The Single Supervisory Mechanism (SSM)

ECB Central Banking Seminar
Frankfurt, 9 July 2018
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Recent financial crises lead to the establishment of the banking union

Purposes of the banking union

- Increased transparency by consistently applying common rules and standards
- Equal treatment of national and cross-border banking activities
- Early intervention of banks in problem situations and if necessary resolution
The banking union is based on three pillars, amongst which the SSM

**Single Supervisory Mechanism (SSM)**
- ECB+NCAs
- Since November 2014

**Single Resolution Mechanism (SRM)**
- SRB+NRAs
- Since January 2016

**European Deposit Guarantee Scheme Directive (DGSD)**
- Since April 2014

**Single rule book: Capital requirements regulation (‘CRR’) and directive (‘CRD IV’) – Bank resolution directive (‘BRRD’)**
The SSM aims to achieve a resilient banking system and further harmonised supervision...

1. SSM raison d’être

The SSM aims to achieve a resilient banking system and further harmonised supervision...

Article 1 SSM Regulation

“This Regulation confers on the ECB specific tasks [...] relating to the prudential supervision of credit institutions, with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State, with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory arbitrage.”

Objectives of European banking supervision

1. Resilient banking system
   - Identification of relevant risks
   - Fair and consistent assessment of risks
   - Timely and tough intervention in case of identified deficiencies
   - Tough and forward-looking supervision of credit institutions

2. Harmonised supervision
   - Development of harmonised supervisory methodologies and approaches
   - Consistent application of the supervisory framework across all participating countries
   - Creation of a supervisory level playing field
... while avoiding conflicts of interest between the supervisory and monetary policy tasks

Article 25 SSM Regulation

“The tasks conferred on the ECB by this Regulation shall neither interfere with, nor be determined by, its tasks relating to monetary policy. [...] The staff involved in carrying out the tasks conferred on the ECB by this Regulation shall be organisationally separated from, and subject to, separate reporting lines from the staff involved in carrying out other tasks conferred on the ECB.”

Implementation of the separation principle

- **Independent Supervisory Board**
- **Governing Council to adopt or object** but not modify proposed decisions
- **Rules on information-sharing** between monetary policy and supervisory functions
  - Confidential information only shared on a need-to-know basis and with approval of the Executive Board
- **Separation at staff level** with the establishment of a **dedicated organisational structure** reporting to Chair/ Vice-Chair of the Supervisory Board
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The SSM is an integrated system based on cooperation between national supervisors and ECB

Distribution of tasks within the SSM

Direct supervision

ECB oversees the system

Indirect supervision

Joint Supervisory Teams (JSTs)

National supervisors

Horizontal divisions support

Significant institutions

Less significant institutions

Criteria for Classification as Significant Institution

1. Assets over EUR 30 billion

2. Representing > 20% of national GDP unless total assets < EUR 5 billion

3. Being among the three most significant institutions in each participating Member State

4. Institutions that have requested or received ESM or EFSF public financial assistance

5. Less significant institutions when necessary to ensure consistent application of high supervisory standards

ESM: European Stability Mechanism
EFSF: European Financial Stability Facility
2. Organisation of the SSM

The SSM is organised around an effective operating structure...

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<td>Joint Supervisory Teams</td>
<td>Supervisory Oversight &amp; NCA Relations</td>
<td>Secretariat to the Supervisory Board</td>
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<tr>
<td>Micro-prudential Supervision II</td>
<td>Joint Supervisory Teams</td>
<td>Institutional &amp; Sectoral Oversight</td>
<td>Authorisation</td>
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<tr>
<td>± 35 credit institutions</td>
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<td>Analysis &amp; Methodological Support</td>
<td>Decision-Making</td>
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<td>Supervisory Quality Assurance</td>
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- **DGs MS1&2**: conduct of day-to-day supervision of Significant Institutions via JSTs
- **DG MS3**: oversight of the LSI supervision performed by NCAs
- **DG MS4**: provides horizontal and specialised supervisory expertise, ensures consistency, early identification of risks and promotes best practices via experts’ networks between NCAs and ECB
- **DG SSB**: ensure efficient decision-making, quality assurance, authorisations, enforcement & sanctions
... and had to create a new European supervisory culture

