The Single Supervisory Mechanism (SSM)

ECB Central Banking Seminar
Frankfurt, 1 July 2019

The views expressed are those of the presenter and not necessarily those of the ECB
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Recent financial crises led to the establishment of the banking union

**1. SSM raison d’être**

Recent financial crises led 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
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

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<th>ECB oversees the system</th>
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#### 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...

**Direct Supervision**
- Micro-prudential Supervision I
- Micro-prudential Supervision II
- Joint Supervisory Teams
- ± 35 credit institutions

**Indirect Supervision**
- Micro-prudential Supervision III
- Supervisory Oversight & NCA Relations
- Institutional & Sectoral Oversight
- Analysis & Methodological Support

**Horizontal functions & specialised expertise**
- Micro-prudential Supervision IV
- Centralised on-site Inspections
- Crisis Management
- Methodology & Standards Development
- Risk Analysis

**Secretariat**
- Secretariat to the Supervisory Board
  - Authorisation
  - Decision-Making
  - Enforcement & Sanctions
  - Supervisory Quality Assurance

- **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

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- **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
2. Organisation of the SSM

**Key SSM facts**

- The SSM is one of the **largest banking supervisory authorities in the world.**
- Currently **116 banking groups** in 19 countries are under direct ECB supervision *(as of 2 May 2019)*
- More than **80%** of euro-area banking assets are under direct ECB supervision *(as of November 2018)*
- **2,874 smaller institutions** at solo level are directly supervised by the National Competent Authorities (NCAs), with the ECB being responsible for the system at large *(as of 31 March 2019)*
- Banking assets under direct and indirect ECB supervision amount to **more than 23 trillion Euros** ➔ **about 2.1 times euro-area GDP** *(as of end 2017)*
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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
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
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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

Indirect ECB-supervision of LSIs

- 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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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

DG MS4

DG MS1-2
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3. Looking back: Impact until now

Our work in numbers...

The Supervisory Board discussed and decided on issues* in

- 126 meetings
- 6,884 written procedures
- 8,690 supervisory decisions were taken²

*2014 - 2019 May

The most common decisions were on

- 4,108 fit and proper assessments
- 479 internal models
- 735 own funds
- 571 SREP
- 735 qualifying holdings
- 500 significance
3. Looking back: Impact until now

**Harmonisation**

- European banking supervision provides a level playing field for banks across the euro area
- We have harmonised the Supervisory Review and Evaluation Process (SREP), the main tool of banking supervisors in the euro area
- We have harmonised the methodology for on-site inspections
- We have agreed on exercising options and discretions that are provided in European legislation in a consistent manner

**Supervision**

- European banking supervision ensures that all banks are supervised according to the same high standards (and the banks have adapted)
- Most importantly, we have taken measures to reduce non-performing loans
- We also launched a targeted review of banks’ internal models
- On top of that, we have dealt with important topics such as governance, cyber risk, leveraged finance, data quality, IFRS9 …
European banking supervision has a visible impact

3. Looking back: Impact until now

Non-performing loans

- NPL ratio for SIs down from 7.5% in Q4 2014 to 3.9% in Q4 2018

Liquidity

- Liquidity Coverage Ratio up from 128% in 2014 to 145.61% in Q4 2018

Capital

- CET1 ratio increased from 11.2% in Q4 2014 to 14% in Q4 2018
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4. Looking ahead: SSM Supervisory Priorities 2019 and beyond

Key risk drivers for SSM banks in 2019

- The map shows an **aggregate risk picture to SSM banks for the next 2-3 years**
- The top three risk drivers are **geopolitical uncertainties, NPL and cybercrime and IT disruptions**
- Compared to the previous published Risk Map, there was an **increase in risks related to geopolitical uncertainties and to repricing in financial markets**
- Moreover, progressing **digitalisation** intensifies the risks related to Cybercrime and IT disruptions.

SOURCE: ECB Banking Supervision: Risk Assessment for 2019 Publication
## SSM Supervisory Priorities for 2019 and beyond

### Priorities 2019

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<th>Credit risk</th>
<th>Risk management</th>
<th>Multiple risk dimensions</th>
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<td>Follow-up on NPL guidance</td>
<td>TRIM - Credit risk, market risk and counterparty credit risk models</td>
<td>Brexit preparations</td>
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<tr>
<td>Credit underwriting criteria &amp; exposure quality (e.g. real estate, leverage finance)</td>
<td>Improvement of banks’ ICAAP and ILAAP approaches &amp; further integration into SREP</td>
<td>Trading risk &amp; asset valuations</td>
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### Activities for 2019 & beyond

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<td>Activity planned</td>
<td>Activity possible</td>
<td>Not yet planned</td>
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- **The on-site phase of the project is expected to be concluded in 2019; in 2020 residual activities would be performed.**
- **In 2020 the EU-wide stress test exercise will be conducted.**

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**Timelines are indicative.**
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The SSM: looking back and ahead

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

- For 2019, the SSM has set the following high-level priority areas: **credit risk, risk management and activities compromising multiple risk dimensions**.

- 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.