BANCO DE ESPAÑA
Eurosistema

The Single Supervisory Mechanism: Coordination of Supervision and Bank Crisis Management

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These views do not necessarily represent those of Banco de España or the Eurosystem

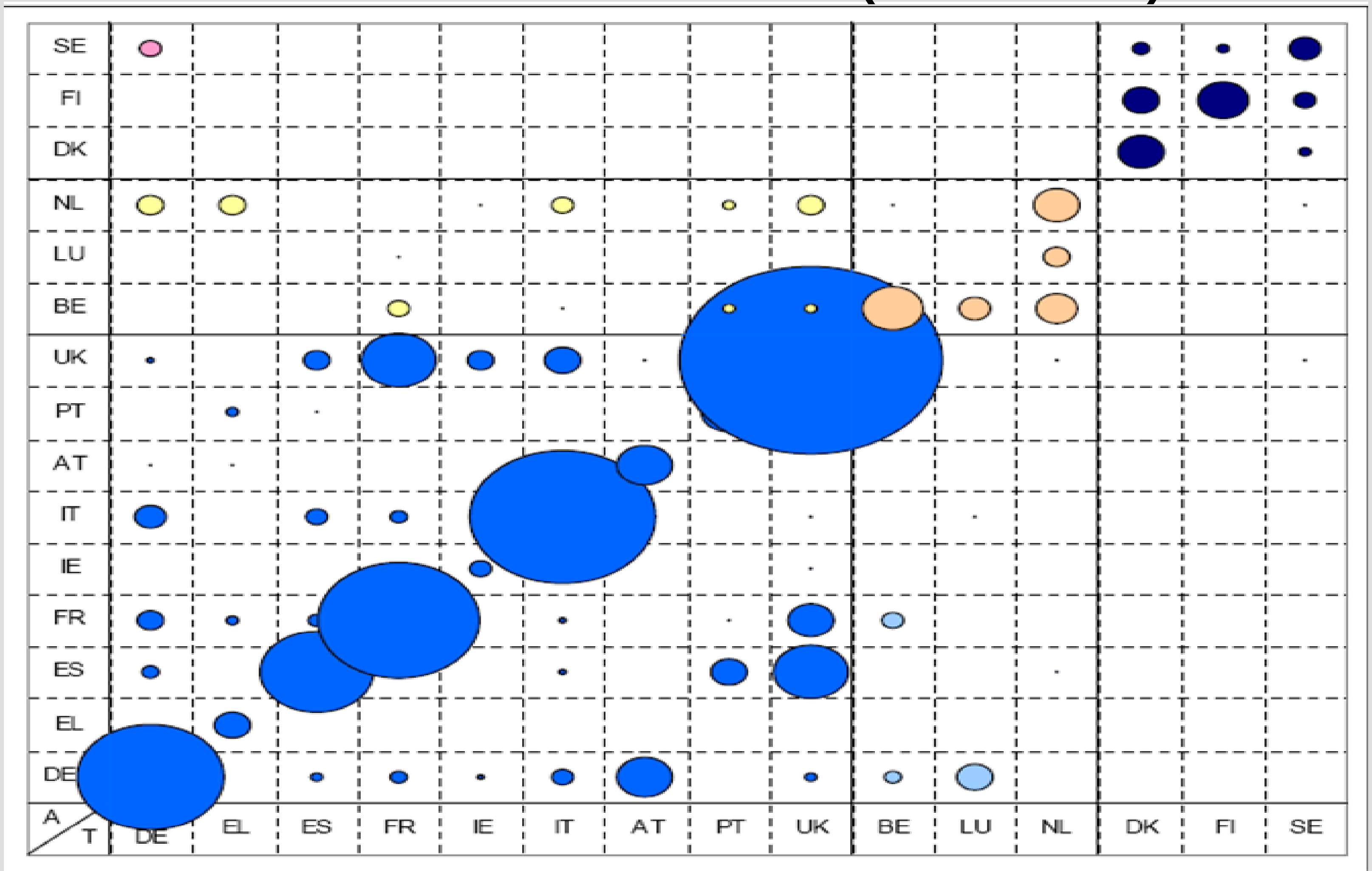
OUTLINE

- Coordination in the EU: Some stylized facts … and its economic consequences
- The SSM: Characterization of the supervisory model
    - *Coordination within the SSM*
        - ECB- participating euro area NCAs (significant and non significant)
        - ECB- participating non euro area NCAs
    - *Coordination with supervisors of other financial sectors*
- The SSM and bank crisis management in the EU
- Final reflections

