



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

# ECB Annual Report on supervisory activities

2014

BANKENTOEZICHT

March 2015

BANKTILLSYN BANKU UZRAUDŽĪBA

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## Foreword by Mario Draghi, President of the ECB



The setting-up of European banking supervision has been the greatest step towards deeper economic integration since the creation of Economic and Monetary Union. The crisis forced us to fundamentally reflect on what is necessary to achieve a genuine economic and monetary union. The desire to protect citizens as well as businesses from the dire effects of the crisis was the driving force behind the “Four Presidents’ report”, which mapped out a route towards this objective. The establishment of a banking union was deemed the best way to decisively and credibly address one of the key challenges: the weaknesses in the banking sector. It entailed a Single Supervisory Mechanism (SSM), a Single Resolution Mechanism and a single rulebook, including for harmonised deposit guarantee schemes, which may evolve into a common European deposit guarantee.

The decision to establish the SSM and entrust the ECB with supervisory tasks was a fundamentally political one, taken by the European legislators – the EU Council and the European Parliament – in October 2013. The ECB was honoured to take on this new role and is committed to fulfilling the high expectations. It was nevertheless a major organisational challenge to get the SSM up and running in only one year, while also conducting the comprehensive assessment of the euro area’s 130 most important banks. Thanks to its staff, old and new, the ECB has shown an impressive ability to adapt. While a strict separation between monetary policy and banking supervision is ensured, both these areas of activity are able to rely on the accumulated expertise in the shared services areas. The SSM is also benefiting from the experience and resources of the national authorities. All these strengths have been combined to create a unique form of cooperation.

The SSM creates the institutional conditions for overcoming fragmentation in supervisory practices and defines a single supervisory model. We are establishing common methodologies, a joint culture and a shared reputation, which will ensure that we have the right instruments and incentives to effectively carry out our supervisory tasks. This foundation has already been successfully tested – as the comprehensive assessment shows. This was just the beginning. The ECB will have to perform consistently well day after day, year after year, in the face of highly challenging supervisory tasks.

In accordance with the SSM Regulation as well as the Interinstitutional Agreement with the European Parliament and the Memorandum of Understanding with the EU Council, the ECB is committed to high standards of accountability. This includes the submission of an annual report on its supervisory tasks, the first version of which the ECB is proud to publish here.

## Foreword by Danièle Nouy, Chair of the Supervisory Board



Since 4 November 2014 the ECB has assumed responsibility for the supervision of the euro area banking sector. The ECB directly supervises 123 banking groups (comprising about 1,200 credit institutions) in the euro area, covering close to 85% of total banking assets. Around 3,500 smaller institutions are supervised indirectly through the national competent authorities (NCAs).

Establishing this integrated system of banking supervision was a major task, which was formally launched on 3 November 2013 with the entry into force of the [SSM Regulation](#). This first issue of the ECB Annual Report on supervisory activities covers this historic period from 4 November 2013 to 31 December 2014.

Implementing the SSM was an undertaking of unprecedented scale. It required harmonised, comprehensive and clearly defined supervisory standards and processes; practical infrastructures such as functional and tested IT systems; and appropriate governance structures for swift and effective decision-making. Recruiting highly competent staff was one of the most important and earliest challenges for the ECB.

The comprehensive assessment of the banks that were likely to fall under direct ECB supervision – as set out in the SSM Regulation – was in itself an exercise of unprecedented magnitude. It consisted of an asset quality review (AQR) and a stress test. Close involvement of all relevant stakeholders, in particular through constant interaction with the banks, was a crucial aspect. Banks at which capital shortfalls were identified were asked to develop capital plans to be implemented over the coming months.

In conducting the stress test in combination with a rigorous balance sheet review, we substantially enriched our knowledge of the banks we now supervise and gained valuable insights into trends within the entire European banking system. We also enhanced transparency regarding the condition of our banks. Overall, the comprehensive assessment served as a strong foundation and was one of the key building blocks in renewing confidence and stability in the euro area banking sector.

