EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Guide to banking supervision

This publication has been replaced by the Supervisory Manual. You can find the latest version of the Supervisory Manual on the ECB's banking supervision website.

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Foreword

This guide is fundamental to the implementation of the Single Supervisory Mechanism (SSM), the new system of financial supervision comprising, as at November 2014, the European Central Bank (ECB) and the national competent authorities (NCAs)[1] of euro area countries. It explains how the SSM functions and gives guidance on the SSM's supervisory practices

The SSM, which officially entered into operation in November 2014, is itself a step towards greater European harmonisation. It promotes the single rulebook approach to the prudential supervision of credit institutions in order to enhance the robustness of the euro area banking system. Established as a response to the lessons learnt in the financial crisis, the SSM is based on commonly agreed principles and standards. Supervision is performed by the ECB together with the national supervisory authorities of participating Member States[2]. The SSM will not "reinvent the wheel", but aims to build on the best supervisory practices that are already in place. It works in cooperation with the European Banking Authority (EBA), the European Parliament, the Eurogroup, the European Commission, and the European Systemic Risk Board (ESRB), within their respective mandates, and is mindful of cooperation with all stakeholders and other international bodies and standard-setters.

The SSM is composed of the ECB and the NCAs of participating Member States and therefore combines the strengths, experience and expertise of all of these institutions. The ECB is responsible for the effective and consistent functioning of the SSM and exercises oversight over the functioning of the system, based on the distribution of responsibilities between the ECB and NCAs, as set out in the SSM Regulation[3]. To ensure efficient supervision, credit institutions are categorised as "significant" or "less significant": the ECB directly supervises significant banks, whereas the NCAs are in charge of supervising less significant banks. This guide explains the criteria used to assess whether a credit institution falls within the significant or less significant institution category.

This guide is issued in accordance with the Interinstitutional Agreement[4] between the European Parliament and the ECB.

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[1] Some national central banks (NCBs) that are not designated as an NCA but are conferred certain supervisory tasks and competences under national law continue to exercise these competences within the SSM. References to NCAs in this guide apply as appropriate to NCBs for the tasks assigned to them under national law.

[2] Participating Member States are euro area countries and those EU Member States whose currency is not the euro but which have chosen to participate in the SSM by their NCAs entering into close cooperation with the ECB.

[3] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

[4] Interinstitutional Agreement between the European Parliament and the European Central Bank on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the Single Supervisory Mechanism (OJ L 320, 30.11.2013, p. 1).

The procedures described in the guide may have to be adapted to the circumstances of the case at hand or the necessity to set priorities. The guide is a practical tool that will be updated regularly to reflect new experiences that are gained in practice.

This guide is not, however, a legally binding document and cannot in any way substitute for the legal requirements laid down in the relevant applicable EU law. In case of divergences between these rules and the guide, the former prevail.

1 Introduction

1 The Single Supervisory Mechanism (SSM) comprises the ECB and the national competent authorities (NCAs) of participating Member States. The SSM is responsible for the prudential supervision of all credit institutions in the participating Member States. It ensures that the EU's policy on the prudential supervision of credit institutions is implemented in a coherent and effective manner and that credit institutions are subject to supervision of the highest quality. The SSM's three main objectives are to:

- ensure the safety and soundness of the European banking system;
- increase financial integration and stability;
- ensure consistent supervision.

2 On the basis of the SSM Regulation, the ECB, with its extensive expertise in macroeconomic policy and financial stability analysis, carries out clearly defined supervisory tasks to protect the stability of the European financial system, together with the NCAs. The SSM Regulation and the SSM Framework Regulation[5] provide the legal basis for the operational arrangements related to the prudential tasks of the SSM.

3 The ECB acts with full regard and duty of care for the unity and integrity of the Single Market based on the equal treatment of credit institutions with a view to preventing regulatory arbitrage. Against this background, it should also reduce the supervisory burden for cross-border credit institutions. The ECB considers the different types, business models and sizes of credit institutions as well as the systemic benefits of diversity in the banking industry.

5 Regulation ECB/2014/17 of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the ECB and national competent authorities and with national designated authorities (OJ L 141, 14.5.2014, p. 51).

4 In carrying out its prudential tasks, as defined in the SSM Regulation, the ECB applies all relevant EU laws and, where applicable, the national legislation transposing them into Member State law. Where the relevant law grants options for Member States, the ECB also applies the national legislation exercising those options. The ECB is subject to technical standards developed by the European Banking Authority (EBA) and adopted by the European Commission, and also to the EBA's European Supervisory Handbook. Moreover, in areas not covered by this set of rules, or if a need for further harmonisation emerges in the conduct of the day-to-day supervision, the ECB will issue its own standards and methodologies, while considering Member States' national options and discretions under EU legislation.

5 This guide sets out:

- the supervisory principles of the SSM;
- the functioning of the SSM, including:
  - the distribution of tasks between the ECB and the NCAs of the participating Member States;
  - the decision-making process within the SSM;
  - operating structure of the SSM;
  - the supervisory cycle of the SSM;
- the conduct of supervision in the SSM, including:
  - authorisations, acquisitions of qualifying holdings, withdrawal of authorisation;
  - supervision of significant institutions;
  - supervision of less significant institutions;
  - overall quality and planning control.

2 Supervisory principles

6 In the pursuit of its mission, the SSM constantly strives to maintain the highest standards and to ensure consistency in supervision. The SSM benchmarks itself against international norms and best practices. The revised Basel Committee's Core Principles for Effective Banking Supervision as well as the EBA rules form

a sound foundation for the regulation, supervision, governance and risk management of the banking sector.

7 The SSM approach is based on the following principles, which inspire any action at the ECB or centralised level and at the national level, and which are essential for an effective functioning of the system. These principles underlie the SSM's work and guide the ECB and the NCAs in performing their tasks.

Principle 1 – Use of best practices

The SSM aspires to be a best practice framework, in terms of objectives, instruments, and powers used. The SSM's evolving supervisory model builds on state-of-the-art supervisory practices and processes throughout Europe and incorporates the experiences of various Member States' supervisory authorities to ensure the safety and soundness of the banking sector. The methodologies are subject to a continuous review process, against both internationally accepted benchmarks and internal scrutiny of practical operational experience, in order to identify areas for improvements.

Principle 2 – Integrity and decentralisation

All participants in the SSM cooperate to achieve high-quality supervisory outcomes. The SSM draws on the expertise and resources of NCAs in performing its supervisory tasks, while also benefiting from centralised processes and procedures, thereby ensuring consistent supervisory results. In-depth qualitative information and consolidated knowledge of credit institutions is essential, as is reliable quantitative information. Decentralised procedures and a continuous exchange of information between the ECB and the NCAs, while preserving the unity of the supervisory system and avoiding duplication, enable the SSM to benefit from the national supervisors' closer proximity to the supervised credit institutions, while also ensuring the necessary continuity and consistency of supervision across participating Member States.

Principle 3 – Homogeneity within the SSM

Supervisory principles and procedures are applied to credit institutions across all participating Member States in an appropriately harmonised way to ensure consistency of supervisory actions in order to avoid distortions in treatment and fragmentation. This principle supports the SSM as a single system of supervision. The principle of proportionality (see Principle 7) is applied.

Principle 4 – Consistency with the Single Market

The SSM complies with the single rulebook. The SSM integrates supervision across a large number of jurisdictions and supports and contributes to the further development of the single rulebook by the EBA, while helping to better address systemic risks in Europe. The SSM is fully open to all EU Member States whose currency is not the euro and who have decided to enter into close cooperation. Given its central role in the SSM, the ECB contributes to further strengthening the convergence process in the Single Market with respect to the supervisory tasks conferred on it by the SSM Regulation.

Principle 5 – Independence and accountability

The supervisory tasks are exercised in an independent manner. Supervision is also subject to high standards of democratic accountability to ensure confidence in the conduct of this public function in the participating Member States. In line with the SSM Regulation, there will be democratic accountability at both the European and national levels.

Principle 6 – Risk-based approach

The SSM approach to supervision is risk-based. It takes into account both the degree of damage which the failure of an institution could cause to financial stability and the possibility of such a failure occurring. Where the SSM judges that there are increased risks to a credit institution or group of credit institutions, those credit institutions will be supervised more intensively until the relevant risks decrease to an acceptable level. The SSM approach to supervision is based on qualitative and quantitative approaches and involves judgement and forward-looking critical assessment. Such a risk-based approach ensures that supervisory resources are always focused on the areas where they are likely to be most effective in enhancing financial stability.

Principle 7 – Proportionality

The supervisory practices of the SSM are commensurate with the systemic importance and risk profile of the credit institutions under supervision. The implementation of this principle facilitates an efficient allocation of finite supervisory resources. Accordingly, the intensity of the SSM’s supervision varies across credit institutions, with a stronger focus on the largest and more complex systemic groups and on the more relevant subsidiaries within a significant banking group. This is consistent with the SSM’s risk-based and consolidated supervisory approach.

Principle 8 – Adequate levels of supervisory activity for all credit institutions

The SSM adopts minimum levels of supervisory activity for all credit institutions and ensures that there is an adequate level of engagement with all significant institutions, irrespective of the perceived risk of failure. It categorises credit institutions according to the impact of their failure on financial stability and sets a minimum level of engagement for each category.

Principle 9 – Effective and timely corrective measures

The SSM works to ensure the safety and soundness of individual credit institutions as well as the stability of the European financial system and the financial systems of the participating Member States. It pro-actively supervises credit institutions in participating Member States to reduce the likelihood of failure and the potential damage, with a particular focus on the reduction of the risk of a disorderly failure of significant institutions. There is a strong link between assessment and corrective action. The SSM's supervisory approach fosters timely supervisory action and a thorough monitoring of a credit institution's response. It intervenes as early as possible, thus reducing the potential losses for the credit institution's creditors (including depositors). However, that does not mean that individual credit institutions cannot be allowed to enter resolution procedures. The SSM works with other relevant authorities to make full use of the resolution mechanisms available under national and EU law. In the event of a failure, resolution procedures as provided by the Bank Recovery and Resolution Directive[6] are applied to avoid, in particular, significant adverse effects on the financial system and to protect public funds by minimising reliance on extraordinary public financial support.

3 The functioning of the SSM

8 The SSM combines the strengths of the ECB and the NCAs. It builds on the ECB's macroeconomic and financial stability expertise and on the NCAs' important and long-established knowledge and expertise in the supervision of credit institutions within their jurisdictions, taking into account their economic, organisational and cultural specificities. In addition, both components of the SSM have a body of dedicated and highly qualified staff. The ECB and the NCAs perform their tasks in intensive cooperation. This part of the guide describes the distribution of supervisory tasks, the organisational set-up at the ECB, and the decision-making process within the SSM.