Approach / Safety Net	Centralized	Explicit cross country coordination arrangements	Decentralized Implicit coordination across countries
Prudential Regulation	- o Common rule book	o European System Financial Authorities o EBA (technical standards and recommendations)	o National legislation subject to the restriction of harmonization
Prudential Supervision	o Centralized PS	o Colleges of Supervisors o EBA o ESRB o Coordination via MoU & Cross Border Stability Groups (PS+NCBs+Treasury)	o National on site and off site supervision
LOLR *(Emergency Liquidity to Institutions)*	-	o Coordination via MoU & Cross Border Stability Groups (PS+NCBs+Treasury) o ECB Governing Council	o Implicitly decentralized NCBs
Deposit Insurance	-		o National DIs o Towards more harmonization (implicit coordination)
Reorganization and Winding-Up	o European Resolution Authority	o Colleges of National Resolution Authorities	o National Resolution Authorities o Resolution procedures are partially harmonized

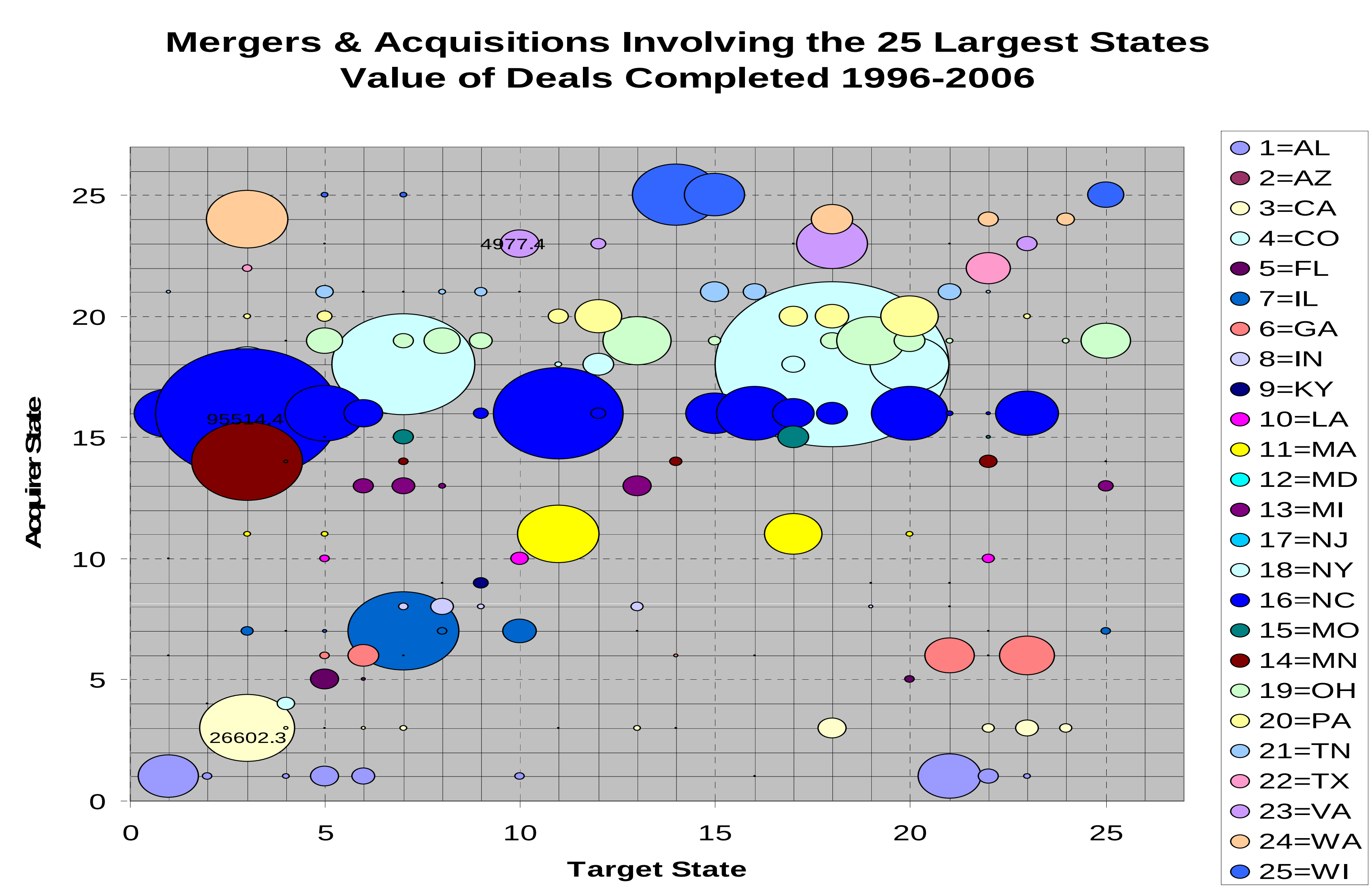
Value of deals within EU 15 (1999 – 2004)

