



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

PRESS RELEASE

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Insufficient strategic steering may exacerbate banks' profitability challenges

- Thematic review of profitability and business models analyses the profitability drivers and business models of the directly supervised large banks
- Euro area banks' profitability and business models improved but remain under pressure
- The situation differs widely across institutions, both within and across business models
- ECB Banking Supervision issued bank specific recommendations and findings of the thematic review are considered in the 2018 Supervisory Review and Evaluation Process (SREP)

European Central Bank (ECB) Banking Supervision has published today the findings of the thematic review of banks' profitability and business models conducted from 2016 to the end of the first quarter of 2018. The review shows that although the economic situation of banks in the euro area has generally improved, profitability and business models remain under pressure.

Euro area banks are still adjusting after the crisis. High impairments, legacy issues and pressure on revenues from the economic environment, low interest rates and high competition continue to challenge the profitability of many significant banks in the euro area. However, the profitability situation differs widely across institutions and banks that have outperformed others over the last years are geographically spread out, have different sizes and have differing business models. Our analysis also confirms that banks strategic steering capabilities are an important factor influencing the profitability of institutions.

The thematic review investigated the strategic steering capabilities of the significant banks directly supervised by the ECB. Strategic steering capabilities refer to the management's ability to set a course

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towards the bank's long-term objectives. The review identified differences in the quality of banks' internal set-up to steer profitability. In general, banks with better steering capabilities have generated higher relative returns over the last three years.

Examples of the process deficiencies identified include the fact that, in many cases, banks did not allocate costs to a business line or distribution channel. Also, many banks need to improve the governance around the strategic planning processes, which calls for more involvement of the risk management function, a clearer linkage to risk appetite and a more comprehensive sensitivity analysis of key profit and loss drivers. In addition, loan pricing capabilities need to be enhanced. Most banks need to develop a more comprehensive pricing framework and apply it consistently across the organisation. This includes an understanding of minimum floors for pricing decisions.

ECB Banking Supervision expects banks to have strong strategic steering and risk management capabilities. Bank-specific recommendations were issued regarding the necessary improvements to strategic steering or risk management capabilities. The recommendations related to understanding income and expense drivers, cost management and allocation, loan pricing and strategy-setting processes. ECB Banking Supervision will monitor implementation of the expected improvements in strategic steering capabilities as part of the ongoing supervision.

The results of the thematic review feed into the 2018 SREP and may trigger on-site inspections and "deep dives" where further analysis is required. The thematic review report and frequently asked questions are published on the ECB Banking Supervision website.

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Notes:

- [SSM thematic review of profitability and business models](#)
- [FAQs](#)