Pills

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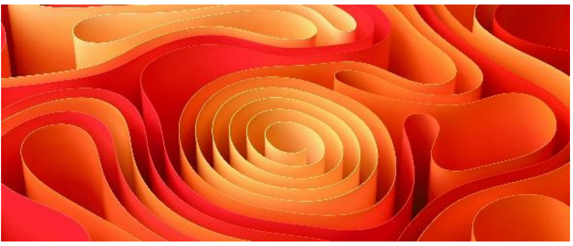

TOPICS:

Credit risk

SOURCE:

European Central Bank

ECB: Effectiveness of Supervisory Activities in Mitigating Banks' Commercial Real Estate Risk

- This paper evaluates **whether supervisory interventions** by the Single Supervisory Mechanism (SSM) **have improved banks' management of commercial real estate** (**CRE**) credit risk in the euro area. The study focuses on a period of heightened CRE vulnerability caused by rising interest rates, declining property valuations, remote-working trends, e-commerce expansion and the green transition.
- The authors examine **two supervisory tools: On-Site Inspections** (**OSIs**) – intensive, resource-heavy reviews conducted directly within banks that assess risk management, governance, collateral valuation, and provisioning practices; **Targeted Reviews** (**TRs**) – broader off-site thematic assessments designed to benchmark banks' practices and identify emerging sectoral vulnerabilities.
- Using confidential supervisory and FINREP data from 81 significant euro-area banks between 2020 and 2024, the study measures effectiveness through changes in the **CRE coverage ratio** (provisions relative to non-performing CRE exposures), a key indicator of banks' loss-absorption capacity and prudential risk management.
- The findings show that **both supervisory tools are associated with improved prudential behaviour**, but their effects differ substantially. OSIs lead to statistically significant and persistent increases in coverage ratios, with effects lasting at least eight to nine quarters after intervention. By contrast, TRs generate a quicker but shorter-lived response.
- The paper concludes that **OSIs and TRs are complementary supervisory instruments**. OSIs are more effective at producing durable behavioural and provisioning changes, while TRs provide broader supervisory reach and facilitate early identification of emerging risks across a larger population of banks. A balanced combination of both approaches can therefore strengthen supervisory effectiveness and enhance resilience within the banking sector's CRE portfolios.