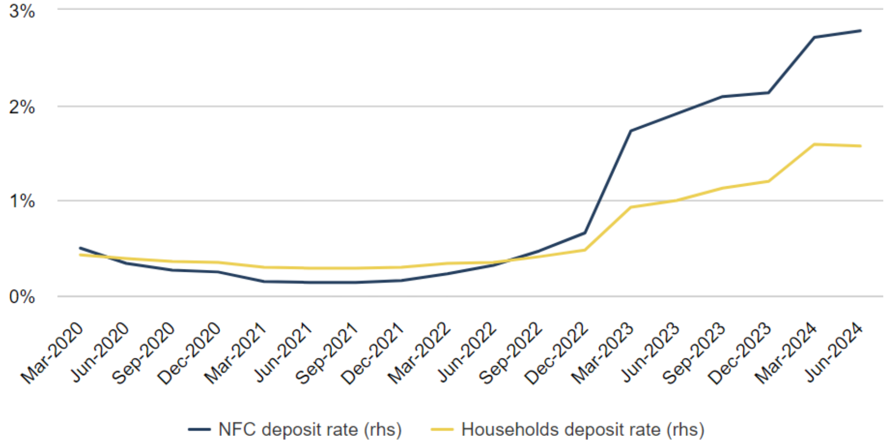
Consumer deposits remained an attractive funding instrument for banks, yet competition for deposits may increase

- Despite market volatility and increased market funding costs, banks remained active in primary funding markets, though with lower issuance volumes than last year for the first three quarters of 2024 for most debt classes.
- Customer deposits remain the primary funding source for EU/EEA banks, while central bank funding has decreased substantially, which also brought the asset encumbrance ratio down.
- Most banks target retail deposits as the main funding source for the next quarters. They also anticipate lower funding costs due to lower interest rates.
- Except for covered bonds, the 'greenium' on specific bank-issued debt was volatile across different debt types.