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[6] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

3.1 The distribution of tasks between the ECB and NCAs

9 The SSM is responsible for the supervision of around 4,700 supervised entities within participating Member States. To ensure efficient supervision, the respective supervisory roles and responsibilities of the ECB and the NCAs are allocated on the basis of the significance of the supervised entities. The SSM Regulation and the SSM Framework Regulation contain several criteria according to which credit institutions are classified as either significant or less significant (see Box 1).

Box 1 Classification of institutions as significant or less significant

To determine whether or not a credit institution is significant, the SSM conducts a regular review: all credit institutions authorised within the participating Member States are assessed to determine whether they fulfil the criteria for significance. A credit institution will be considered significant if any one of the following conditions is met:

- the total value of its assets exceeds €30 billion or – unless the total value of its assets is below €5 billion – exceeds 20% of national GDP;
- it is one of the three most significant credit institutions established in a Member State;
- it is a recipient of direct assistance from the European Stability Mechanism;
- the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating Member State to its total assets/liabilities is above 20%.

Notwithstanding the fulfilment of these criteria, the SSM may declare an institution significant to ensure the consistent application of high-quality supervisory standards. The ECB or the NCAs may ask for certain information to be submitted (or resubmitted) to help facilitate the decision.

Through normal business activity or due to exceptional occurrences (e.g. a merger or acquisition), the status of credit institutions may change. If a group or a credit institution that is considered less significant meets any of the relevant criteria for the first time, it is declared significant and the NCA hands over responsibility for its direct supervision to the ECB. Conversely, a credit institution may no longer be significant, in which case the supervisory responsibility for it returns to the relevant NCA(s). In both cases, the ECB and the NCA(s) involved carefully review and discuss the issue and, unless particular circumstances exist, plan and implement the transfer of supervisory responsibilities so as to allow for a continued and effective supervision.

To avoid rapid or repeated alternations of supervisory responsibilities between NCAs and the ECB (e.g. if a credit institution's assets fluctuate at around €30 billion), the classification has a moderation mechanism: whereas the shift in status from less significant to significant is triggered if just one criterion is met in any one year, a significant group or credit institution will only qualify for a reclassification as less significant if the relevant criteria have not been met over three consecutive calendar years.[7]

Institutions are notified immediately of the SSM's decision to transfer supervisory responsibilities from the NCA to the ECB, or vice versa: prior to the adoption of the decision, the ECB gives the institution the opportunity to provide written comments. During the transition, institutions receive regular updates as needed and are introduced to their new team of supervisors. Once the transition is complete, a formal handover meeting is organised for representatives from the supervised institution and the outgoing and incoming supervisors.

10 The ECB directly supervises all institutions that are classified as significant (see Figure 1), around 120 groups[8] representing approximately 1,200 supervised entities, with the assistance of the NCAs. The day-to-day supervision will be conducted by Joint Supervisory Teams (JSTs), which comprise staff from both NCAs and the ECB (see Box 3). The NCAs continue to conduct the direct supervision of less significant institutions, around 3,500 entities, subject to the oversight of the ECB. The ECB can also take on the direct supervision of less significant institutions if this is necessary to ensure the consistent application of high supervisory standards.

11 The ECB is also involved in the supervision of cross-border institutions and groups, either as a home supervisor or a host supervisor in Colleges of Supervisors (see Box 2). Moreover, the ECB participates in the supplementary supervision of financial conglomerates in relation to the credit institutions included in a conglomerate and assumes the responsibilities of the coordinator referred to in the Financial Conglomerates Directive.

Box 2 Colleges of Supervisors

Established in accordance with the Capital Requirements Directive (CRD IV), Colleges of Supervisors are vehicles for cooperation and coordination among the national supervisory authorities responsible for, and involved in, the supervision of the different components of cross-border banking

[7] See the SSM Regulation and the SSM Framework Regulation for exceptions to this rule.

[8] In some cases, the term "groups" refers also to credit institutions or subsidiaries, which are supervised by the SSM on a stand-alone basis.

groups. Colleges provide a framework for the supervisors and competent authorities to carry out the tasks referred to in CRD IV, for example reaching joint decisions on the adequacy of own funds and their required level and on liquidity and model approvals.

Within the SSM, the ECB may have the following roles in supervisory colleges for significant banking groups:

- home supervisor for colleges that include supervisors from non-participating Member States (European colleges) or from countries outside the EU (international colleges);
- host supervisor for colleges in which the home supervisor is from a non-participating Member State (or a country outside the EU).

Where the ECB is the consolidating or home supervisor, it acts as chair of the college, both in European and international colleges. The NCAs of the countries in which the banking group has an entity participate in the college as observers. This means that the NCAs continue their regular participation in, and contribution to, the college's tasks and activities and receive all information, but do not take part in decisions or voting procedures.

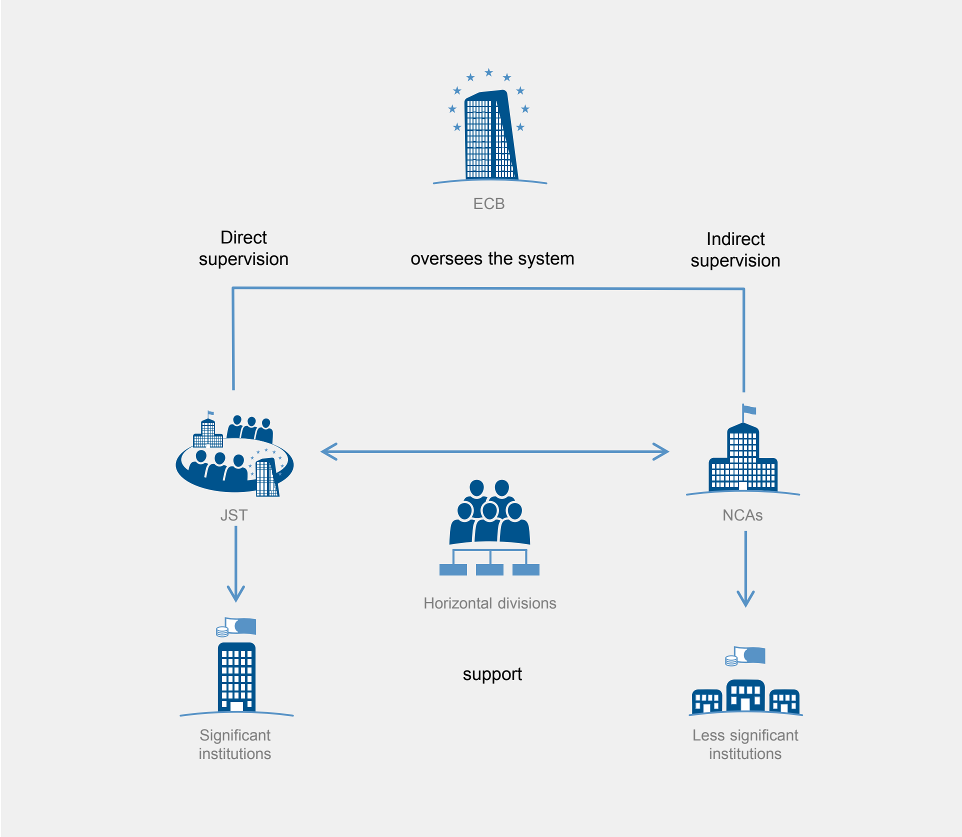
When the ECB acts as a host supervisor, the NCAs of the countries in which the banking group has an entity generally participate in the college as observers, unless the group has less significant entities in their respective countries, i.e. entities that are not under the ECB's direct supervision, in which case the NCAs continue to participate as members.

The EBA[9] and the Basel Committee[10] have issued guidelines/principles for the operational functioning of the colleges.

[9] CEBS: Guidelines for the operational functioning of Supervisory Colleges (Guideline 34), issued on 15 June 2010. Article 51(4) of the CRD IV requires the EBA to issue regulatory and implementing technical standards on the functioning of the colleges.

[10] Basel Committee on Banking Supervision, *Principles for effective supervisory colleges*, June 2014.

Figure 1 **The distribution of tasks within the SSM**



12 Against this background, the ECB is responsible for the direct supervision of around 120 groups, which together account for almost 85% of total banking assets in the euro area. Supervised credit institutions that are considered less significant are supervised directly by the relevant NCAs under the overall oversight of the ECB. This structure for banking supervision adequately reflects the SSM Regulation. All credit institutions under the SSM's supervision are subject to the same supervisory approach.

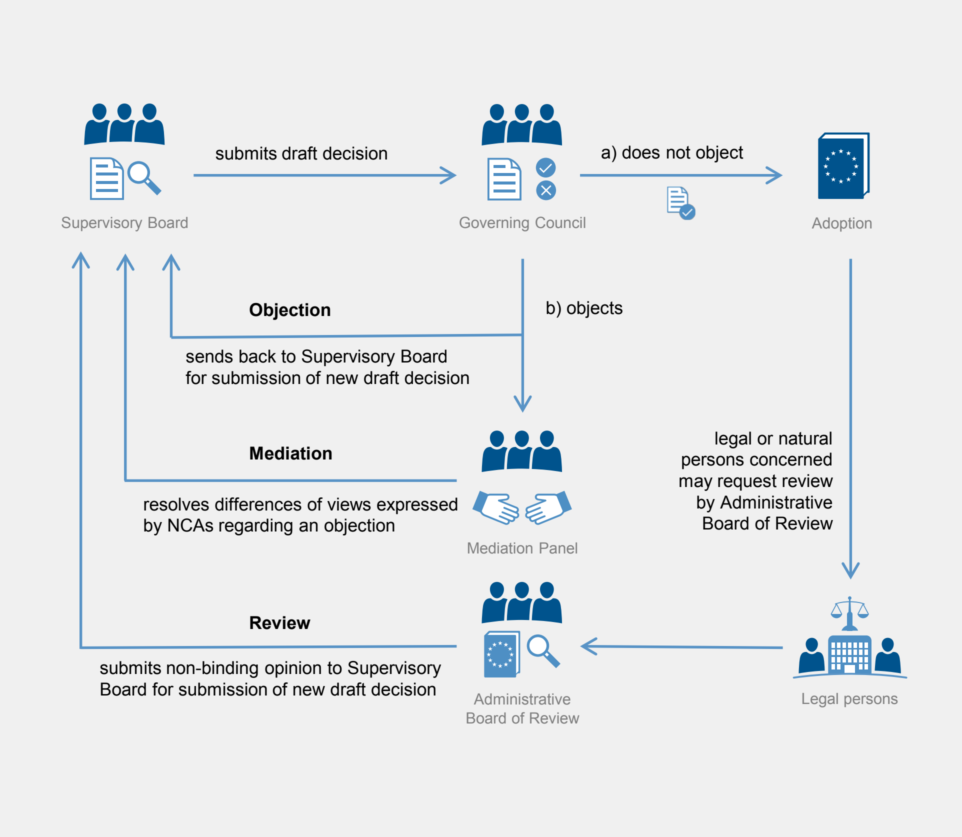
3.2 Decision-making within the SSM

13 The Supervisory Board plans and carries out the SSM's supervisory tasks and proposes draft decisions for adoption by the ECB's Governing Council. The Supervisory Board is composed of the Chair and Vice-Chair, four representatives of the ECB, and one representative of the NCAs in each participating Member State, usually the top executive of the relevant NCA responsible for banking supervision. The Supervisory Board's draft decisions are proposed on the basis of thorough, objective, and transparent information, bearing in mind the interest of the EU as a whole. The Supervisory Board operates in a way that ensures its independence.