For meeting all of the challenges in establishing the SSM, the ECB was a perfect and natural home. No other institution could have offered better support for the creation of the SSM. For a new European supervisory authority starting its work, the ECB's long-established services and its credibility as an institution are tremendous assets.

For the first time in the history of the EU, we have a banking supervisor with a truly European mandate. We are committed to using this mandate to make the banks we supervise safer and sounder, in the interest of all European citizens.

## The SSM model of supervision

The most important objective of the SSM is to improve the quality and consistency of banking supervision within the euro area. The SSM will deliver increased opportunities for benchmarking and peer comparison among banks across the euro area. The SSM will allow us to improve the tools of supervisory risk assessment, with due regard to the diversity of banks' business models within Europe – which I believe is a clear strength.

The SSM is certainly very well placed to assess, monitor and address the risks in the banking sector on a European scale. Its micro-prudential view is enriched by its macro-prudential responsibilities for monitoring and addressing risks from a system-wide perspective. In addition, the SSM gives us a stronger consolidated perspective, and enhances efficiency in the allocation and transfer of intra-group capital and liquidity.

Looking more closely at the SSM approach to banking supervision, it is already clear to the institutions we have been supervising since November 2014 that the SSM will not shy away from intrusive and hands-on supervision. Our supervisors implement the single rulebook diligently and assertively. We ask the hard questions and challenge the responses where necessary. We will be a tough supervisor but, at all times, will strive to be fair and even-handed in our actions.

The concept of the Joint Supervisory Teams (JSTs), which directly supervise the significant institutions, is a cornerstone of the SSM. JSTs are composed of ECB and NCA staff and are managed by an ECB coordinator. They are essential to achieving the SSM's aim of maintaining proximity and close contact with the banks during the ongoing supervisory activities. The structure of JSTs, as well as that of the horizontal services with the relevant networks of experts at the NCAs, combines the deep specific knowledge of national supervisors with the broad-ranging experience of the ECB.

NCAs continue to conduct the direct supervision of less significant institutions, under the oversight of the ECB. As the ECB is responsible for the overall functioning of the SSM, it may address general instructions to NCAs regarding the supervision of less significant banks and will retain investigatory powers over all supervised banks.

The SSM approach to banking supervision is forward-looking. Our purpose is to address potential issues in a timely manner. We promote multiple perspectives on risk and aim to develop a deep understanding of the risk factors, risk appetite and business model of each entity. We combine this individual approach with a cross-sector view and look at the linkages between banks and the rest of the financial system. In order for the SSM to work effectively, we will also actively encourage further harmonisation of the banking regulatory environment. As long as the regulation remains fragmented, the mere convergence of supervisory practices cannot ensure a level playing field. In this respect, the SSM will actively contribute to the work of the European Banking Authority (EBA) in establishing, at the EU level, the single rulebook and the single supervisory handbook.

## Priorities for 2015

The SSM's work in 2015, its first full operational year, takes the follow-up to the findings of the comprehensive assessment as a starting point; the Supervisory Board has also shaped priorities in light of the background environment and – most importantly given the SSM's risk-based approach to supervision – the main risks for the banking sector.

In recent years, banks have been operating under adverse macroeconomic conditions, impairing their ability to make profits. In fact, weak economic activity and high unemployment rates continue to weigh on banks' profitability. Against the background of weak economic growth and low inflation expectations, interest rates are at historical lows. This prolonged period of low interest rates, accompanied by low credit spreads, poses specific challenges to banks' revenue generation, risk exposure and asset and liability management.

The supervisory priorities for 2015 **build on the findings of the comprehensive assessment**, particularly regarding credit risk. The JSTs are checking that banks are taking those findings on board, and that they are effectively and consistently implementing other remedial actions arising from the exercise and properly addressing any residual shortcomings. In particular, additions to non-performing exposures and provisioning levels need to be reflected to the maximum extent possible in financial statements and, where this is not the case, in assessments of Pillar 2 capital adequacy. JSTs are also scrutinising portfolios not covered by the comprehensive assessment which may enclose material risks.