Funding instruments banks intend to focus on in the next 12 months



Rates of stock of NFC and household deposits of EU/EEA banks over time

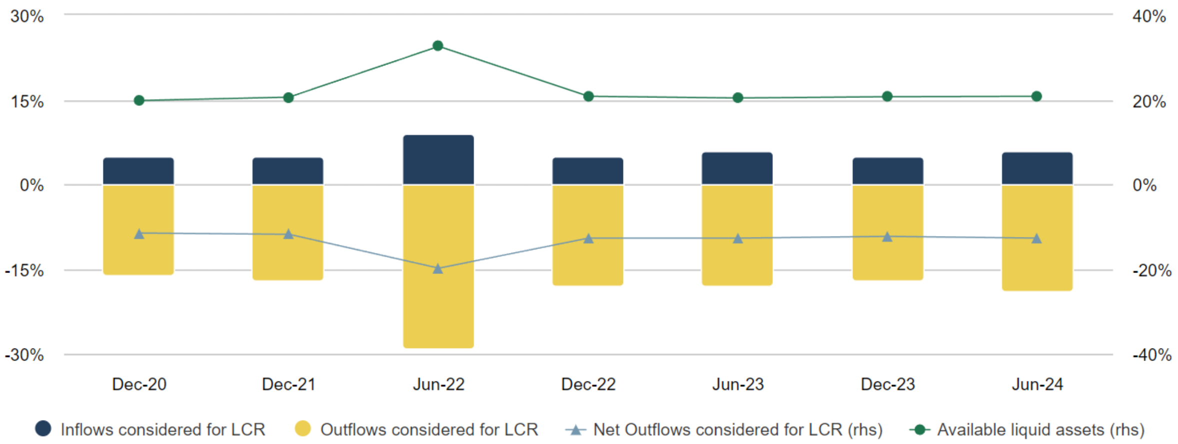


Source: EBA Risk Assessment Questionnaire, EBA Supervisory Data

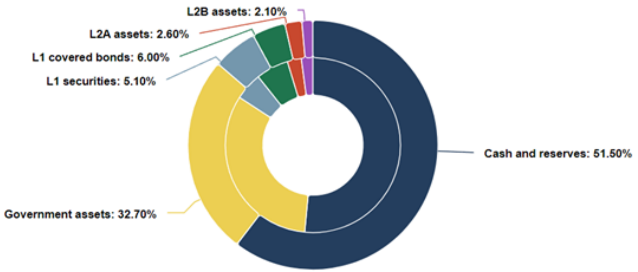
Banks maintain high liquidity levels yet there are challenges ahead

- The liquidity coverage ratio (LCR) stood at 163.2% (down from 168.3% in December 2023) and NSFR at 127.6% (127.1% in December 2023)
- EU banks increased their holdings of government assets and Level 1 covered bonds compensating a reduction in cash and central bank balances.

Main components of the LCR as a share of total assets



Composition of liquid assets, June 2023 (outer circle) and June 2024 (inner circle)



Source: EBA Supervisory data

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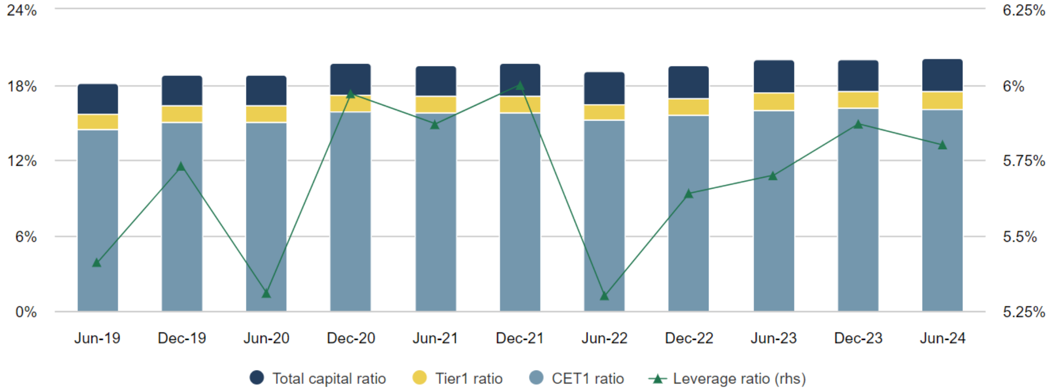
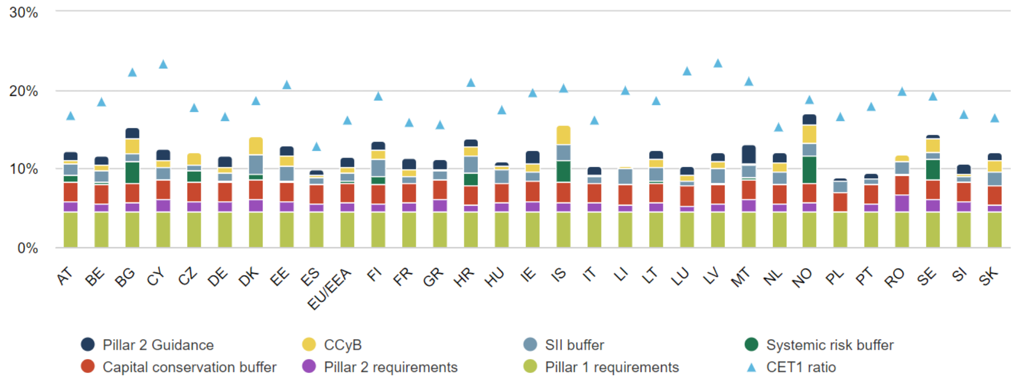
EU banks have robust capitalisation

- High profitability of EU banks enabled them to distribute record dividend payouts and share buybacks while maintaining high capital levels and ample capital headroom
- CET1 capital ratio stood at an all-time high of 16.1%. Although CET1 headroom declined slightly by 26bps it remained at comfortable levels (466bps as of June 2024).
- CET1 capital amounted to EUR 1.57 tn and was supported by rising retained earnings. RWAs increased by 3% YoY to EUR 9.8 tn mainly due to higher credit and operational risk.