14 The decision-making process is based on a “non-objection” procedure (see Figure 2). If the Governing Council does not object to a draft decision proposed by the Supervisory Board within a defined period of time that may not exceed ten working days, the decision is deemed adopted. The Governing Council may adopt or object to draft decisions but cannot change them. The ECB has created a Mediation Panel to resolve differences of views expressed by the NCAs concerned regarding an objection by the Governing Council to a draft decision of the Supervisory Board.

15 The ECB has also established an Administrative Board of Review to carry out internal administrative reviews of decisions taken by the ECB in the exercise of its supervisory powers. Any natural person or supervised entity may request a review of an ECB decision, which is addressed to them, or is of direct and individual concern. The Administrative Board of Review may also propose to the Governing Council that it suspend the application of the contested decision for the duration of the review procedure. The Board is composed of five independent members who are not staff of the ECB or an NCA. A request for a review of an ECB decision by the Administrative Board of Review does not affect the right to bring proceedings before the Court of Justice of the EU.

Figure 2 **Non-objection procedure**

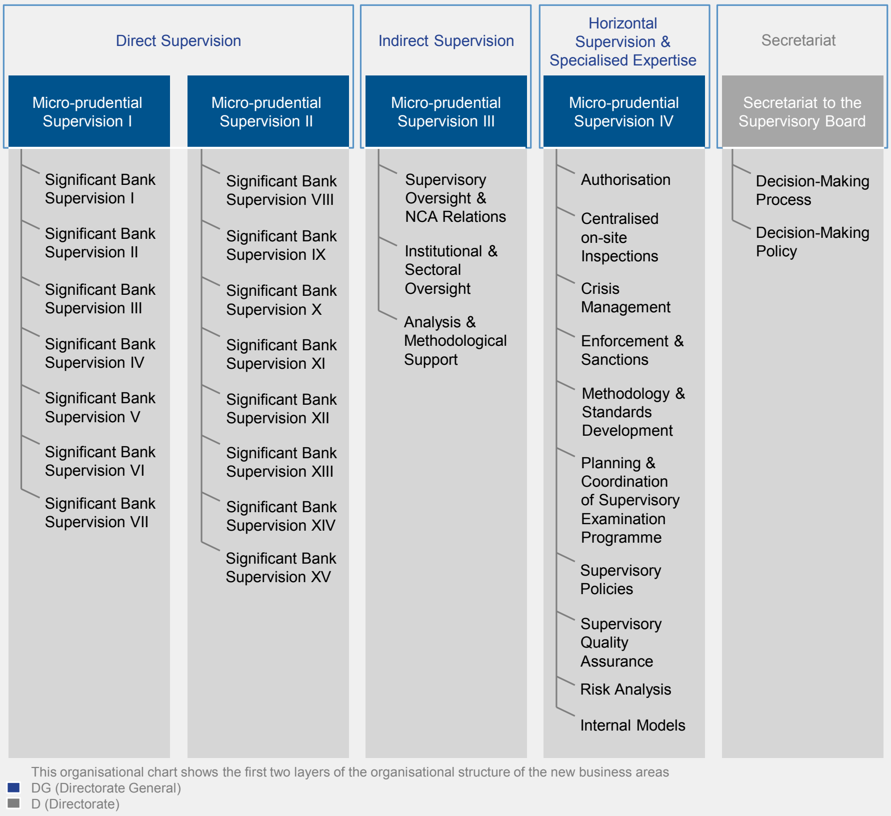


3.3 Operating structure of the SSM

16 The ECB has established four dedicated Directorates General (DGs) to perform the supervisory tasks conferred on the ECB in cooperation with NCAs (see Figure 3):

- DGs Micro-Prudential Supervision I and II are responsible for the direct day-to-day supervision of significant institutions;
- DG Micro-Prudential Supervision III is responsible for the oversight of the supervision of less significant institutions performed by NCAs;
- DG Micro-Prudential Supervision IV performs horizontal and specialised tasks in respect of all credit institutions under the SSM's supervision and provides specialised expertise on specific aspects of supervision, for example internal models and on-site inspections.
- Additionally, a dedicated Secretariat supports the activities of the Supervisory Board by assisting in meeting preparations and related legal issues.

Figure 3 Organisation of the SSM supervisory units in the ECB



17 DG Micro-Prudential Supervision I is responsible for the supervision of the most significant groups (around 30); DG Micro-Prudential Supervision II is in charge of the remaining significant groups. The day-to-day supervision of significant groups is conducted by Joint Supervisory Teams (JSTs), supported by the horizontal and specialised expertise divisions of DG Micro-Prudential Supervision IV (see Box 3).

Box 3 Joint Supervisory Teams

The day-to-day supervision of significant institutions is conducted by Joint Supervisory Teams (JSTs). The JSTs comprise staff from both the ECB and the NCAs of the countries in which the credit institutions, banking subsidiaries or the significant cross-border branches of a given banking group are established. A JST is established for each significant institution. The size, overall composition and organisation of a JST can vary depending on the nature, complexity, scale, business model and risk profile of the supervised credit institution.

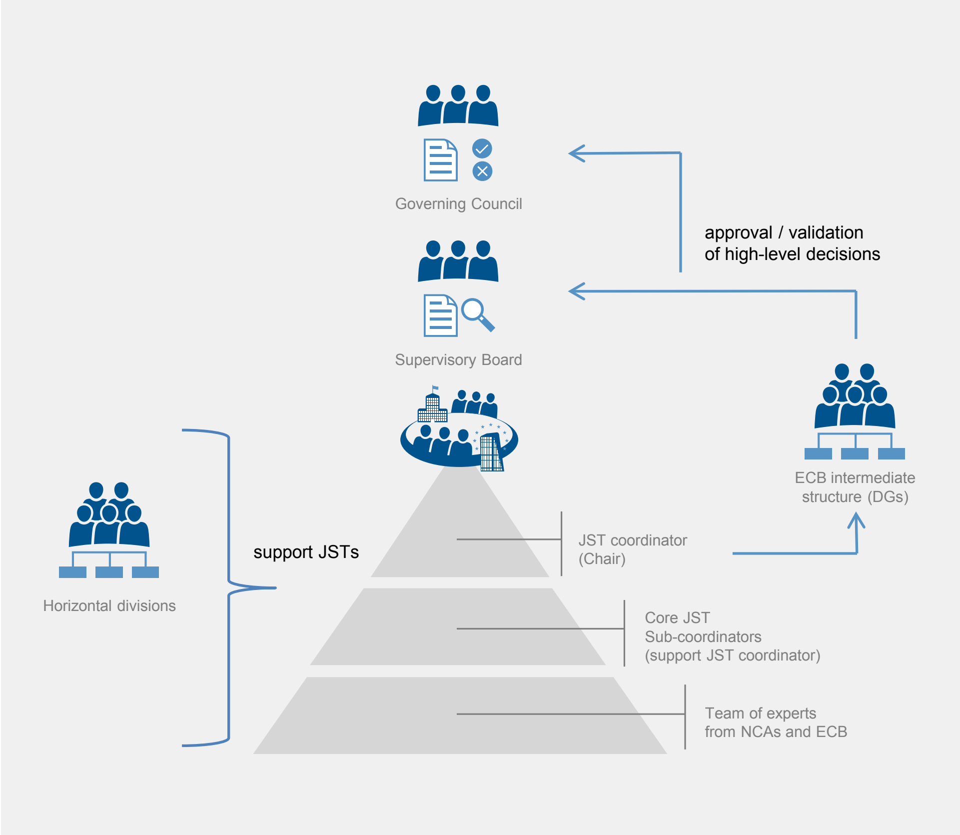
Each JST is led by a coordinator at the ECB (who is generally not from the country where the supervised institution is established) who is responsible for the implementation of the supervisory tasks and activities as included in the Supervisory Examination Programme for each individual significant credit institution.

NCA sub-coordinators of the JSTs are responsible for clearly defined thematic or geographic areas of supervision; they support the JST coordinator in the day-to-day supervision of significant credit institutions, also reflecting the views of the relevant NCAs. For certain tasks with a specific thematic focus, or tasks where particular technical expertise is needed, the JST may require additional support from the horizontal and specialised expertise divisions at the ECB (i.e. DG Micro-Prudential Supervision IV).

In the case of JSTs comprising a large number of staff, a core JST, consisting of the JST coordinator at the ECB and (national) sub-coordinators in the NCAs, organises the allocation of tasks among JST members, prepares and revises the Supervisory Examination Programme and monitors its implementation. It also reviews the consolidated risk, capital and liquidity assessment. The core JST brings the views of the JST members together.

JST coordinators are appointed for a period of three to five years, depending on the risk profile and complexity of the institution. JST coordinators and members are expected to rotate on a regular basis.

Figure 4 Functioning of the Joint Supervisory Teams



18 Ten horizontal and specialised divisions of DG Micro-Prudential Supervision IV support JSTs and NCAs in the conduct of supervision of both significant and less significant credit institutions. These ten divisions are: Risk Analysis, Supervisory Policies, Planning and Coordination of Supervisory Examination Programmes, Centralised On-site Inspections, Internal Models, Enforcement and Sanctions, Authorisations, Crisis Management, Supervisory Quality Assurance, and Methodology and Standards Development. The horizontal divisions interact closely with the JSTs in, for example, defining and implementing common methodologies and standards, offering support on methodological issues and helping them to refine their approach. The aim is to ensure consistency across the JSTs' supervisory approaches.

19 The SSM actively fosters a common supervisory culture by bringing staff from various NCAs together in the JSTs, in the context of the supervision of less significant institutions, and in the horizontal and specialised divisions. In that respect, the ECB also plays a role in organising staff exchanges between NCAs as an important tool for achieving a sense of commonality of purpose. This shared culture is the foundation of consistent supervisory practices and approaches throughout the participating Member States.