- A challenging task ....
  - 26 national authorities from 19 different countries, speaking different languages, having different national supervisory cultures and traditions

- ... tackled from a mutual basis ...
  - Shared objective: safe and sound banking system
  - Common methodologies and harmonised approaches

- ... through an interlinked structure ...
  - Strong JSTs to supervise banks
  - Networks of experts for “horizontal” issues

- ... as well as constant dialogue and improvement
  - Meetings & workshops
  - Staff exchanges
  - System-wide training
  - Special traineeship programme with NCAs
  - Feedback in both directions

Experienced supervisors from the ECB and NCAs:
- 19 Member States involved
- 26 national authorities involved

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Key SSM facts

- The SSM is one of the largest banking supervisory authorities in the world.
- Currently 118 banking groups in 19 countries are under direct ECB supervision.
- Almost 82% of euro-area banking assets are under direct ECB supervision.
- Around 3,200 smaller institutions at solo level are directly supervised by the National Competent Authorities (NCAs), with the ECB being responsible for the system at large.
- Banking assets under direct and indirect ECB supervision amount to more than 26 trillion Euros, about 2.6 times euro-area GDP.
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   - 2c. Horizontal functions and specialised expertise within the SSM
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Supervision of Significant Institutions is based on the Joint Supervisory Teams

Functioning of JSTs

- Established for every banking group
- Comprising staff from ECB and NCA
- Responsible for day-to-day supervision and for implementing the annual supervisory programme
- Responsible for implementing decisions of Supervisory Board/Governing Council

Horizontal divisions

- Governing Council
- Supervisory Board
- ECB intermediate structures (DGs)

JST-Coordinator (Chair)
- Core JST Sub-coordinators (from NCAs) (support JST coordinator)

Team of experts from NCAs and ECB

Support JSTs
Three general principles for supervision of Significant Institutions

- **Forward looking, judgement and risk-based supervision**, grounded in strong analysis and addressing potential problems in a timely manner:
  - Deep understanding of risk factors and core business lines at individual banks and across sector
  - Linkages between banks and the rest of the financial system
  - In-depth analysis of risk governance, risk culture, business model and risk appetite
  - Regular high-level interactions at board and executive management levels

- **Multiple perspectives on risk and free flow of information**
  - to promote cross institutional perspective
  - to foster best supervisory practices and insights across institutions and countries
  - with no over-reliance on one model or methodology

- **Deep integration between ECB and NCAs**
  - dialogue, close cooperation, exchange of information and views
  - ECB supervisory knowledge built upon NCAs knowledge
Applying these principles in SSM supervision

- **Quantitative and qualitative analysis**
  - Risk level and Risk control assessment
  - Backward and forward-looking assessment (e.g. PDs, LGDs, results of stress-tests)

- **“Constrained judgment” as an anchoring point**
  - Ensures consistency across banks while allowing for expert judgment

- **Risk-based approach and compliance with regulatory requirements**
  - Assessing material risks (risk exposures)
  - Assessing organisational safeguards and internal control mechanisms
  - Input from extensive on- and off-site work based on regulatory, external and ad-hoc data

- **Proportionality**
  - Reflecting systemic impact, supervisory complexity and riskiness of a bank
  - Frequency, scope and intensity of the assessment reflect proportionality
  - Minimum engagement levels to ensure continuous and comparable intensity

PD: probability of default
LGD: loss given default
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2b. Supervision of Less Significant Institutions

National competent authorities remain the first contact point for Less Significant Institutions

Distribution of tasks regarding LSIs

- ECB with overall responsibility
- ECB compares on SSM-level and between sectors
- ECB provides expert support
- ECB promotes best practices
- ECB grants or withdraws banking licenses and assesses acquisitions of qualifying holdings