Capital ratios and leverage ratio



Capital requirements and CET1 ratio by country, June 2024



Source: EBA Supervisory data

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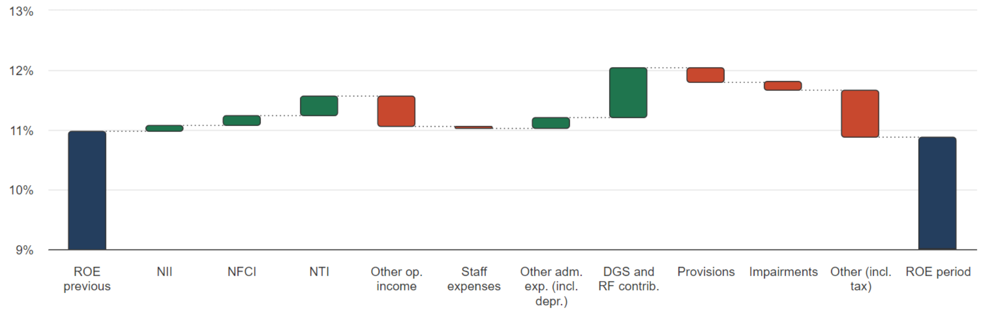
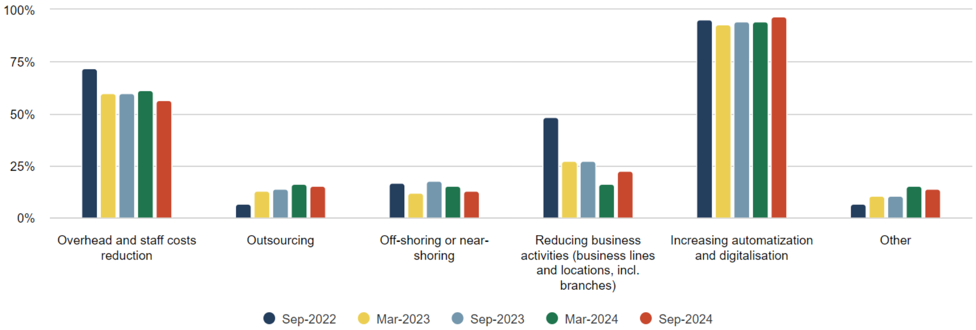
Banks’ profitability remains high, yet sustainability of profits is challenging

- EU/EEA banks reported 10.9% annualised RoE. Net profitability remained close to all-time high.
- However, growth of net interest income decelerated due to the stabilisation of the rate environment. Banks aim to increase fee income further amid pressure on net interest income.
- Although banks' expenses rose, they did so at a pace slower than the average inflation rate.
- A substantial number of EU/EEA banks currently fail to cover their cost of equity (CoE), and their market valuations remain below their book values.

RoE and contribution of the main profit and loss (P&L) items to the RoE’s YoY change, comparison between June 2023 and June 2024