20 The supervisory tasks are supported by the ECB's "shared services", including services for human resources, information systems, communications, budget and organisation, premises and internal audit, and legal and statistical services.

The SSM is thus able to exploit operational synergies while keeping the required separation between monetary policy and banking supervision.

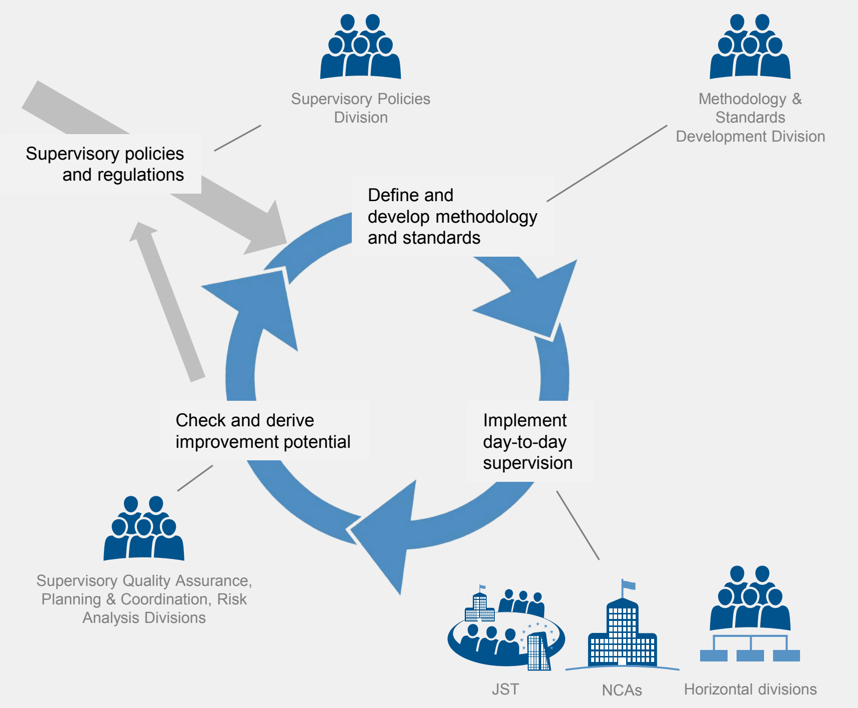
3.4 The supervisory cycle

21 The process for the supervision of credit institutions can be envisaged as a cycle (see Figure 5): regulation and supervisory policies provide the foundation for supervisory activities and for the development of supervisory methodologies and standards.

22 The methodologies and standards underpin the day-to-day supervision that is carried out to the same high standards across all credit institutions. Through various channels, including the SSM's participation in international and European fora, the lessons learnt in the course of supervision and the performance of quality assurance checks feed back into the definition of methodologies, standards, supervisory policies and regulation.

23 Experience gained from the practical implementation of the methodologies and standards feeds through to the planning of supervisory activities for the forthcoming cycle. This planning also incorporates the analysis of key risks and vulnerabilities and strategic supervisory priorities. The supervisory cycle is set out in more detail below.

Figure 5 **The supervisory cycle**



3.4.1 Supervisory policies

24 The European banking regulatory framework follows the Basel Accords and is harmonised through the single rulebook, which is applicable to all financial institutions in the Single Market. The ECB's Supervisory Policies Division assists in developing statutory prudential requirements for significant and less significant banks on, for example, risk management practices, capital requirements and remuneration policies and practices.

25 The Supervisory Policies Division coordinates the SSM's international cooperation and participates actively in various global and European fora, such as the EBA, the European Systemic Risk Board (see Box 4), the Basel Committee on Banking Supervision and the Financial Stability Board. The Supervisory Policies Division supports the JSTs' work in the Colleges of Supervisors by setting up and updating cooperation agreements. Additionally, the Division will establish and coordinate cooperation with non-participating Member States and with countries outside the EU, for example by concluding Memoranda of Understanding.

26 The Supervisory Policies Division launches and coordinates these activities in close cooperation with all stakeholders, such as other ECB business areas, other banking supervision DGs and the NCAs.

Box 4 Cooperation with other European institutions and bodies

To create a safer and sounder financial sector, new rules have been implemented and new institutions and bodies have been established since 2007, within both the EU and the euro area. As a key element of this new institutional framework, the SSM cooperates closely with other European institutions and bodies as explained below.

European Systemic Risk Board

The European Systemic Risk Board (ESRB) is tasked with overseeing risks in the financial system within the EU as a whole (macro-prudential oversight). If the ECB uses the macro-prudential instruments defined in the CRD IV or the Capital Requirements Regulation (CRR), either at the request of the national authorities or by deciding to adopt stricter measures than the ones adopted at the national level, it needs to take the ESRB's recommendations into account. A close cooperation between the ECB and the ESRB and the development of information flows is mutually beneficial: it improves the ESRB's ability to effectively identify, analyse and monitor EU-wide systemic risks, while the SSM may take advantage of the ESRB's expertise, which goes beyond the banking sector and covers the entire financial system, including other financial institutions, markets and products.

European Banking Authority

The ECB closely cooperates with the European Supervisory Authorities, especially the European Banking Authority (EBA). As banking supervisor, the SSM should carry out its tasks subject to, and in compliance with, the EBA's rules. The SSM is involved in the EBA's work and contributes significantly to supervisory convergence by integrating supervision across jurisdictions.

Single Resolution Mechanism

The Single Resolution Mechanism (SRM) is one of the components of the banking union, alongside the SSM and a common deposit guarantee scheme. It is set to centralise key competences and resources for managing the failure of any credit institution in the participating Member States. The SRM complements the SSM; it will ensure that if a bank subject to the SSM faces serious difficulties, its resolution can be managed efficiently with minimal costs to taxpayers and the real economy. The interaction and cooperation among resolution and supervisory authorities is the key element of the SRM. Thus, the resolution authorities, the ECB and NCAs will inform each other without undue delay on the situation of the credit institution in crisis and discuss how to effectively address any related issues. The SSM will assist the SRM in reviewing the resolution plans, with a view to avoiding a duplication of tasks.

European Stability Mechanism

With the establishment of the SRM, the European Stability Mechanism (ESM) will be able to recapitalise institutions directly (the credit institution would have to be – or be likely to be in the near future – unable to meet the capital requirements established by the ECB in its capacity as supervisor, and the institution must pose a serious threat to the financial stability of the euro area as a whole or of its Member States). The functioning of the recapitalisation tool necessitates effective cooperation and the development of robust information flows between the SSM, the ESM and the national resolution authorities. If an ailing credit institution that is directly supervised by the ECB needs to be recapitalised, the ECB will be responsible for compiling the necessary information. For institutions that it does not directly supervise, the ECB, on notification of the petition for direct ESM support, must immediately start preparations to assume direct supervision of the respective credit institution. The ECB will also actively participate in the negotiations with the ESM and the management of the ailing credit institution regarding the terms and conditions of the recapitalisation agreement.

3.4.2 Methodology and standards development

27 Supervisory methodologies and standards of the highest quality are essential to achieve consistent and efficient supervisory outcomes. The ECB has established a dedicated Methodology and Standards Development Division, which regularly reviews and develops supervisory methodology. Supervisory methodologies and standards may also evolve from work by international standard-setting bodies on harmonising financial sector regulations or from work by EU authorities on developing a single rulebook.

28 The ECB may issue its own regulations, guidelines and instructions on supervisory methodologies and common standards, taking into account the developments in international and European regulations and the role of the EBA in establishing the single rulebook to ensure harmonised supervisory practices and consistency of supervisory outcomes within the SSM over time.

29 The common set of methodologies and standards covers topics such as the details of the Supervisory Review and Evaluation Process (SREP) and the notification and application procedures for supervised entities.

3.4.3 The Supervisory Review and Evaluation Process

30 For the purpose of performing the Supervisory Review and Evaluation Process (SREP), the SSM has developed a common methodology for the ongoing assessment of credit institutions' risks, their governance arrangements and their capital and liquidity situation. The methodology benefits from the NCAs' previous experience and best practices and will be further promoted and developed by the JSTs and the ECB horizontal divisions. The SSM SREP is applied proportionately to both significant and less significant institutions, ensuring that the highest and most consistent supervisory standards are upheld.

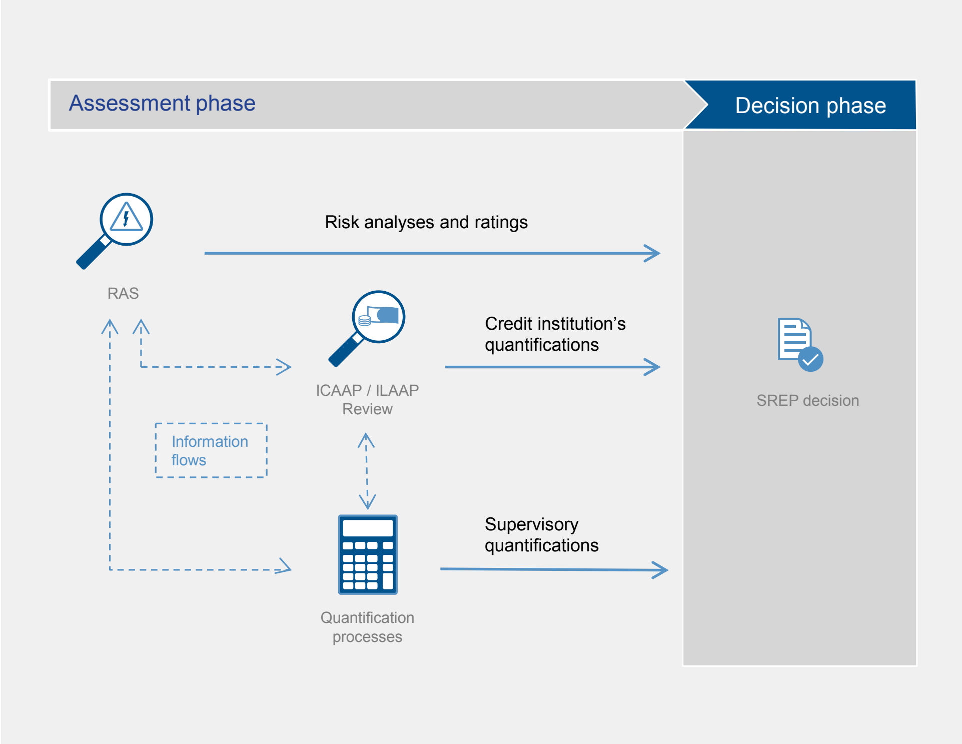
31 As defined in CRD IV, the SREP requires that the supervisors (for significant institutions, the JSTs; for less significant institutions, the NCAs under the overall oversight of the ECB) review the arrangements, strategies, processes and mechanisms implemented by the credit institutions and evaluate the following:

- risks to which the institutions are or might be exposed;
- risks that an institution poses to the financial system in general;
- risks revealed by stress testing, taking into account the nature, scale and complexity of an institution's activities.