The analysis of the main risks suggested a particularly high level of exposure to the corporate segment, in which **non-performing exposures** are steadily increasing. Banks located in SSM Member States most heavily hit by the crises are more prone to corporate defaults and are therefore being monitored more closely. Moreover, in 2015, a specific focus on **leveraged lending** is warranted.

With regard to qualitative issues, the supervisory focus is on **the effectiveness and robustness of banks' credit risk management functions** with a view to assessing the risk mitigation capacity of the control environment. Specific weaknesses identified in the AQR in relation to methodologies, policies, misclassifications of non-performing exposures and provisioning models are being carefully tackled, fostering harmonisation and a level playing field in accounting practices. JSTs are assessing the need for supervisory action, be it through operational acts or the use of supervisory powers.

The **viability of business models and profitability drivers** are another supervisory priority for 2015. The supervisor is keeping an eye on aggressive "search-for-yield" strategies with a view to identifying lax credit standards and defective pricing policies. Building on the work of the comprehensive assessment, capital plans of banks showing weaknesses, even if they have passed the assessment, are subject to close scrutiny, with a focus on executing sound and credible business plans.

JSTs are also focusing on **governance at the institutional level**, such as the set-up of the board, its expertise, diversity, challenges and culture. A top-down assessment of the quality of the banks' risk appetite frameworks and business practices is under development. Significant institutions will be strongly encouraged to formally define their risk appetite and JSTs will check that it is reflected in everyday risk management.

The **quality of management information** is another supervisory focus in 2015, with JSTs questioning whether the board and executive management are obtaining the quality and granularity of risk reports necessary to exercise their oversight role. They are also assessing the rigour of banks' internal stress-testing practices as a key input to a credible risk appetite framework. Building on the comprehensive assessment, JSTs are developing a deeper understanding of the governance of banks' stress-testing frameworks, the integrity of the methodologies used and the quality of the underlying data.

**Capital adequacy and liquidity** remain a concern and a key priority that JSTs will address on an ongoing basis, taking the results of the comprehensive assessment and the Supervisory Review and Evaluation Process (SREP) decisions for 2015 as their starting point.

Another crucial area of investigation is the **review of the validation of banks' internal models**. Greater consistency in internal models frameworks is essential for the credibility of banks' risk-weighted assets and capital ratio calculations. Thorough and ongoing monitoring is required to enhance consistency in the validation practices and to address possible shortcomings arising from the use of models by banks. Although this is a priority for 2015, given the large number of existing models, the review is a multi-annual project.

Concerning the regulatory framework, one of the main challenges is the **ability of banks to transition to the phased-in CRD IV/CRR package**, which includes tougher capital requirements. The ECB is looking closely at national discretions to reduce the fragmentation within the SSM countries and the resulting possible decrease in the quality of capital. It is monitoring the quality of capital (i.e. its capacity to truly absorb losses) as well as the distribution of capital within and across banking groups. Weaknesses in the capital base are to be addressed through the SREP capital planning process to promote banks' resilience. The ECB aims to improve convergence in the implementation of legislation in the euro area.

Together with capital adequacy, **monitoring the liquidity of the most vulnerable banks** remains a top priority. The supervisor will meet more frequently with banks whose liquidity situation is deteriorating and may impose additional requirements where needed.

For **operational risks**, the main focus is the **adequacy of the governance framework** and the effectiveness of processes to identify the risk and mitigate material exposures to losses. In response to increasing concern about detrimental business practices, banks that are considered materially exposed to "conduct risks" are being requested to provide a quantification of potential litigation costs. Internal



measures will be challenged to assess the adequacy of provisions and prevent unforeseen impacts. Regarding banks' IT systems, the main concerns are: **underinvestment and loopholes in IT solutions and in the risk management framework, cyber security and data integrity** as well as weaknesses identified through the comprehensive assessment.