Measures banks are primarily taking to reduce their operating expenses / costs

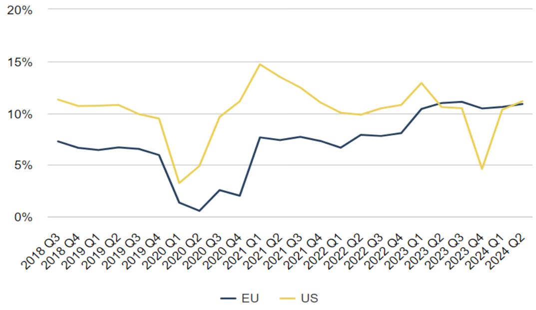


Source: EBA Risk Assessment Questionnaire, EBA Supervisory Data

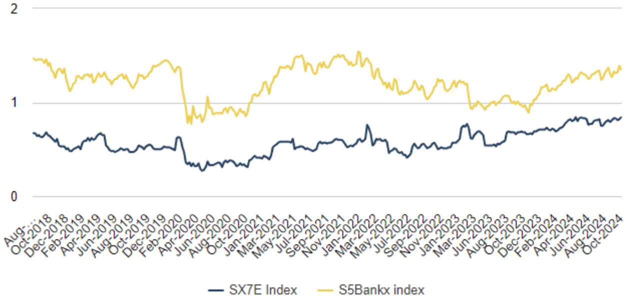
EU banks’ valuations lag US peers

- The profitability, and similarly valuation of EU/EEA banks lags behind that of their US counterparts.
- An analysis of the differences in profitability between EU and US banks indicates differences in their revenues as a main driver.
- Possible reasons for US banks’ higher revenues, include diversification of income, asset mix (including the use of securitisations), asset quality, but also the macroeconomic environment.
- Consolidation of the sector may help increase efficiencies, yet cross border transactions are reported as being less attractive than domestic ones for EU banks.

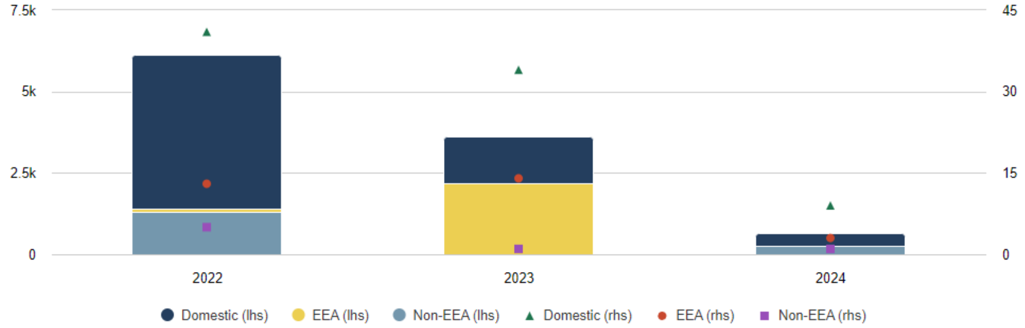
EU vs. US banks’ RoE



EU vs US banks’ price-to-book multiples, using the EuroStoxx banks (SX7E) and the S&P US banks index (S5BANKX)



EU/EEA banking sector related M&A transactions since 2022 (per year in 2022 and 2023, and YtD 2024), number and volume in EUR millions

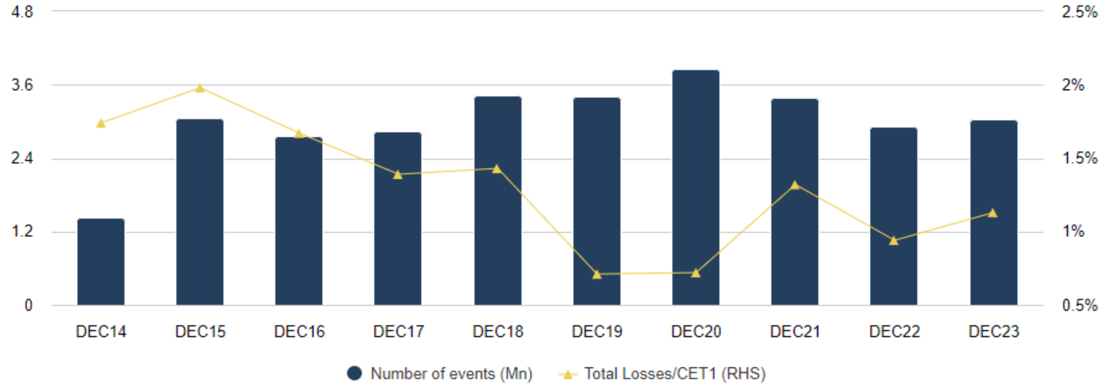


Source: S&P Capital IQ, Federal Reserve Bank of New York, Bloomberg, EBA supervisory reporting data and EBA calculations,