32 The SSM SREP (see Figure 6) encompasses three main elements:

- a risk assessment system (RAS), which evaluates credit institutions' risk levels and controls;
- a comprehensive review of the institutions' Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP);
- a capital and liquidity quantification methodology, which evaluates credit institutions' capital and liquidity needs given the results of the risk assessment.

Figure 6 **Supervisory Review and Evaluation Process**



33 Both the RAS and capital and liquidity quantification follow a multi-step approach. They aim to produce supervisory assessments rooted in quantitative and qualitative analysis. They rely on a wide range of backward and forward-looking information (e.g. probability of default, loss given default, stress tests). They are built on a "constrained judgement" approach, so as to ensure consistency across the SSM, while allowing for expert judgement to consider the complexity and variety of situations within a clear and transparent framework.

34 The risks to which credit institutions are exposed are assessed by risk levels and by the corresponding risk controls/risk mitigation measures. Institutions' business risk and profitability, as well as their internal governance and overall risk management, are assessed from a more holistic perspective. All assessments are then integrated into an overall assessment.

35 The SSM follows a risk-based approach while focusing on compliance with regulatory requirements. It also respects the principle of proportionality, taking into account an institution's potential impact on the financial system, its intrinsic riskiness and whether it is a parent entity, subsidiary or solo institution. This results in a differentiated frequency and intensity for the institution's risk profile assessment within the year. The risk profile assessment in turn may result in a wide range of supervisory actions and measures, including short-term ones that are taken immediately by the relevant JST and more long-term ones that are covered by the SREP report and annual supervisory planning. There is a direct link between an institution's overall risk profile assessment and the level of supervisory engagement.

36 Traceability and accountability are key features of the entire supervisory assessment process. The capital requirements defined under Pillar 1 of the Basel Accords are minimum requirements that credit institutions must fulfil at all times. Therefore, the SSM constantly monitors the institutions' compliance with the requirements and also considers Pillar 1 capital requirements as a floor. Internal models, which institutions – subject to supervisory approval – are allowed to use to calculate capital requirements for Pillar 1 risks, are regularly reviewed by the SSM.

37 Furthermore, credit institutions may be required to hold additional capital and liquidity buffers for risks that are not, or not fully, covered by Pillar 1. To this end, credit institutions must use their internal assessment and calculation methods, specifically their Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP). Credit institutions are required to carefully document these processes and calculations. They are also required to create adequate governance structures to ensure that their ICAAP/ILAAP outcomes are reliable. Therefore, a comprehensive review of the ICAAP/ILAAP is performed as part of the SREP.

38 As recommended by the EBA Guidelines[11], the SSM strives to take adequate SREP decisions using a wide range of information coming from several building blocks. These include the credit institutions' regular reports, ICAAP/ILAAP, the institutions' risk appetite, supervisory quantifications used to verify and challenge the credit institutions' estimates, risk assessment outcomes (including risk level and control assessments), the outcome of stress tests, and the supervisor's overall risk priorities.

39 Supervisory quantifications calculated for assessing institutions' capital and liquidity needs, as well as ICAAP and ILAAP, play a key role in anchoring the process.

40 The SSM uses both top-down and bottom-up supervisory stress tests as part of the capital and liquidity adequacy assessments[12]. Stress tests are a key forward-looking tool for assessing institutions' exposure and resilience to adverse but plausible future events. They can also be used to test the adequacy of credit institutions' risk management procedures, their strategic and capital planning and the robustness of their business models.

41 Based on all the information reviewed and evaluated during the SREP, the SSM makes the overall assessment of the capital and liquidity adequacy of the credit institution and prepares SREP decisions (see Figure 6). At the end of the process, it takes an overall view on the adequate level of capital and liquidity for an institution. SREP decisions may also include qualitative measures, for instance to deal with shortcomings in institutions' risk management. The outcome of this analysis and any necessary corrective actions are presented to the credit institution and the credit institution is given the opportunity to comment in writing to the ECB on the facts, objections and legal grounds relevant to the ECB's supervisory decision. Where appropriate, specific meetings can be

11 https://www.eba.europa.eu

12 Credit institutions are also required to create their own stress testing programmes.

organised with the credit institution to discuss the outcomes and corrective actions to be taken.

42 The outcome of the SREP for significant credit institutions is submitted to the Supervisory Board. For institutions with subsidiaries in non-SSM EU countries, the SREP decision will be taken jointly by all of the relevant competent authorities.

43 The result of the SREP is also a key input for the SSM's strategic and operational planning. In particular, it has a direct impact on the range and depth of off-site and on-site activities that are carried out for a given institution. This planning is defined annually and revised on a semi-annual basis.

3.4.4 Risk analysis

44 As a natural complement to the JST's day-to-day analysis of a credit institution's risks, risks are also analysed horizontally by a dedicated Risk Analysis Division, which provides benchmarking and contextual information to line supervisors.

45 The assessment of the risks facing credit institutions requires an understanding of the external context in which they operate. The Risk Analysis Division hence also considers system-wide risks, such as those arising from international imbalances or excessive risk concentration potentially leading to sectorial bubbles (e.g. residential or commercial real estate). Its risk analysis also draws on analyses performed by other ECB business areas, particularly macro-prudential analysis. Sectoral analysis also facilitates the understanding of key market developments.

46 Risk analyses performed by JSTs and by the dedicated Risk Analysis Division complement each other. The Risk Analysis Division monitors the overall risk environment of the SSM and delivers timely and in-depth risk analyses across institutions. JSTs are an important source of institution-specific information for the Risk Analysis Division.

47 Adequate, reliable and up-to-date supervision and risk analysis is based on accurate supervisory data. The ECB therefore maintains close cooperation with the NCAs and their reporting units, which are the first receivers of supervisory reporting data. The ECB's reporting and statistics units performs its own quality checks before the data are used for supervisory and risk analysis purposes and for decision-making. The SSM reporting schedule defines the reporting timelines and formats, taking into account the harmonised requirements applicable across the EU.

4 The conduct of supervision in the SSM

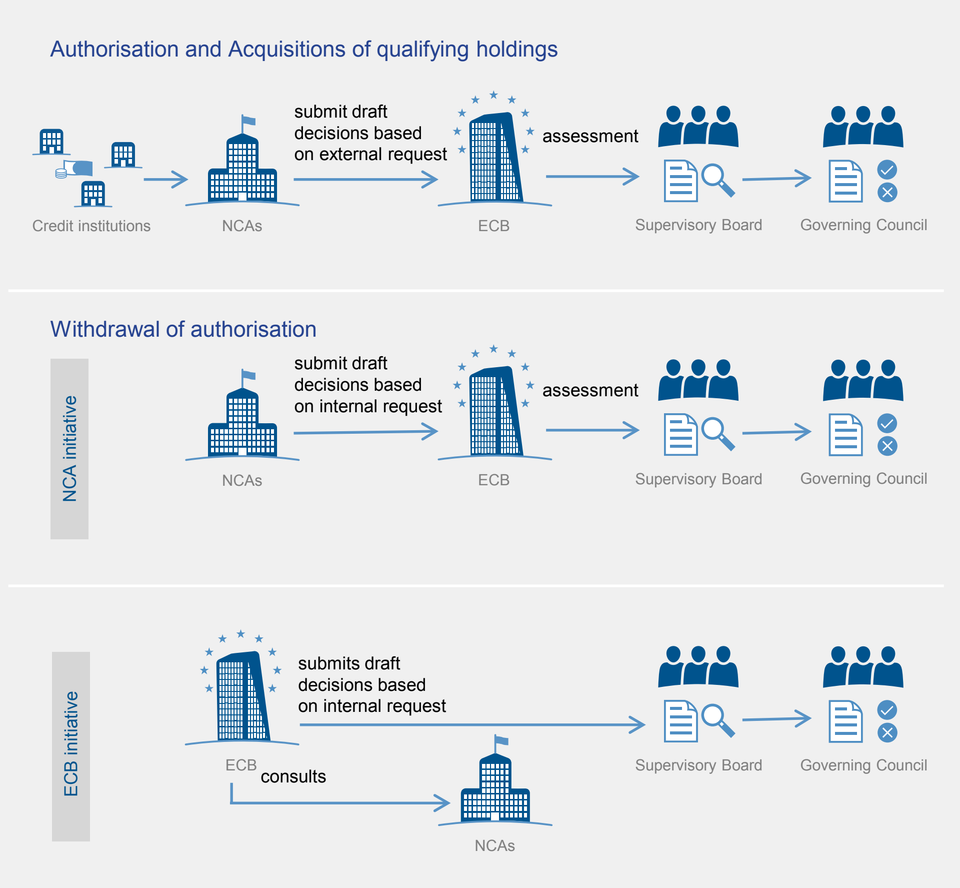
48 The SSM Regulation speaks about creating a “truly integrated supervisory mechanism”. In practice, this implies, first of all, that key processes are generally the same for all credit institutions – regardless of whether they are significant or less significant – and involve both the ECB and the NCAs. It also implies a single supervisory approach. Each credit institution that is covered by the SSM is supervised according to the same methodology and with due respect to the principle of proportionality. The common procedures applying to both significant and less significant institutions, and the approaches to the supervision of both categories, are set out below.

4.1 Authorisations, acquisitions of qualifying holdings, withdrawal of authorisations

49 The ECB has the power to grant and withdraw the authorisation of any credit institution and to assess the acquisition of holdings in credit institutions in the euro area. This is done jointly with the NCAs. The ECB also must ensure compliance with EU banking rules and the EBA regulation and applies the single rulebook. Where appropriate, it may also consider imposing additional prudential requirements on credit institutions in order to safeguard financial stability. The ECB’s Authorisation Division is responsible for these tasks.

50 The SSM Regulation has established a number of procedures, known as the “common procedures”, which ultimately are decided on by the ECB, regardless of the significance of the credit institution concerned. These are the procedures for authorisations to take up the business of a credit institution, withdrawals of such authorisations and the assessment of acquisitions of qualifying holdings. The SSM Framework Regulation sets out how the ECB and the NCAs are involved in these common procedures (see Figure 7).