- NCAs bear primary responsibility for supervisions
- No duplication of national tasks at ECB level

Indirect ECB-supervision of LSIs

- Ex ante Notification
- Annual reports
- Ex post Notification
- Supplementary ad hoc Information
- Crisis
- High
- All LSIs

ECB intermediate structures (DGs)
National supervisors

ECB with overall responsibility
ECB compares on SSM-level and between sectors
ECB promotes best practices
ECB grants or withdraws banking licenses and assesses acquisitions of qualifying holdings

NCAs bear primary responsibility for supervisions
No duplication of national tasks at ECB level
General principles for supervision of Less Significant Institutions

- **Cooperation**
  - NCAs directly supervise less significant banks
  - ECB will receive information on less significant banks
  - ECB will exercise oversight over the system; this ensures the ‘singleness of the SSM’

- **National supervisory teams**
  - ECB may request NCAs to involve staff from other NCAs when appropriate

- **Tools for ECB oversight**
  - NCAs will have to abide by ECB regulations, guidelines and general instructions
  - ECB may decide to exercise direct supervision to ensure ‘consistent application of supervisory standards’
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2c. Horizontal functions and specialised expertise within the SSM

A comprehensive supervisory cycle - achieving homogenous supervision
Close cooperation between on-going Significant Institutions’ supervision and horizontal functions

Horizontal support / Specialized expertise

Methodology & Standards
Risk Analysis
Crisis Management
Planning and SEP
Internal Models
On-site
Supervisory policies

Day-to-day supervision through JSTs

Direct knowledge & contact with banks
Direct contact with NCAs procedures
Practical methodology implementation
SEP drafting and execution
On-going assessment of internal models
Participation on on-site inspections
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### 3. Looking back: Impact until now

**SSM achievements in the course of the first year**

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<th>Harmonisation</th>
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<td>- More than 1,000 SSM-related staff recruited</td>
<td>- Comprehensive Assessment and supervisory follow-up tasks completed</td>
<td>- Harmonised methodology for SSM SREP developed and implemented</td>
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<td>- SSM methodological and legal framework implemented</td>
<td>- Key risks within European banking sector identified and supervisory priorities defined</td>
<td>- Harmonisation of Options and National Discretions (ONDs): 150+ ONDs identified, draft ECB policy package on c.120 ONDs prepared</td>
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<td>- Key supervisory infrastructures set up and made operational</td>
<td>- Supervisory programmes for 123 SIs defined and implemented for 2015/2016</td>
<td>- Official SSM guidance on dividend payouts published</td>
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<tr>
<td>- JSTs set up and made operational</td>
<td>- First SSM Supervisory Review and Evaluation Process (SREP) completed</td>
<td>- Uniform supervisory practices implemented in several areas (e.g. fit &amp; proper assessments)</td>
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<td>- Collaboration with NCAs operationalised</td>
<td>- Thematic reviews on governance &amp; risk appetite, leverage finance and IT Cyber risks security conducted</td>
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3. Looking back: Impact until now

Scaled-up development in 2016

SSM organisation

- Ongoing development of the **institutional structure** with over 300 additional positions approved by the Governing Council
- Participation in 45 **supervisory colleges**
- Extensive **engagement with others externally**, including European bodies, BCBS, FSB
- LSI crisis management cooperation framework
- Enhanced **transparency**: disclosure of aggregate supervisory statistics
- **Cooperation agreements** with other authorities

Replies to questions from Members of the European Parliament increased in 2016:

- 2013: 1
- 2014: 9
- 2015: 28
- 2016: 34

Decisions by the Supervisory Board in 2016:

- 28 meetings
- 1,708 written procedures
- 1,835 decisions taken

Most common decisions:

- 1,191 Authorisation procedures
- 192 Own fund decisions
- 130 SREP decisions

Note: The numbers in the figure relate to individual supervisor decisions addressed to supervised entities or their potential acquirers and instructions to NCAs or SAs or LIs. In addition, the Supervisory Board took decisions on a number of horizontal issues (e.g. common methodologies and institutional issues).