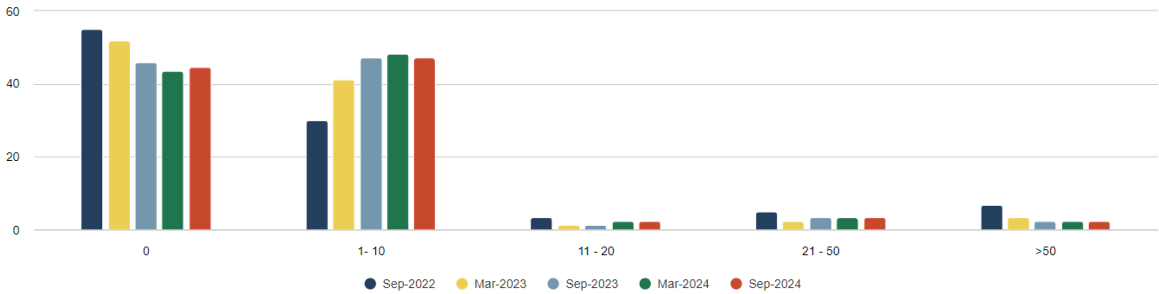
Operational risks continue to rise

- Operational risk capital requirements accounted for 10.2% of total requirements, up from 9.7% in June 2023.
- Geopolitical tensions have further increased operational risks, particularly related to cyberthreats.
- Technological advancements and digitalisation have heightened the importance of operational resilience. Cyber and ICT risks have become more prominent and the frequency of cyberattacks has increased.
- Fraud risk has increased substantially over the last quarters.

Number of new operational risk events over time and total losses in operational risk as a share of CET1, Dec-14 to Dec-23



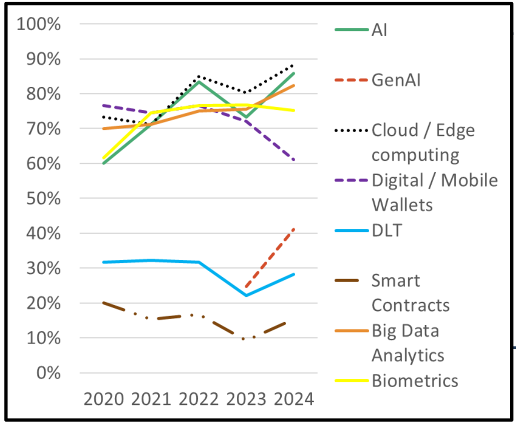
Number (in intervals) of cyberattacks to which banks fell victim in the first half of 2024 that resulted or could have potentially resulted in a 'major ICT-related incident' in the last semi-annual assessment period



Source: EBA Risk Assessment Questionnaire, EBA Supervisory Data

AI widely deployed by EU/EEA banks but there are risks related to the use of AI

Evolution of the level of involvement of AI



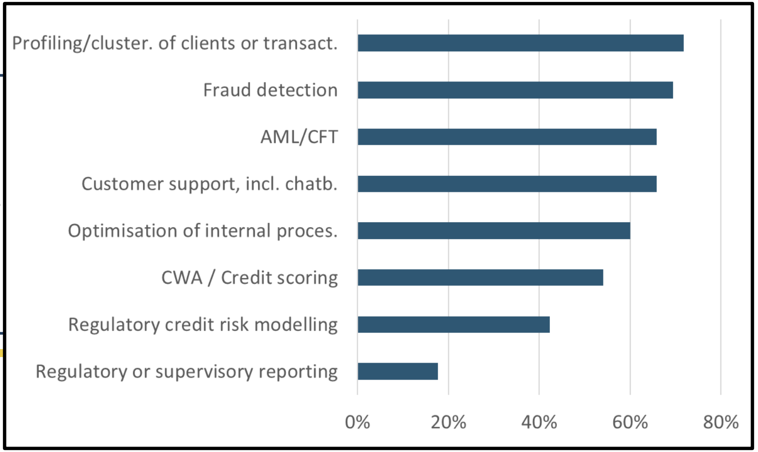
AI among major technologies used by EU banks