Figure 7 Common procedures



4.1.1 Granting of authorisations and acquisitions of qualifying holdings

51 The SSM common procedures are governed by the following key principles:

- Applications for authorisations and notifications of an acquisition of a qualifying holding are always sent by the applicant entity to the relevant NCA: for the granting of new banking licences, this is the NCA of the Member State where the new credit institution is to be established; for intended acquisitions of qualifying holdings, the relevant NCA is the NCA of the Member State where the institution being acquired is established.
- The NCA notifies the ECB of receipt of an application for authorisation within 15 working days. As regards notification of an intention to acquire a qualifying holding, the NCA notifies the ECB of such notification no later than five working days following its acknowledgement of receipt to the applicant. A common procedure cannot be finalised until the required information has been submitted. Applicants should therefore ensure that their applications are complete and well structured. If the first review of an application reveals omissions or inconsistencies, the receiving NCA immediately asks the applicant to make the necessary amendments.

- Once applications have been submitted and their completeness verified, they are subject to a complementary assessment by the receiving NCA, the ECB and any other NCAs concerned. The assessment seeks to ensure that all relevant parties gain a thorough understanding of the business model and its viability. To this end, the assessment covers all the criteria set out in relevant national and EU laws.

52 If the NCA is satisfied that the application complies with national conditions for authorisations, it proposes to the ECB a draft decision containing its assessment and recommendations. As regards qualifying holdings, the NCA proposes a draft decision to the ECB to oppose or not to oppose the acquisition. The final decision on the approval or rejection rests thereafter with the ECB following the usual decision-making procedure. If an application is to be rejected or additional conditions need to be imposed, it will become the subject of a hearing procedure. Once a final decision has been reached, the applicant is notified by either the NCA processing the application (in the case of licensing applications) or the ECB (in the case of intended acquisitions of qualifying holdings).

4.1.2 Withdrawal of authorisations

53 Both the ECB and the NCAs of participating Member States where an institution is established have the right to propose the withdrawal of a banking licence. NCAs can propose a withdrawal upon the request of the credit institution concerned or, in other cases, on its own initiative in accordance with national legislation. The ECB can initiate a withdrawal in cases set out in the relevant EU laws. The ECB and the relevant NCAs consult on any proposals for the withdrawal of a licence. These consultations are intended to ensure that, before a decision is taken, the relevant bodies (i.e. NCAs, national resolution authorities and the ECB) have sufficient time to analyse and comment on the proposal, raise potential objections and take the necessary steps and decisions to preserve the going concern or resolve the institution, if deemed appropriate.

54 Following the consultation, the proposing body composes a draft decision explaining the rationale behind the proposed withdrawal of the licence and reflecting the results of the consultation. Thereafter, the final decision rests with the ECB.

55 Before a draft decision proposal is submitted to the ECB, the supervised institution in question is prompted to provide its own views on the matter and is given the right to be heard by the ECB. Once taken, the ECB’s final decision is notified to the respective credit institution, the NCA, and the national resolution authority.

4.2 Supervision of significant institutions

4.2.1 Supervisory planning

56 The planning of supervisory activities is decided through a two-step process: strategic planning and operational planning. Strategic planning is coordinated by the ECB's Planning and Coordination of Supervisory Examination Programmes Division. It encompasses the definition of the strategic priorities and the focus of supervisory work for the following 12 to 18 months. More specifically, it takes into account factors such as the assessment of risks and vulnerabilities in the financial sector, as well as guidance and recommendations issued by other European authorities, in particular the ESRB and the EBA, findings of the JSTs through the SREP and priorities highlighted by the relevant NCAs. The strategic plan frames the nature, depth and frequency of activities to be included in the individual Supervisory Examination Programmes (SEPs), which are defined for each significant institution.

57 Operational planning is conducted by the JSTs under the coordination of the ECB's Planning and Coordination of SEPs Division. JSTs produce individual SEPs, which set out the main tasks and activities for the following 12 months, their rough schedules and objectives, the need for on-site inspections, and internal model investigations. The Planning and Coordination of SEPs Division, along with the relevant horizontal functions and NCAs, coordinates the allocation of SSM resources and expertise to ensure that each JST has the capacity to carry out the annual supervisory tasks and activities. Although the main items of individual SEPs are discussed with the credit institution beforehand, JSTs are always able to perform ad hoc tasks and activities that are not part of the supervisory plan, especially to address rapidly changing risks at individual institutions or at the broader system level.

58 There are several tools for conducting the basic supervisory activities. In their day-to-day supervision, the JSTs analyse the supervisory reporting, financial statements and internal documentation of supervised institutions; hold regular and ad hoc meetings with the supervised credit institutions at various levels of staff seniority; conduct ongoing risk analyses and ongoing analysis of approved risk models; and analyse and assess credit institutions' recovery plans. Box 5 explains the regulations regarding the language the institution can use in its communication with the ECB.

Box 5 Language regime of the SSM

Under Article 24 of the SSM Framework Regulation, any document sent to the ECB by a supervised credit institution (or any other legal or natural person individually subject to ECB supervisory procedures) may be drafted in any of the official EU languages.

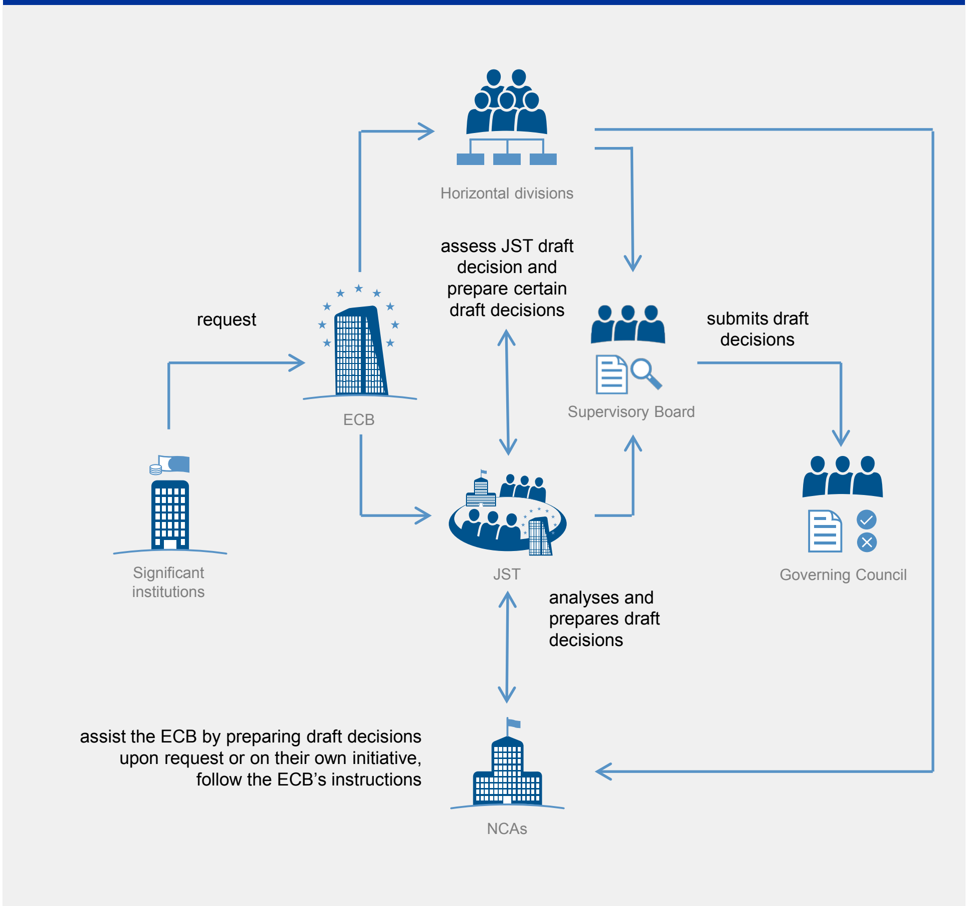
The ECB, the supervised credit institutions and any other legal or natural person individually subject to ECB supervisory procedures may agree to use one official EU language in their written communication. If a credit institution revokes the agreement, this change will only affect the parts of the ECB supervisory procedure that have not yet been carried out.

If participants in an oral hearing ask to be heard in an official EU language other than the language of the ECB supervisory procedures, advance notice must be given to the ECB so that the necessary arrangements can be made.

4.2.2 General process requests, notifications and applications

59 The general process regarding requests, notifications and applications (i.e. “permission requests”) for significant credit institutions is described in Figure 8. The procedure starts when a credit institution files a permission request. The JST – where applicable, in close cooperation with the relevant horizontal division – checks if the permission request includes all relevant information and documents. If necessary, it can request additional information from the credit institution. The JST and the relevant horizontal division check that the request meets the supervisory requirements set out in the respective legislation, i.e. EU laws or its national transposition. Once the analysis has been completed and a decision taken, the ECB notifies the applicant of the outcome.

Figure 8 **General process for requests, notifications and applications**



60 For other processes – such as passporting, the approval of internal models and the appointment of new managers – different procedures have to be followed. These are described in more detail below.

4.2.3 Right of establishment of credit institutions within the SSM

61 If a significant[13] institution in a participating Member State wishes to establish a branch within the territory of another participating Member State via passporting procedures[14], it has to notify the NCA of the participating Member State where it has its head office and provide the necessary documentation. On receipt of this notification, the NCA immediately informs the ECB's Authorisation Division, which then assesses the adequacy of the administrative structure in light of the activities envisaged. Where no decision to the contrary is taken by the ECB

[13] Less significant institutions have to notify their intention to establish a branch or provide services within the European Economic Area to their NCA.

[14] The single European passport is a system which allows financial services operators legally established in one EU Member State to establish/provide their services in another Member State without further authorisation requirements.

within two months of receipt of the credit institution's notification, the significant institution may establish the branch and commence its activities. A credit institution in a participating Member State wishing to establish a branch or exercise the freedom to provide services within the territory of a non-participating Member State informs the relevant NCA of its intention. On receipt of such notification from a significant institution, the relevant NCA immediately informs the ECB, which then carries out the required assessment.

4.2.4 Internal models

62 CRD IV establishes two different types of supervisory activities related to internal models used for calculating minimal capital requirements: those concerned with the approval of such models (or material changes/extensions thereof) and those concerned with ongoing model supervision.

63 The general procedure for the approval of internal models for the calculation of minimum capital requirements under the CRR for significant and less significant banks encompasses different steps, involving the JST as the contact point for the significant institutions, supported by the ECB's Internal Models Division. For less significant institutions, NCAs are the contact point. Where appropriate, discussions are held with the credit institution to address critical points and to establish the operational schedule of the approval process.

64 The JST, supported by the ECB's Internal Models Division, checks if the credit institution complies with the legal requirements and the relevant EBA Guidelines. At this stage, credit institutions need to be prepared for intensive interaction and collaboration to make the process smooth and efficient for all parties. This process comprises a range of tools, including off-site and on-site evaluations. These activities are carried out by a dedicated project team responsible for the entire model assessment process. Project teams can consist of members of the JSTs, experts from the ECB's horizontal divisions and dedicated model experts from the NCAs, and are led by project managers who report to the JST coordinator.

