



SPECIAL FEATURES

A PREPARATORY WORK FOR BANKING SUPERVISION AT THE ECB¹

This special feature briefly outlines the work currently being undertaken at the European Central Bank, in close cooperation with the national competent authorities of the participating Member States, for the assumption of supervisory responsibilities in November 2014. Following a short introduction, which summarises some of the features of the single supervisory mechanism, the preparatory developments are outlined, around five main themes, which reflect the organisation of the preparatory structures.

INTRODUCTION

The European Central Bank (ECB) is currently preparing to take on new banking supervision tasks as part of the single supervisory mechanism (SSM). The main aims of the SSM are to ensure the safety and soundness of the European banking system and to increase financial stability in Europe. The SSM will create a new system of financial supervision, whereby the ECB will be responsible for the effective and consistent functioning of the SSM, cooperating within the SSM with the national competent authorities (NCAs) of participating EU Member States.² Specific tasks relating to the prudential supervision of credit institutions have been conferred on the ECB under Article 127 (6) of the Treaty on the Functioning of the European Union.³

Council Regulation (EU) No 1024/2013 of 15 October 2013, conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions, was published on 29 October 2013 and entered into force on 3 November 2013.⁴ The ECB shall assume the tasks conferred on it by this SSM regulation (henceforth “SSMR”) on 4 November 2014.

Under the new system of supervision, the ECB will directly supervise “significant” credit institutions. It will work closely with the NCAs to supervise all other credit institutions under the overall oversight of the ECB. Around 130 banks will be directly supervised, representing almost 85% of total banking assets in the euro area. These credit institutions will be identified according to criteria, outlined in the SSMR, to determine their significance. In each participating country, at least the three most significant credit institutions will be subject to direct supervision by the ECB. All other credit institutions in the participating countries will continue to be supervised by the NCAs. According to Article 6 (5) of the SSMR, the ECB can decide at any time to exercise direct supervision of any one of these credit institutions in order to ensure consistent application of high supervisory standards.

At the centre of the SSM governance structure, a Supervisory Board will be established to plan and carry out the ECB’s supervisory tasks, undertake preparatory work, and propose complete draft decisions for adoption by the ECB’s Governing Council. It will be composed of a Chair, a Vice-Chair (to be chosen from among the members of the ECB’s Executive Board), four ECB representatives and one representative of the NCA of each participating country.

The ECB is currently preparing to take on new banking supervision tasks

The ECB will directly supervise around 130 “significant” banks

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2 To date, this includes all euro area countries plus Latvia. Member States whose currency is not the euro will have the possibility to participate in the SSM under the procedure of close cooperation.

3 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:en:PDF>

4 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:287:0063:0089:EN:PDF>

Preparations remain under the guidance of the transitory structures...

... overseen by a High-Level Group on Supervision...

... and supported by a Task Force on Supervision organised into five work streams

Work stream 1 has mapped the euro area banking system

PREPARATORY WORK

The Supervisory Board is expected to be in place in early 2014, and until that time, preparations will remain under the guidance of the transitory structures, comprising senior supervisors and technical experts from the NCAs and the ECB and established in order to make the preparations and provisions for the commencement of the SSM. Below, some of the key tasks and considerations of five preparatory work streams that have been established are outlined, which reflect the work that has been undertaken over the last year of preparations and/or which remains to be completed before November 2014.

Temporary governance structures

The early preparation for the SSM has been overseen, since the summer of 2012, by a High-Level Group on Supervision, chaired by the President of the ECB and composed of ECB Executive Board members and the heads, at Board level, of the national authorities in charge of supervision in the Member States belonging to the euro area (at the moment of writing, the 17 euro area Member States plus Latvia, which will join the euro area in 2014). When distinct from the supervisory authorities, the central banks are also represented in the High-Level Group by representatives with a comparable level of seniority.

Reporting to the aforementioned Group, a Task Force on Supervision was established to coordinate the technical preparation, chaired by the Director General Financial Stability of the ECB and composed of the heads, at staff level, of the supervisory functions in the same authorities represented in the High-Level Group. In turn, the Task Force established five work streams, each dedicated to a specific area and composed of experts from the ECB and the national authorities. The activities of these work streams are described in the following sections.

Mapping the euro area banking system

A fundamental task in the preparations for the establishment of the SSM has been the mapping of the euro area banking system. To this end, a catalogue comprising all supervised entities falling within the scope of the SSM, as well as systematic disclosure on the structure and composition of all euro area banking groups has been created. Data collections have been carried out for these purposes which have also benefited broader policy discussions.