- The adoption of AI has consolidated among the major technologies used within the EU banking sector (together with Cloud, Big Data, Biometrics and Digital Wallets), and General Purpose AI (GPAI) is gaining traction.
- Its adoption is accompanied by a range of challenges and risks that demand careful management and rigorous testing - e.g. cybersecurity, consumer protection, data governance and data protection.
- Banks are taking a cautious approach towards AI, driven by the need to ensure compliance (mainly in consumer-facing systems).

Use of AI is prevalent in many use cases

- AI is deployed in all areas of banking, while most frequently in client and transaction clustering/profiling (for commercial purposes) and customer support, thanks to its role in enhancing the accuracy and efficiency of customer segmentation and improving the responsiveness of customer service channels.
- Use of AI to improve fraud detection and in AML/CFT is also widespread.

AI applications used by banks



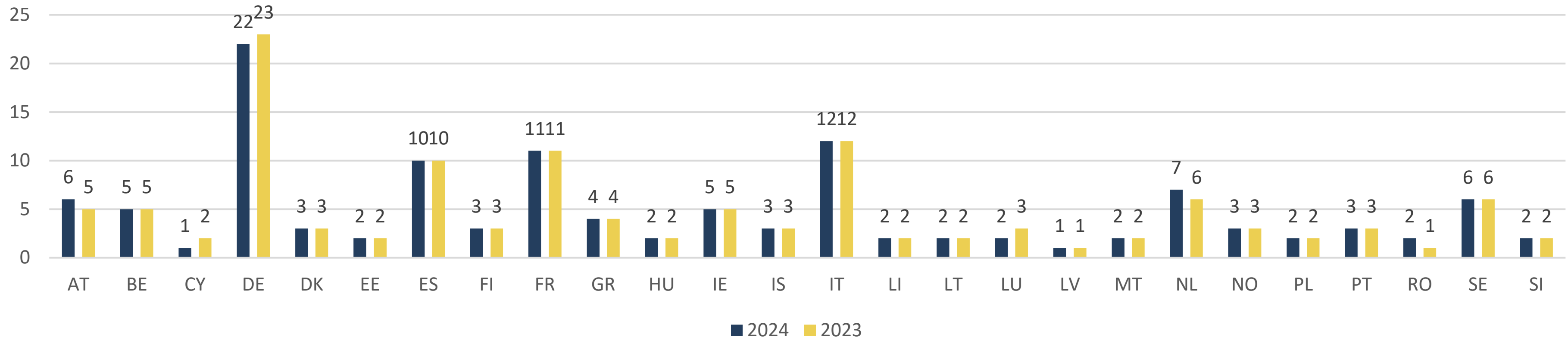
Source: EBA Risk Assessment Questionnaire