These priorities apply in the first instance to the significant institutions supervised directly by the ECB. For the **less significant institutions** (LSIs), which are indirectly supervised by the ECB, the overarching objectives for 2015 are to finalise the design and set-up of the ECB's supervisory approach, in discussion with the NCAs and in line with the standards developed for the SSM as a whole. The wide variety of LSIs calls for supervisory approaches that effectively combine local knowledge with common methodologies. The ECB prioritises its activities, ensuring an adequate focus on institutions whose inherent risk level is assessed to be high. The principle of proportionality is thus enshrined in the framework for LSI supervision and concretely reflected in the way different tools of indirect supervision are applied.

For the horizontal activities, a priority for 2015 is to **foster greater harmonisation of supervisory approaches** across the SSM. This involves taking stock of existing national supervisory practices and identifying best practices among them; developing standards and testing and further refining harmonised supervisory methodologies.

**Promoting a more intrusive approach** to banking supervision is a second area of strategic focus.

Finally, for the horizontal activities, a key task for 2015 lies in **setting up robust information-sharing and cooperation lines** with all relevant stakeholders. This will cover: the negotiation of MoUs and cooperation agreements with relevant external stakeholders; participation in international fora on the definition of standards and regulations; and the development of communication lines and discussion platforms for the vital ECB-NCA networks of experts.

This leads me to the strategic objective of **developing the SSM team culture** within the ECB and the NCAs. This is essential to enable our highly skilled people – employed by different authorities and located in different countries – to work towards shared goals. SSM human resources policies on training, performance feedback and intra-SSM mobility will continue to be developed, in line with the general request of the EU legislators to promote a common supervisory culture and a truly integrated supervisory mechanism.

Much work still lies ahead for the SSM to implement best practices for independent, intrusive and forward-looking supervision that ensures a level playing field for banks. In this first year of implementation we are assessing whether our assumptions were correct, especially in terms of the adequacy of resources and speed of harmonisation of supervisory approaches. The achievement of challenging SSM objectives can be expected to increase considerably as the organisation gains experience and matures.

The comprehensive assessment was an important precedent for the vertical and horizontal supervision the SSM is undertaking and it showed that consistent supervision requires fully harmonised regulation in the euro area. The ECB is fully committed to a regulatory and supervisory framework that ensures the safety and soundness of the banking system and the stability of the financial system.

# 1 Overview of the SSM

This Chapter focuses on:

- the establishment of the new institutional framework for banking supervision in the euro area, and the related governance structures;
- the organisation of the supervisory function at the ECB.

Reference is also made to new arrangements for the ECB Banking Supervision's <sup>1</sup> involvement in the relevant EU and international institutions and fora.

## 1.1 Accountability and external communication

The SSM Regulation provides that the conferral of supervisory tasks on the ECB should be balanced by appropriate transparency and accountability requirements. Accordingly, establishing a framework for regular accountability to the European Parliament and the EU Council, as well as effective external communication channels, were among the ECB's priorities.

### 1.1.1 Implementing a strong accountability framework

The [SSM Regulation](#) sets out a substantive and robust accountability framework for the ECB's supervisory function vis-à-vis the European Parliament and the EU Council. The practical aspects of the exercise of democratic accountability of the tasks conferred on the ECB by the SSM Regulation were laid down in:

- an [Interinstitutional Agreement](#) between the European Parliament and the ECB;
- a [Memorandum of Understanding](#) between the EU Council and the ECB.

In addition, the SSM Regulation sets out a number of reporting requirements that also include the European Commission and national parliaments.

#### Main channels of accountability

For the implementation of the SSM Regulation, the ECB is held accountable by the representatives of European citizens in the European Parliament through regular public hearings and ad hoc exchanges of views with the Chair of the Supervisory Board at meetings of Parliament's Committee on Economic and Monetary Affairs, as well as by answering written questions from Members of the European Parliament (MEPs). The Eurogroup may also submit oral and written questions and hold regular and ad hoc exchanges of views in the presence of representatives of non-euro area

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<sup>1</sup> ECB Banking Supervision refers to the ECB business areas involved in supervision.

participating Member States. The Chair of the Supervisory Board also presents the SSM Annual Report to both Parliament's Committee and the Eurogroup. The Report is also transmitted to the European Commission and national parliaments. National parliaments may also submit written questions to the ECB and invite the Chair or another member of the Supervisory Board to participate in exchanges of views regarding the supervision of credit institutions in the relevant Member State.