Acquirer



Source: EU Commission

Target

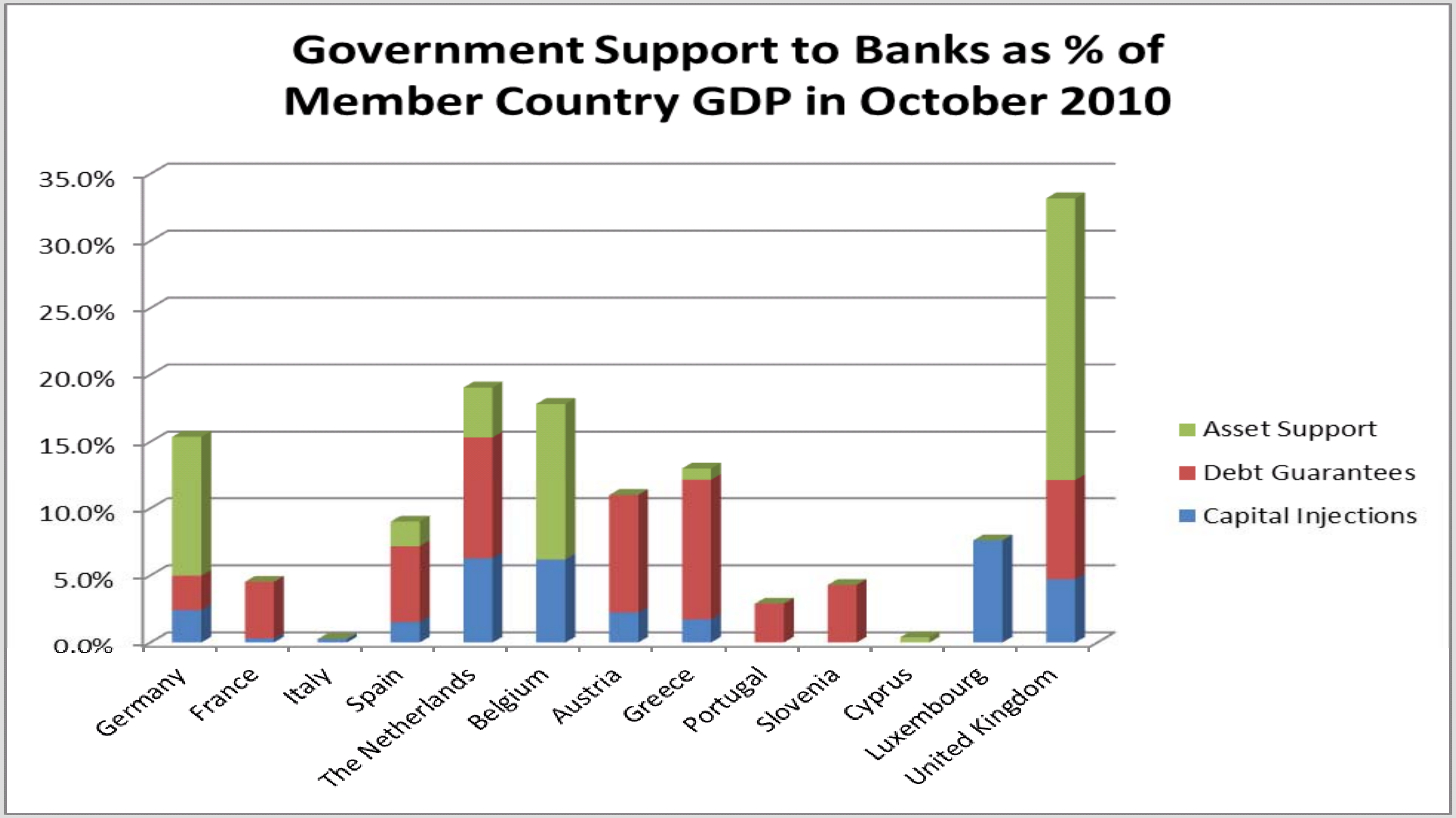


Source: Fed Atlanta

- The decentralized EU safety net has embedded in it incentive conflicts that have substantially increased taxpayer losses in bank crisis resolution whether X-B or not

  - Safety net regulators/agents should be expected to follow the interests of their home country/ principals

  - Some academic proposals:
    - ***Pratti and Schinasi (1999)***
    - ***Freixas (2003)***
    - ***Holthausen and Rønde (2005)***
    - ***…***



Source: Nieto and Garcia (2012)

Figure excludes Ireland !!!

Public Support to Financial Sector 7.9% EU GDP (2013)

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THE SSM: A “DUAL SUPERVISION MODEL”

- **The SSM “dual system” of banking supervision with oversight powers for both the ECB and national supervisors**

- **The ECB assigned the ultimate responsibility for the effectiveness and consistency of the SSM**
  - ECB powers are encompassing
  - Differences between the SSM “dual supervision” and some academic proposals:

    - Čihák and Decressin (2007)

    - Hertig, Lee and McCahery (2009)

    - Mayes, Nieto and Wall (2010)

THE SSM: COORDINATION

- **The framework of coordination between the ECB and euro area national bank supervisors participating in the SSM varies depending on whether the banks are considered "significant" or "less significant"**
  - ECB supervisory tasks regarding ALL credit institutions
    - *Authorization (and withdrawal)*
    - *M&As (no resolution)*
    - *Compliance with prudential requirements*
    - *Compliance with banks´ governance arrangements*
    - *Sanctioning*
    - *Supervision of financial conglomerates (banks)*
    - *Supervision of branches of banks legally incorporated in non participating countries*
    - *Supervisory tasks in relation to recovery plans and early intervention as established in the EU regulation*

THE SSM: COORDINATION

- **The framework of coordination between the ECB and non euro area supervisors**
  - Opt-In: If both the national bank supervisors and the ECB so agree under two conditions :
    - *National supervisors will abide by the guidelines or requests issued by the ECB, including the exchange of information and*
    - *National supervisors will adopt relevant national legislation to ensure that they will be obligated by any measure requested by the ECB*
  - Such close cooperation brings closer the perimeter of the Single Rule Book and the single supervision
  - Reversibility of the agreement (opt-out / suspension-termination)

THE SSM: COORDINATION WITH THE ESFA

- The SSM crystallizes the sector approach of financial supervision in Europe

- Particularly close coordination between the SSM and the banking regulators (EBA) will be needed in developing a true single rule book, which is fundamental to the success of the SSM

- Limitations of the sector approach to financial supervision

THE SSM: GOVERNANCE

- **Supervisory Board is responsible for the planning and execution of the supervisory tasks conferred upon the ECB**

  - Importance of their European mandate and governance arrangements
    - Involvement of EU institutions in the appointment of Chair and Vice Chair → Strengthens its European mandate
    - The ECB enjoys a sufficient level of independence as bank supervisor, however, such independence could be further enhanced

  - The ECB enjoys strong arrangements for accountability providing public oversight, maintaining legitimacy and enhancing integrity and performance

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THE SSM AND BANKING CRISIS MANAGEMENT

- The SSM is not a resolution authority
- **First best solution**:
  - Full centralization of the EU safety net:
    - *SSM*
    - *Single Resolution Authority cum Resolution Fund*
    - *Single deposit insurance*
- Centralization of supervision (SSM) is valuable and will reduce the cost of financial crisis ...even if coordination amongst resolution / liquidation authorities is limited (Hardy and Nieto,2009)

COORDINATION AMONG RESOLUTION AUTHORITIES

Proposed Crisis Management Directive

	Decentralized	*Centralized*	
Authority	Resolution Colleges ("lead administrator/liquidator")	Delegation in the Home Country ("Ad hoc" centralization)	European Resolution Authority
Legal Changes	Harmonization (early intervention powers and resolution tools)	Contractual Agreement in the context of the CRR	EU Special Resolution Regime for resolving Significant institutions

Source: Nieto (2010)

Banking Union

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FINAL REFLECTIONS

- The integration of bank prudential supervision in the ECB strengthens supervisory powers at the center in a “dual supervisory system”
  - The ECB will have full access to information and ultimate responsibility for the effective and consistent functioning of the SSM
  - The SSM that still relies on coordination
  - The ECB has encompassing powers limiting competition in laxity
  - Governance arrangements of the SB are consistent with the European mandate
- Existing coordination mechanisms can be further strengthened via harmonization to the highest standards …
  - Methodologies of on-site and off-site supervision
  - Supervisory teams of geographical diversity
  - Common accounting framework for the valuation of assets, liabilities and off balance sheet items in line with international financial standards
  - Single set of supervisory call reports
  - Single closure rule for banks
  - Governance arrangements (independence and accountability) of NCAs
- Centralization of supervision (SSM) is valuable and will reduce the cost of financial crisis … but incentives to cooperate will only be fully aligned when Banking Union is completed

Thank you!