65 On the basis of the project team's report, the JST, supported by the ECB's Internal Models Division, prepares a proposal for a draft decision for approval by the Supervisory Board and the Governing Council. The proposal comprises the JST's views on the authorisation (or refusal) of the use of internal models to calculate the capital requirements. Conditions, such as additional reporting requirements as well as additional supervisory measures, may be attached to the authorisation.

66 Furthermore, the objective of ongoing model supervision is to keep a close watch on a credit institution's permanent compliance with applicable requirements. It comprises the analysis of risk, capital or other reports on model aspects, the analysis of credit institutions' model validations and the assessment of (immaterial) model changes. In addition, a full review of internal models with a special focus on appropriateness in the light of best practice and changes to business strategies takes place regularly, at least every three years. The

reviews are conducted by the JST, where necessary with the support of the Internal Models Division. The annual benchmarking required by Article 78 of the CRD is performed by the EBA and the SSM as competent authority.

4.2.5 Assessment of the suitability of members of management bodies

67 The fit and proper assessment of the members of the management body[15] of significant and less significant institutions is a key part of supervisory activities. The members need to be of sufficiently good repute and to possess sufficient knowledge, skills and experience to perform their duties. In the case of an initial authorisation (licensing) of a credit institution, the fit and proper assessment is performed as part of the authorisation procedure.

68 Changes to the composition of the management body of a significant institution are declared to the relevant NCA, which then informs the relevant JST and the ECB's Authorisation Division, which, together with the staff of the NCA, collects the necessary documentation (which may include an interview with the nominated candidate). With the assistance of the NCA, the JST and the Authorisation Division jointly carry out the assessment and then present a detailed proposal to the Supervisory Board and Governing Council for a decision.

4.2.6 On-site inspections

69 The SSM carries out on-site inspections, i.e. in-depth investigations of risks, risk controls and governance with a pre-defined scope and time frame at the premises of a credit institution. These inspections are risk-based and proportionate.

70 The ECB has established a Centralised On-site Inspections Division, which is – among other things – responsible for planning the on-site inspections on a yearly basis.

71 The need for an on-site inspection is determined by the JST in the context of the SEP and scheduled in close cooperation with the ECB's Planning and Coordination of SEPs Division. The scope and frequency of on-site inspections are proposed by the JST, taking into account the overall supervisory strategy, the SEP and the characteristics of the credit institution (i.e. size, nature of activities, risk culture, weaknesses identified). In addition to these planned inspections, ad hoc inspections may be conducted in response to an event or incident which has emerged at a credit institution and which warrants immediate

[15] Under CRD IV, "management body" means an institution's body or bodies, which (i) are appointed in accordance with national law, (ii) are empowered to set the institution's strategy, objectives and overall direction, (iii) oversee and monitor management decision-making, and (iv) include the persons who effectively direct the business of the institution. In this regard, "management body" should be understood to have executive and supervisory functions. As the competence and structure of management bodies differ across Member States (one-tier structure versus two-tier system), separate tasks are assigned to the different entities within the management body.

supervisory action. If deemed necessary, follow-up inspections may be carried out to assess a credit institution's progress in implementing remedial actions or corrective measures identified in a previous planned or ad hoc inspection.

72 In general, the purpose of on-site inspections is to:

- examine and assess the level, nature and features of the inherent risks, taking into account the risk culture;
- examine and assess the appropriateness and quality of the credit institution's corporate governance and internal control framework in view of the nature of its business and risks;
- assess the control systems and risk management processes, focusing on detecting weaknesses or vulnerabilities that may have an impact on the capital and liquidity adequacy of the institution;
- examine the quality of balance sheet items and the financial situation of the credit institution;
- assess compliance with banking regulations;
- conduct reviews of topics such as key risks, controls, governance.

73 Different types of inspections can be carried out by the ECB. Whereas full-scope inspections cover a broad spectrum of risk and activities of the credit institution concerned in order to provide a holistic view of the credit institution, targeted inspections focus on a particular part of the credit institution's business, or on a specific issue or risk. Thematic inspections focus on one issue (e.g. business area, types of transactions) across a group of peer credit institutions. For example, JSTs may request a thematic review of a particular risk control or the governance process across institutions. Thematic reviews may also be triggered on the basis of macro-prudential and sectoral analyses that identify threats to financial stability on account of weakening economic sectors or the spread of risky practices across the banking sector.

74 The composition of the team – in terms of size, skills, expertise and seniority – will be tailored to each individual inspection. The staffing of inspection teams is looked after by the ECB in close cooperation with the NCAs. The head of the inspection team (head of mission) and inspectors are appointed by the ECB in consultation with the NCAs. Members of the JST may participate in inspections as inspectors, but not as heads of mission, to ensure that on-site inspections are conducted in an independent manner. Where necessary and appropriate, the ECB can call on external experts. The outcome of on-site inspections is reflected in a written report on the inspected areas and findings. The report is signed by the head of mission and sent to the JST and the NCAs concerned. Based on the report, the JST is responsible for preparing recommendations. The JST then sends the report and recommendations to the credit institution and, in general, calls for a closing meeting with the institution.

75 Under the SSM Regulation, the ECB may at any time make use of its investigatory powers vis-à-vis less significant banks. These powers include the possibility to conduct on-site inspections.

4.2.7 Crisis management

76 With the transposition of the Bank Recovery and Resolution Directive (BRRD) into national law, the ECB as a banking supervisor will be enabled to react in a timely manner if a credit institution does not meet, or is likely to breach, the requirements of CRD IV and will ensure that credit institutions establish reliable recovery plans.

77 The ECB has established a Crisis Management Division, tasked with supporting the JSTs in times of crisis. The ECB's Crisis Management Division is also reviews the significant supervised credit institutions' recovery plans and conducts further analysis, which allows for benchmarking, quality control, consistency checks and expert support to the JSTs. With regard to resolution planning, the SSM has a consultative role under the BRRD and the SRM Regulation. The Crisis Management Division is a key player in this consultative process. Moreover, the ECB's Crisis Management Division and the JSTs will participate in Crisis Management Groups set up for specific banks (see Box 6).

Box 6 Crisis Management Groups and Cross-Border Stability Groups

Over the past few years, a number of groups have been set up and agreements concluded with a view to increasing cooperation and coordination among different parties (e.g. NCAs, national central banks, resolution authorities). The underlying purpose has been to enhance the preparedness of all involved parties in normal times and to increase their ability to act in a timely and effective manner in a crisis situation. Within the SSM, representatives of the ECB's Crisis Management Division and the JSTs will participate in Crisis Management Groups (CMGs) and Cross-Border Stability Groups (CBSGs). In cases where the SSM serves as the home country supervisory authority, the Crisis Management Division and the JSTs will be jointly responsible for these groups.

1. Crisis Management Groups

According to the Key Attributes of Effective Resolution Regimes for Financial Institutions[16], published by the Financial Stability Board (FSB) in October 2011, home and key host authorities of all Global Systemically Important Financial Institutions (G-SIFIs) should maintain CMGs. The

[16] http://www.financialstabilityboard.org/publications/r_111104cc.pdf

objective of these groups is to enhance coordination and cooperation between home and host authorities of a G-SIFI as regards the preparation for, and facilitation of, an effective management and/or resolution of an institution in the case of a cross-border financial crisis affecting the firm. Supervisory authorities, central banks, resolution authorities, finance ministries and the public authorities responsible for guarantee schemes of jurisdictions that are home or host to entities of the group that are material to its resolution should participate in CMGs, and they should cooperate closely with authorities in other jurisdictions where firms have a systemic presence. As CMGs are responsible for recovery and resolution tasks, for example recovery and resolution plans, they should be chaired jointly by a representative of the supervisory authority and a representative of the resolution authority.

2. Cross-Border Stability Groups

Already in 2008 a Memorandum of Understanding (MoU) was signed at the EU level, which introduced the Voluntary Specific Cooperation Agreements (VSCAs) among the parties with common financial stability concerns stemming from the presence of one or several financial groups. According to the MoU, the relevant parties in the VSCAs may agree, among other things, to establish and utilise a CBSG as a cooperation forum in order to enhance their readiness to react to a crisis and to facilitate the management and/or resolution of a cross-border financial crisis.

4.2.8 Use of supervisory measures and powers

78 The ECB is empowered to require significant credit institutions in participating Member States to take steps at an early stage to address problems regarding compliance with prudential requirements, the soundness of management, and sufficiency of the coverage of risks in order to ensure the viability of the credit institution. Before making use of its supervisory powers with regard to significant credit institutions, the ECB may consider first addressing the problems informally, for example by holding a meeting with the management of the credit institution or sending a letter of intervention.

79 The type of action taken depends on the seriousness of the deficiencies, the required time frame, the degree of awareness at the credit institution, the capability and reliability of corporate bodies, and the availability of human, technical and capital resources within the credit institution. If the action is based on the national law of a participating Member State, the respective NCA might be asked for support to ensure that all the legal prerequisites are covered.

80 Supervisory powers consist of measures characterised by increasing intensity in terms of content and form and may imply:

- the accurate listing of goals and the time frame for their achievement, while entrusting the credit institution, on its own responsibility, with the task of identifying the most effective measures without enforcing limits or rules other than the ones laid down in the legal framework;
- the adoption of specific measures for prudential purposes, such as requiring the credit institution to take specific actions concerning regulatory matters (organisation of risk management and internal controls, capital adequacy, permissible holdings, limitation of risk, disclosure) or operational limits or prohibitions;
- the use of other legal powers of intervention intended to correct or resolve irregularities, inaction or specific negligence;
- the obligation for a credit institution to present a plan for restoring compliance with supervisory requirements.

81 The use of supervisory powers is monitored by means of a timely assessment by the ECB of the credit institution's compliance with the recommendations, supervisory measures or other supervisory decisions imposed on it. The follow-up is based on ongoing supervisory activities and on-site inspections; the ECB will respond if non-compliance is identified. The monitoring procedures ensure that the ECB adequately addresses any irregularities or insufficiencies detected in a credit institution in implementing the supervisory measures, thereby mitigating the risk of failure of the credit institution.

4.2.9 Enforcement and sanctions

82 If regulatory requirements have been breached, the supervisor may impose sanctions on credit institutions and/or their management. The ECB may impose administrative pecuniary penalties on credit institutions of up to twice the amount of the profits gained or losses avoided because of the breach where those can be determined, or up to 10% of the total annual turnover in the preceding business year. In addition, in the case of a breach of a supervisory decision or regulation of the ECB, the ECB may impose a periodic penalty payment with a view to compelling the persons concerned to comply with the prior supervisory decision or regulation of the ECB. The periodic penalty payment will be calculated on a daily basis until the persons concerned comply with the supervisory decision or regulation of the ECB, provided that the periodic penalty is imposed for a period of no longer than six months.