Policy Conclusions of EBA's RAR

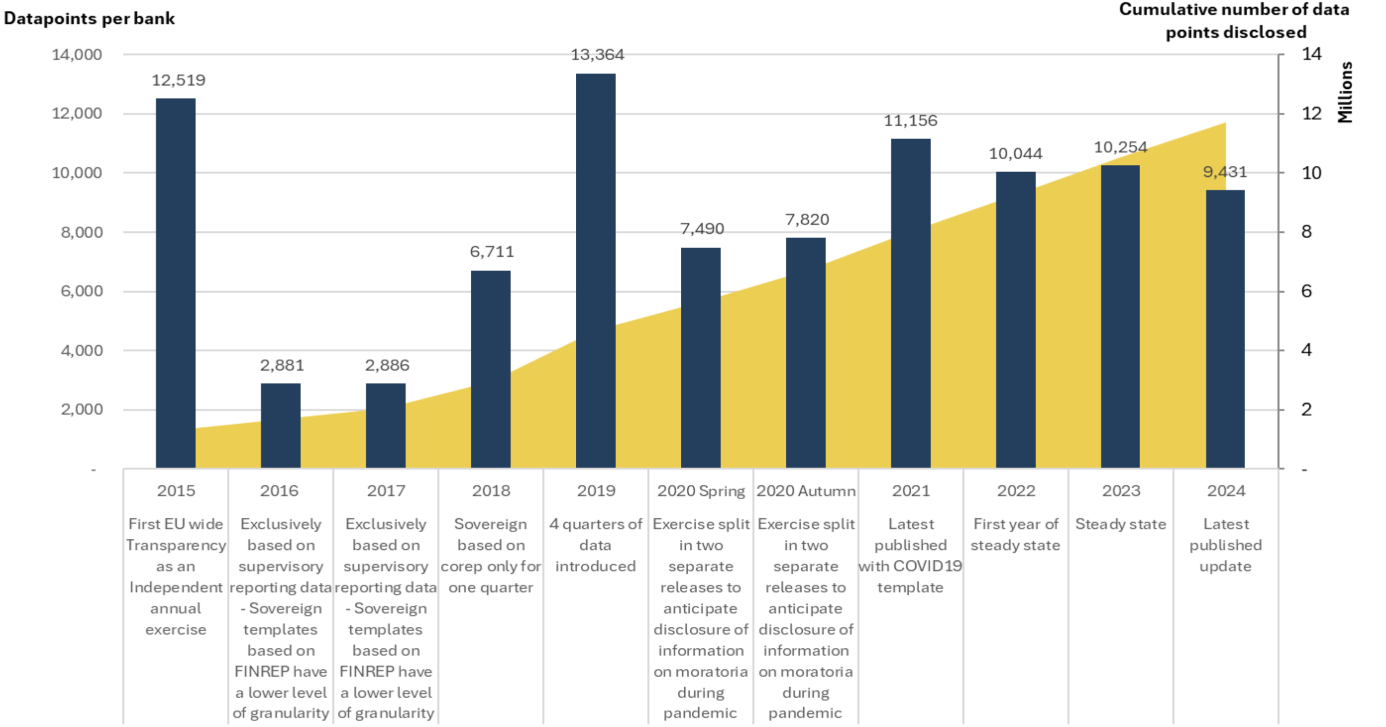
- EU/EEA banks need to maintain their strong capital and liquidity positions to withstand potential shocks, amid elevated macroeconomic uncertainty and increased geopolitical risks.
- Robust credit risk management frameworks are essential to identify and mitigate risks early.
- Banks should closely monitor asset quality trends and detect early signs of deterioration, including collateral valuations.
- Banks must integrate climate risk into their risk management frameworks to maintain financial stability. Enhance sustainable finance while effectively managing greenwashing risks.
- Banks need to seize favourable moments to issue bonds, especially given the possibility of ongoing market volatility.
- Need to diversify banks' revenue base and control costs in order to support profitability. Where there is business case, consolidation could prove beneficial for efficiency.
- Increasing urgency to further bolster banks' operational resilience against increasing digital and cyber threats.

EU-wide Transparency covering 123 banks

- An average of around 9,500 data points per bank; 123 banks from 26 countries at the highest level of consolidation in the EU/EEA.
- Reference dates: September 2023, December 2023, March 2024 and June 2024.



EBA's Transparency exercises: data disclosed over the years



What's on the website: the full package

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

Thank you!

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