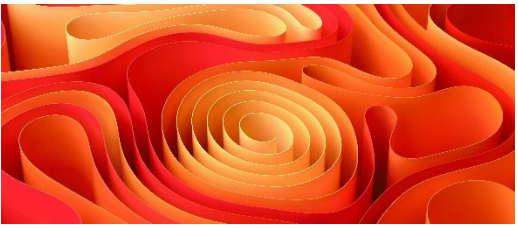
Pills
Regulatory/Supervisory Pills | N.141 October 2025



TOPICS:
Credit risk

SOURCE
European Central Bank

ECB: Extinguishing Sparks Before the Fire - Credit Crisis Managed Well

- The ECB has conducted **a targeted review of banks' lending to small and medium-sized enterprises (SMEs)**, recognizing their systemic importance to the EU economy, where they represent over 65% of employment and 53% of value creation. Given their reliance on bank financing, **the ECB examined how well-prepared European banks are to manage potential SME-related credit crises.**
- **The review** covered 14 significant banks (nine banking groups) and four less-significant German banks, **focusing on governance, rating practices, early warning systems, and management of financial difficulties.** Results highlighted wide divergences: **leading banks demonstrated strong digital infrastructure, automated risk processes, and even artificial intelligence-based tools**. These allowed efficient crisis response, early borrower engagement, and proactive risk identification. Conversely, **weaker banks relied on manual, outdated systems, with excessive dependence on expert judgment and delayed responses.** Most institutions fell in between, able to withstand moderate but not protracted stress
- A key finding was **the critical role of robust IT and data infrastructures.** Effective risk management requires comprehensive, timely borrower data to support ratings, **IFRS9 models, and early warning indicators.** Banks lacking these capabilities often applied outdated borrower ratings, undermining capital adequacy and provisioning. Furthermore, **many institutions did not adequately incorporate sectoral risk analysis**, despite sector-specific vulnerabilities being highly influentia**l**, particularly during crises such as the energy shock or real estate downturn.
- **Good practices identified** include: (i) **proactive detection of risks** through integrated early warning systems; (ii) **systematic borrower engagement**, supported by automated communication tools; (iii) **rigorous governance structures** with clear escalation procedures; and (iv) **sectoral segmentation** with conservative treatments for high-risk industries. Smaller banks benefitted from shared IT systems within cooperative structures, helping them achieve comparable standards to larger peers.