83 The ECB's Enforcement and Sanctions Division investigates – in the spirit of transparent investigation and decision-making – alleged breaches by credit institutions of directly applicable EU law, national law transposing EU directives or ECB regulations and decisions, observed by a JST during the day-to-day supervision. In this case, the JST will establish the facts and refer the case to the Enforcement and Sanctions Division for follow-up. The Enforcement and Sanctions Division acts independently from the Supervisory Board to ensure the impartiality of the Supervisory Board members when they adopt a sanctioning decision.

84 The Enforcement and Sanctions Division is also responsible for processing reports of breaches of relevant EU law by credit institutions or competent authorities (including the ECB) in the participating Member States. The ECB has established a reporting mechanism in order to encourage and enable persons with knowledge of potential breaches of relevant EU law by supervised entities and competent authorities to report such breaches to the ECB. Such reports on violations are an effective tool for bringing incidents of business misconduct to light.

4.3 Supervision of less significant institutions

85 The SSM aims to ensure that the EU's policy relating to the prudential supervision of credit institutions is implemented in a coherent and effective manner, that the single rulebook for financial services is applied in the same manner to credit institutions in all Member States concerned, and that credit institutions are subject to supervision of the highest quality, unfettered by non-prudential considerations. Moreover, the experience of the financial crisis has shown that smaller credit institutions can also pose a threat to financial stability; the ECB should therefore be able to exercise supervisory tasks in relation to all credit institutions and branches, which are established in participating Member States of credit institutions established in non-participating Member States. These objectives can only be achieved through:

- collaboration in good faith between NCAs and the ECB;
- an effective exchange of information within the SSM;
- a harmonisation of both processes and consistency of supervisory outcomes.

86 NCAs are responsible for the direct supervision of less significant institutions (with the exception of common procedures, which are a joint responsibility of the ECB and the NCAs[17]). They plan and carry out their ongoing supervisory activities according to the common framework and methodologies created for the SSM. In doing so, NCAs act in line with the SSM's overall supervisory strategy, using their own resources and decision-making procedures.[18] Ongoing activities include organising meetings with the senior management of less significant institutions, conducting regular risk analyses within the country concerned, and planning and carrying out on-site inspections. NCAs will also continue to perform supervision in areas that are not covered by the SSM Regulation.

87 Even though NCAs have primary responsibility for organising and conducting the supervision of less significant institutions, ECB staff may also participate in certain activities, for example on-site inspections. As well as providing expertise

[17] See Figure 7 and Articles 14 and 15 of the SSM Regulation regarding authorisation, acquisitions of qualifying holdings, and withdrawal of authorisation.

[18] The SSM Framework Regulation defines the situations where draft decisions have to be notified to the ECB *prior to being addressed* to the less significant institutions.

and support to NCAs, this promotes and facilitates the exchange of staff among NCAs (and between NCAs and the ECB) and helps to foster a common supervisory culture within the SSM.

88 At the same time, the ECB is responsible for the effective and consistent functioning of the SSM and is entrusted with an oversight responsibility to ensure that the supervisory activities carried out by the NCAs are of the highest quality and that supervisory requirements on all credit institutions covered by the SSM are consistent. This task is performed by DG Micro-Prudential Supervision III.

89 DG Micro-Prudential Supervision III achieves these objectives by applying the supervisory approaches developed by DG Micro-Prudential Supervision IV for significant credit institutions in a proportional manner. DG Micro-Prudential Supervision III comprises three divisions:

- The Supervisory Oversight and NCA Relations Division is responsible for cooperation with NCAs and oversees their supervisory approaches vis-à-vis less significant institutions, with the objective of ensuring high standards of supervision and supporting the consistent application of supervisory processes and procedures by NCAs, thereby serving as the primary contact point for NCAs towards the ECB as banking supervisor. The Division also takes care of the quality assurance regarding the supervisory processes in NCAs in liaison with DG Micro-Prudential Supervision IV (horizontal and specialised divisions).
- The Institutional and Sectoral Oversight Division – in cooperation with DG Micro-Prudential Supervision IV – monitors specific banking sub-sectors (e.g. savings banks, cooperative banks) and individual institutions among the less significant institutions according to their priority ranking (i.e. risk and impact assessment) and organises thematic reviews. It also evaluates whether the ECB should take over direct supervision of a specific institution and participates – in cooperation with DG Micro-Prudential Supervision IV – in on-site examinations of less significant institutions. Furthermore, it is responsible for crisis management activities related to less significant institutions.
- The Analysis and Methodological Support Division develops and maintains the methodology – based on the supervisory approach developed by DG Micro-Prudential Supervision IV – for the classification of less significant institutions and the application of the RAS and the SREP to them. It is also responsible for the regular supervisory reporting on less significant institutions and for overseeing the risks and vulnerabilities of banking sub-sectors.

90 The following sections provide an overview of the processes and procedures carried out by the ECB in relation to the supervision of less significant institutions.

4.3.1 Information gathering

91 Credit institutions in Europe are interconnected through their mutual short and long-term lending and their trading activities. It is important, therefore, that a wider sector-level analysis is performed, for example to capture possible contagion effects and to assess the kind of supervisory policy measures the ECB and the NCAs should take with respect to less significant institutions.

92 To be able to exercise its oversight function and to ensure financial stability in the euro area, the ECB regularly receives quantitative and qualitative information on the less significant institutions. This information is provided using defined reporting procedures between the ECB and NCAs. The information received enables the ECB to identify particular risks in individual institutions and to perform a sector-wide analysis, which in turn supports the ECB's overall supervisory objectives. Based on the analysis, the ECB can also identify areas where ECB regulations, guidelines or general instructions are needed to ensure consistency in supervision and the application of high supervisory standards.

93 In addition to the regular information received from NCAs (including supervisory reporting to competent authorities) and taking account of the principle of proportionality, the ECB may also request additional information on less significant institutions, generally from NCAs, as necessary to exercise its oversight task.

4.3.2 Oversight activities

94 The ECB is responsible for conducting the general oversight of the NCAs' supervisory activities to ensure the adequate and harmonised conduct of supervision of the less significant institutions. Oversight activities can be conducted, for example, through reviews of specific topics (e.g. risk areas) across all or a sample of NCAs. They provide a targeted insight into the NCAs' supervision at the level of individual institutions or classes of similar institutions.

95 Furthermore, NCAs provide material draft supervisory decisions and procedures to the ECB. The scope of these decisions and procedures is defined in the SSM Framework Regulation. They consist of procedures that have a significant impact on the less significant institutions and the removal of members of the management boards of less significant institutions and the appointment of special managers. A balance is pursued between providing the ECB with information on NCA activities crucial to the integrity of the SSM, but avoiding an overflow of notifications to the ECB. NCAs must also inform the ECB if the financial situation of a less significant institution deteriorates rapidly and significantly.

96 NCAs report regularly to the ECB on the less significant institutions in a format defined by the ECB. In addition, some ex post reporting procedures have been established under which NCAs report regularly on the measures that they have taken and the performance of their tasks with regard to the less significant institutions.

97 The ECB also reviews how NCAs apply SSM supervisory standards, processes and procedures, such as the SREP, with regard to the less significant institutions. The oversight of processes includes assessing whether standards are applied in a harmonised way and checking whether comparable situations lead to comparable outcomes across the SSM. The ECB can also recommend changes to areas where further harmonisation is needed and, where appropriate, may also develop standards as regards supervisory practices. The ECB's oversight activities are a collaborative assessment of whether and how SSM standards and processes can be improved to reach the common goal of harmonised and effective supervision across the SSM.

4.3.3 Intervention powers of the ECB

98 The ECB, in cooperation with the NCAs, determines regularly whether an institution changes its status from "less significant" to "significant" by fulfilling any of the criteria established in the SSM Regulation (see Box 1) or vice versa, and decides to take over supervisory responsibilities for individual less significant institutions from one or more NCAs accordingly or to end direct supervision.

99 The ECB may also at any time on its own initiative, after consulting with the NCAs, decide to directly exercise supervision on less significant institutions, when necessary, to ensure consistent application of high supervisory standards, for example if the ECB's instructions have not been followed by the NCA and thus the consistent application of high supervisory standards is compromised. It should be noted that the deterioration of a less significant institution's financial condition or the initiation of crisis management proceedings are not necessarily reasons for the ECB to take over supervision from the responsible NCAs.

4.4 Overall quality and planning control

100 The supervision of both significant and less significant institutions requires overall mechanisms to ensure that the SSM approach to supervision remains consistent and of the highest quality across all supervised entities. This implies avoiding distortions between the two sets of credit institutions while applying supervisory approaches and the principle of proportionality in a structured way.

4.4.1 Quality assurance

101 The aim of quality assurance is to assess the consistent application of the common methodological framework and to ensure that it is complied with. Furthermore, quality assurance monitors the quality of supervisory practices. The horizontal quality control of the JSTs is performed by a dedicated division within DG Micro-Prudential Supervision IV, whereas the quality assurance of the NCAs' supervision of the less significant institutions is carried out by the ECB's Supervisory Oversight and NCA Relations Division within DG Micro-Prudential Supervision III.

102 This is all the more important as the SSM operates across participating Member States and involves both national supervisors and the ECB. The main goal of quality assurance is to identify improvement potential for methodologies, standards and supervisory policies.

4.4.2 Planning control

103 As regards significant institutions, the ECB's Planning and Coordination of SEPs Division checks regularly to see whether the tasks specified in the SEPs have been fulfilled by the JSTs and requests corrective actions if needed. For the less significant institutions, supervisory planning is carried out by NCAs and, when necessary, overseen by DG Micro-Prudential Supervision III. Furthermore, SEPs are designed and updated based on the findings made in previous periods. Findings are discussed with the parties involved with a view to improving and further harmonising future activities.

5 Abbreviations

BRRD	Bank Recovery and Resolution Directive
CBSG	Cross-Border Stability Group
CMG	Crisis Management Group
CRD IV	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
ECB	European Central Bank
ESAs	European Supervisory Authorities
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
EU	European Union
FSB	Financial Stability Board

G-SIFIs	Global Systemically Important Financial Institutions
ICAAP	Internal Capital Adequacy Assessment Process
ILAAP	Internal Liquidity Adequacy Assessment Process
JST	Joint Supervisory Team
MoU	Memorandum of Understanding
NCA	national competent authority
RAS	risk assessment system
SEP	Supervisory Examination Programme
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism