2020 EU-wide Transparency Exercise and Risk Assessment Report

Directorate of Economic Analysis and Statistics

Background briefing with analysts and journalists | 11 December 2020
Outline of the presentation

- Transparency exercise – what we publish today

- Risk Assessment Report (RAR): main findings, outlook and policy implications
The 2020 EU-wide Transparency Exercise covers 135 banks

- On average more than 7,600 data points per bank; 129 banks from 26 countries at the highest consolidation in the EU-27/EEA plus 6 UK banks.

- Reference dates: **March 2020** and **June 2020**.

- Based on supervisory reporting data (FINREP, COREP). Information in line with previous exercises with two new templates:
  - Information on loans and advances subject to legislative and non-legislative moratoria,
  - Collateral valuation - loans and advances.
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

- **Single bank PDFs**

- **Online interactive dashboards:**
  - Main indicators – visual exploration tool
  - Key Metrics, Capital, Leverage, P&L, RWAs, Assets and Liabilities
  - NPE and forborne exposures
  - NACE
  - Sovereign
  - Covid-19
Exploiting data via interactive dashboards

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

- Banks data
- Country aggregates
- EU-27/EEA aggregates
Outline of the presentation

- Transparency exercise – what we publish today

- Risk Assessment Report (RAR): main findings, outlook and policy implications
Solid capital positions, profitability at record low levels

- European banks have increased their capital ratios due to a higher pick-up in eligible capital than in RWAs in the past year. In June 2020, the CET1 ratio stood at 15.0% (+60 bps YoY).
- Banks hold additional capital above the overall capital requirement (OCR) and P2G of around EUR 318 billion (3.6% of RWAs).
- Profitability significantly contracted YoY. In June 2020, the average return on equity (RoE) stood at 0.5%, down from 6.7% in June 2019.
- The decline is largely explained by the surge in impairment costs and, to a lesser extent, by the contraction in revenues.
- In contrast, operating expenses have registered a positive contribution to the RoE due to their contraction YoY.

**Capital requirements and buffers, by country, June 2020**

**Contribution to the fall in RoE of the main profit and loss (P&L) items, calculated as a ratio to total equity (2019-2020)**

*Source: Supervisory reporting data.*
NPLs have hardly risen (yet)...

- The deterioration in asset quality is not yet reflected in the NPL ratio. In June 2020, the NPL ratio stood at 2.9% (-50 bps YoY).
- Following a multi-year period of decreasing volumes, the volume of NPLs increased for the first time, albeit marginally, during the second quarter of 2020.
- Despite the substantial progress that has in general been made, a significant number of EU banks have not yet managed to complete the repair of their balance sheets.
- NPL vintage profiles also show that some banks still face challenges with older NPLs, which are in general more difficult to tackle.
- Accumulated impairments for performing loans increased by around 26% compared with 2019. This was driven by the increase in provisions booked during the first half of this year.

Source: Supervisory reporting data.
… but strong indications of a deterioration in asset quality

- The volume of forborne loans (FBLs) increased by around 10% in Q2 and stood at around EUR 360 billion, driven by forborne performing loans.
- Banks have also markedly increased the classification of loans in stage 2, with an equivalent decrease in the share of stage 1 loans.
- In June 2020, EU banks classified 88.4% of their loans and advances recognised at amortised cost into stage 1 (89.2% in June 2019), 8.2% into stage 2 (6.9%) and 3.4% into stage 3 (3.9%).
- In the second quarter of the year, the total volume of stage 3 loans at amortised cost reached EUR 0.5 trillion (-10% compared with June 2019), whereas stage 2 loans amounted to EUR 1.2 trillion (23% higher than in June 2019).
About 50% of banks’ large corporate exposures are towards climate policy-relevant sectors (CPRS)

In 2020 the EBA launched an exercise on climate risk with a sample of 29 volunteer banks. The exercise focuses on transition risk.

An analysis of banks’ corporate (excl. SME) exposures shows that 55% of these are allocated to climate policy-relevant sectors (CPRS).

A second analysis is based on greenhouse gas (GHG) emissions. Corporate exposures are classified in relation to GHG emission intensity, based on the distribution of individual companies’ GHG emission data.

According to this analysis, almost 34% of the original exposures are assigned to obligors with CO2 emission intensity above the median of the distribution.

The EBA is further assessing the risks of these exposures and possible implications for banks’ business models.

Source: 2020 EBA analysis of climate risk, Trucost, EBA calculations.
Abundant central bank funding drives banks’ liquidity

- Strong liquidity position at the start of the crisis: in June 2019, the LCR was 147.7% and increased to 166% in June this year.
- The importance of central bank funding has materially increased. Customer deposits also grew, whereas market-based funding was broadly resilient to the crisis after the initial turmoil subsided.
- Risk Assessment Questionnaire (RAQ) results indicate that senior non-preferred and subordinated debt instruments are in banks’ focus in the next 12 months.
- An additional analysis shows that banks have sufficient liquidity resources to meet their expected payments in different timeframes (3, 6 and 12 months).
- The results also show that the liquidity position of banks was somewhat affected by the COVID-19 outbreak, but then strongly recovered, not least reflecting central bank measures.

**Banks’ liquidity position with a time horizon of 3, 6 and 12 months (as share of total assets)**

**Intentions to attain more funding via different funding instruments**

Source: Risk Assessment Questionnaire (RAQ) for banks; supervisory reporting data and EBA calculations.

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Conclusions and policy recommendations

- **The new wave of COVID-19 infections is increasing uncertainty.** A continued coordinated fiscal, monetary and regulatory response is essential to minimise the impact of COVID-19 on the real economy.

- **Banks need to keep supporting the real economy.** Banks should avoid restricting lending to viable borrowers to prevent the failure of NFCs due to cash flow shortfalls that might trigger further defaults and banks’ losses. At the same time banks should increasingly pay attention to ESG risks of their counterparties.

- **Banks should brace themselves for a deterioration in asset quality.** Banks should engage, as soon as possible, with struggling borrowers in order to find solutions through forbearance or similar measures.

- **Banks should take advantage of favourable liquidity windows to advance in their MREL build-up.** Although central bank support has dissipated short-term liquidity concerns, and debt spreads have returned to pre-COVID levels, a lot of uncertainty remains.

- **COVID-19 has aggravated the need for cost reduction measures.** COVID-19 might be the catalyst for many clients to become digital customers. Banks might opt for M&A deals to exploit potential cost synergies.

- **Banks will need to make further progress in adapting their systems to a challenging technological environment and increasing AML/CFT risks.** During the pandemic, cybercrime and phishing attacks have accelerated in parallel with digitalisation and the usage of information and communication technology. Furthermore, banks’ preparedness for the replacements of benchmark rates remains a key risk.