1) The 1,104 decisions on authorisation procedures cover 2,488 individual procedures (see Section 21.2).
3. Looking back: Impact until now

Examples of targeted SSM supervisory actions in the course of 2016 and 2017

- 2016 stress test for euro area banks
- 2017 sensitivity analysis of interest rate risk in the banking book
- In depth analysis of NPLs and dedicated dialogues
- Continued improvement of capital adequacy of banks
- Launch of SSM-wide review of models used by banks to determine their risk-weighted assets (TRIM)
- Guidance on governance and risk appetite
- Reviews of IFRS9 and profitability
- …
3. Looking back: Impact until now

Achieving a substantial increase in harmonisation

- SREP
  - Harmonising options and discretions
- Guide to fit and proper assessments
- On-site methodology
- Internal capital and liquidity assessment (ICAAP and ILAAP)
- Recovery planning
- Involvement in EBA and global supervisory fora

Correlation between P2R and overall SREP scores

Based on banks with a final SREP 2017 decision as of 30 November 2017

Note: Correlation cannot reach 100% due to the facts that risks can also be addressed by other measures e.g. qualitative measures.

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Key risks for SSM banks in 2018

- Continued period of low interest rates puts pressure on interest rate margins challenging banks’ profitability.
- NPL ratios declined over the last year, however the number of high-NPL banks in the euro area remains substantial.
- While euro area economic and fiscal conditions improved, some countries still face debt sustainability concerns.
- This is particularly relevant against historically high levels of geopolitical uncertainty which could lead to a sudden repricing of risk in financial markets.
- Political uncertainty around Brexit creates additional challenges, including business continuity and transitional risks, as well as macroeconomic and regulatory risks.

Source: ECB and national supervisory authorities.

Note: Risks are not independent and might trigger or reinforce each other — indicated by arrows on the chart which represent the main transmission channels.

(*) NPLs: this risk driver is only relevant for euro area banks with high NPL ratios.
## SSM Supervisory Priorities for 2018 and beyond

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<td>Interest rate risk implications for banks’ business models’ profitability</td>
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<tr>
<td>Credit risk</td>
<td>Consistent approach to NPLs/ forbome exposures (e.g. deep dives / OSIs)</td>
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<td>✔️</td>
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<td>Exposure Concentrations &amp; Collateral Management and Valuation (e.g. real estate)</td>
<td>✔️</td>
<td>✔️</td>
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<td>Risk management</td>
<td>TRIM Credit risk, market risk and counterparty credit risk models</td>
<td>✔️</td>
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<td>Improvement of banks’ ICAAP and ILAAP approaches</td>
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<td>Evaluate banks’ preparedness for IFRS 9 and other regulatory changes</td>
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<td>✔️</td>
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<td>Multiple risk dimensions</td>
<td>Brexit preparations</td>
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<td>EU-wide (biennial) and SSM-wide stress test exercises</td>
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   2c. Horizontal functions and specialised expertise within the SSM

3. Looking back: Impact until now

4. Looking forward: SSM Supervisory Priorities 2018 and beyond

5. **Key conclusions**
5. Key conclusions

The SSM: looking back and forward

- The SSM is a **truly integrated system** based on cooperation between the national supervisors and the ECB - which was set up in a short period of time.

- SSM approach aims at building **intrusive, tough and fair supervision**.

- Since its start in 2014, the **SSM has played a decisive role** to increase banks’ resilience and harmonise supervisory practices across the euro area.

- In its fourth supervisory cycle, European banking supervision **continues to make steady progress** on its existing and newly identified priorities.

- In 2018, key SSM areas of supervisory focus remain **banks’ business models, credit risk** and **risk management**. Major initiatives such as **TRIM** are the most visible, but certainly not the only areas of SSM activity.

- The **SSM is a journey**. The objective is clear: a stable, competitive and efficient banking sector.
Questions?

More information on the functioning of the SSM as well as its main supervisory processes and methodologies can be found in the SSM Guide to Banking supervision.