The data collections and analyses have been focused on those entities falling within the scope of the SSM according to the SSMR. They are defined in the latter as “credit institutions, financial holding companies or mixed financial holding companies, or branches, which are established in participating Member States, of credit institutions established in non-participating Member States”.⁵

Apart from mapping the entire system, a clear focus of this work has been on the approach to identifying significant institutions, which the ECB will directly supervise. The criteria for significance derive from Article 6 (4) of the SSMR. It stipulates that an institution shall be considered significant if it meets any of three criteria, on a consolidated basis and at the highest level of consolidation within the participating Member States: i) the total value of its assets exceeds €30 billion; ii) the ratio of its total assets to the GDP of the participating Member State of establishment exceeds 20%, unless the total value of its assets is below €5 billion; or iii) it is among

⁵ The approach to gathering data on those entities was developed to allow for an assessment of their significance according to the criteria provided in Article 6 (4) of the SSMR. This required examinations and assessments of national idiosyncrasies concerning supervisory definitions and data availability, to achieve a maximum degree of consistency across jurisdictions, while duly taking into account the specific features of national banking systems.

the three most significant credit institutions in a participating Member State. Institutions for which public financial assistance has been requested or received directly from the European Financial Stability Facility or the European Stability Mechanism shall be considered significant and the ECB may also consider an institution to be of significant relevance where it has established banking subsidiaries in more than one participating Member States and its cross-border assets or liabilities represent a significant part of its total assets or liabilities.⁶

Supervisory legal issues

Assuming the tasks conferred on the ECB by the SSMR will require the adoption of a number of ECB legal acts in advance of November 2014, in view of the implementation of the SSMR and of the establishment of the SSM. A dedicated work stream has been established to facilitate these legal preparations and to provide legal advice concerning the other preparatory work.

*Work stream 2
has prepared legal
acts and provided
legal advice*

Among these various legal acts, the ECB must adopt, in consultation with the NCAs and on the basis of a proposal from the Supervisory Board, the framework which will set out the practical arrangements for the implementation of Article 6 of the SSMR (concerning the cooperation between the ECB and the NCAs within the SSM). This so-called Framework Regulation will take the form of an ECB regulation, a draft of which will be subject to public consultation in early 2014.

This draft Framework Regulation covers the aspects expressly referred to in Article 6 (7) of the SSMR. This includes the criteria for determining whether a credit institution is significant, as mentioned above, and the arrangements for determining how the ECB or an NCA, respectively, will supervise a credit institution that has been assessed as significant or less significant, not only at the outset of the SSM but also later. The Framework Regulation will include the procedures governing the cooperation between the ECB and the NCAs along with detailed operational arrangements for the implementation of the tasks conferred on the ECB, as required by Article 33 (2) of the SSMR.⁷

Supervisory model

A core element of the preparations for the SSM centre on the proposal and elaboration of a supervisory model. This includes, inter alia, the role for joint supervisory teams (JSTs), which will be composed of staff from both the ECB and NCAs, and the supervisory review and evaluation process (SREP), including the risk assessment system (RAS), based on the principles outlined in the SSMR.

*Work stream 3
has developed
proposals for a
supervisory model*

The JST concept is a core element of the SSM supervisory model. Without prejudice to the role of the Supervisory Board, JSTs will be responsible for the entire annual supervisory programme of each institution supervised directly by the ECB and will conduct the supervisory work. In addition to RAS and SREP activities, JSTs may undertake a range of ongoing supervisory activities to support the fulfilment of the supervisory programmes. JSTs will also play an important role in crisis management and will be responsible for ensuring that credit institutions have in place effective preventive measures to deal with potential crisis situations, for proposing appropriate early intervention tools and for handling crisis situations.

On the basis of Article 4 (g) of the SSMR, the ECB is exclusively competent to carry out the supervisory review of significant credit institutions and, as such, is required to develop its own

⁶ A precise and consistent assessment of whether an institution meets the criteria cited above requires a number of further technical and procedural specifications beyond the basic formulations in Article 6 (4) of the SSMR. As foreseen in the latter, those details will be provided in a dedicated section of the SSM Framework Regulation.

⁷ Matters of direct concern to credit institutions, such as the regime for taking supervisory decisions, the language regime and the rules of cooperation with participating Member States, are also contained within the Framework Regulation.

SREP. This will quantify capital and liquidity needs based on the RAS, the review of institutions' internal capital/liquidity adequacy assessment processes, the Pillar 1 minimum capital requirement, the risk-bearing capacity assessment and other available supervisory information. The definition of a supervisory toolkit, which is available as an adequate supervisory response to identified deficiencies from these assessments, is also under consideration. The RAS preparations cover the scope of the risk assessment and key definitions, the key principles to take into account when performing the risk assessment and the methodology for assessing risks. The methodology is rooted in a combination of quantitative indicators and qualitative inputs. Work on these topics has resulted in the development of an integrated SREP approach. The RAS and capital and liquidity buffer quantification will be conducted both at the risk level and also at the overall level.

In addition to the focus on directly supervised banks, consideration has also been given to the approach for dealing with less significant institutions (LSIs). While NCAs retain responsibility for supervising LSIs, the ECB has an oversight function, to ensure harmonised, high-quality supervision across the system. The ECB may also assume supervisory responsibility for an LSI at any time. NCA supervision of LSIs will be undertaken in accordance with SSM harmonised standards and processes, with a view to supervisory practices for LSIs converging over time. The first building block of this oversight and convergence is the definition of regular reporting requirements and the central analysis of the reports received from the NCAs. The aim of this analysis will be to identify fragile or high-risk LSIs and possible weaknesses in supervision.

This work stream has also considered the development of processes and procedures for supervision, the development of the on-site inspection approach and the preparation of an appropriate information technology architecture for the SSM.

Supervisory data reporting

Another key area of preparation has been focused on the supervisory reporting framework. The design of that framework is primarily driven by the requirements of the centralised RAS. An important element of the framework is flexibility: reporting data have been categorised according to different bank risk profiles, given that advances in the methodologies for assessing risk profiles will continue to inform the reporting framework.

A number of data modules have been defined within the framework. The core supervisory data module, essentially based on the European Banking Authority's common reporting and financial reporting templates, will provide standardised information on solvency measures, as well as financial information on banks and banking groups. The statistical data module relies on monetary financial institution (MFI) statistics as a complement to supervisory information. Data collected from each euro area MFI, in accordance with Eurosystem statistical requirements, provide a detailed source of highly harmonised data. This data is produced at a higher frequency (monthly) and in a more timely manner (just a few days after the reference period) than supervisory data. These data provide important information on the assets and funding structures of MFIs.⁸ The framework also includes other modules, for example: granular credit data, as an essential component to be used for supervisory analyses, and which constitute a powerful planning device to inform supervisory activity; ad hoc data collections, to facilitate, for example, stress testing; national data requirements, to inform national-specific reporting, which remains to be harmonised; and data required for public disclosure.

⁸ The key difference between MFI data and supervisory consolidated data relates to the reporting population and the geographical consolidation scope. For MFI data, the reporting population consists of MFIs resident in each Member State – no consolidation is performed for cross-border subsidiaries or non-bank subsidiaries.

*Work stream 4
has developed
a supervisory
reporting
framework*

The preparation of the supervisory data reporting framework and the associated infrastructures has been, and will continue to be, informed by a series of data collection exercises.

Comprehensive assessment

The fifth technical work stream is focused on planning and preparing for the comprehensive assessment, which will be conducted by the ECB and the participating NCAs, in line with the provisions of the SSMR.⁹ The comprehensive assessment will be carried out prior to the ECB assuming its new supervisory tasks in November 2014, pursuant to Article 33 (4) of the SSMR, and is seen as an essential element of the preparations, providing the necessary clarity and transparency on the banks that will be subject to the ECB's direct supervision.

*Work stream 5
has planned and
prepared for the
comprehensive
assessment*

The comprehensive assessment has been defined to comprise three complementary pillars. The first is the supervisory risk assessment, analysing key risks and vulnerabilities on banks' balance sheets, including liquidity, leverage and funding. Second is the asset quality review (AQR), examining the asset side of banks' balance sheets as of 31 December 2013. This assessment will be broad and inclusive, covering credit and market exposures, on and off-balance-sheet positions, domestic and non-domestic exposures, non-performing loans, forborne loans, and corporate, retail, institutional and sovereign exposures. The AQR will be conducted with reference to harmonised definitions. The third pillar is the stress test, building on and complementing the AQR by providing a forward-looking view of banks' shock-absorption capacity under stress. The ECB and the European Banking Authority have agreed to perform the stress test in close cooperation.

A focus of the preparations to date has been the AQR, which will be risk-based and will concentrate on the most risky and non-transparent elements of individual banks' balance sheets. To ensure that a significant portion of banks' balance sheets are assessed, however, strict minimum coverage criteria, at both country and bank level, will be observed. The AQR has been planned as a three-phase exercise, consisting of portfolio selection, execution and reporting. In order to foster transparency, consistency and sound communication throughout the exercise, the NCAs will involve staff from the ECB and from other Member States' NCAs to assess and review the implementation of the comprehensive assessment at the national level. The AQR will have a strong central governance structure, responsible for establishing the methodologies and for project organisation, overseeing the execution phases and ensuring the quality of the results. It will be supported by an independent expert firm of management consultants.

CONCLUDING REMARKS

Preparations continue apace at the ECB to take on new banking supervision tasks as part of a single supervisory mechanism. This preparatory work has been ongoing since the summer of 2012 in close cooperation with the NCAs of the participating Member States, overseen by the High-level Group on Supervision. As part of this work, significant progress has been made in five key areas: i) mapping the euro area banking system; ii) preparation of legal acts and provision of legal advice; iii) development of a supervisory model, iv) preparations for a supervisory reporting framework; and v) planning and preparing for the comprehensive assessment. The preparations at the ECB, as well as among national authorities, will continue in the coming months to allow the ECB to assume the tasks conferred on it by the SSMR on 4 November 2014.

⁹ Recent communication on the comprehensive assessment can be found at: <http://www.ecb.europa.eu/pub/pdf/other/notecomprehensiveassessment201310en.pdf?065ff8953213aaf23e385c1119dd541a>