## Discharging the accountability requirements

With regard to the **European Parliament**, in 2014, the Chair of the Supervisory Board visited Parliament's Committee on Economic and Monetary Affairs for:

- two ordinary public hearings ([18 March](#) and [3 November](#));
- two ad hoc exchanges of views (4 February and 3 November).

Ms Nouy also participated in a seminar for the ECB and Parliament, held on 14 October 2014, at the start of the new parliamentary term, to explain the preparatory work for the SSM to MEPs. Ms Lautenschläger, Vice-Chair of the Supervisory Board, welcomed MEPs to the ECB on 12 January 2015 to provide them with an outline of the ECB's supervisory priorities for 2015.

The ECB regularly transmitted to the European Parliament the confidential records of proceedings of its Supervisory Board meetings and lists of recently adopted legal acts (see List of the legal instruments concerning the general framework of banking supervision adopted by the ECB).

Between November 2013 and 15 January 2015, the ECB published on its [website](#) 14 replies to questions from MEPs on supervisory matters. Most letters focused on the preparatory work and the comprehensive assessment.

With regard to the **EU Council**, the Chair of the Supervisory Board attended meetings of the ECOFIN Council and the Eurogroup on four occasions in 2014. From 4 November 2014, the Chair of the Supervisory Board began discharging accountability towards the EU Council through the Eurogroup.

As part of the reporting requirements towards **national parliaments**, the Chair of the Supervisory Board had two exchanges of views with:

- the Finance Committee of the German *Bundestag*, on 8 September 2014 – Ms Nouy was accompanied by Ms Elke König, then President of the Federal Financial Supervisory Authority (BaFin);
- the European Affairs Committee of the French *Assemblée nationale* on 16 December 2014 – Ms Nouy was accompanied by Mr Edouard Fernandez-Bollo, Secretary General of the *Autorité de contrôle prudentiel et de résolution* (ACPR).

In 2014 the ECB also completed a number of one-off accountability requirements, in preparation for fully assuming its supervisory tasks, as set out in the SSM Regulation. These included:

- the publication of **quarterly reports** on progress in the operational implementation of the SSM Regulation:
  - [SSM Quarterly Report 2014/1](#)
  - [SSM Quarterly Report 2014/2](#)
  - [SSM Quarterly Report 2014/3](#)
  - [SSM Quarterly Report 2014/4](#)
- the revision of the [Ethics Framework](#) to take into account the ECB's new role as a supervisor;
- the publication of an [ECB Decision on separation](#), which governs the functional separation between the ECB's monetary policy and supervision functions.

### 1.1.2 [Developing effective external communication channels and tools](#)

Effective external communication is essential to build understanding, acceptance and trust in the SSM in the wider context of the banking union and to strengthen the credibility and reputation of ECB Banking Supervision. A communication framework for supervision was devised, taking into account best practices adopted by other supervisors in the field of communication, and approved by the Supervisory Board.

Furthermore, to make external communications more accessible to the public at large, documents are translated, depending on the addressees:

- statutory publications and public information tools are available in all official EU languages;
- information intended for the citizens of the countries participating in the SSM is translated into the official languages of those countries.

The communications channels and tools developed in 2014 included:

- **[Banking supervision website](#)**  
The key communication tool for the SSM is the new dedicated website, which went live on 4 November 2014. The website contains information for the general public, supervised banks and other stakeholders, including press releases (20 published in 2014), speeches, interviews, legal acts and webcasts. Sections of direct relevance to a wider audience were translated into all official EU languages.

## Banking supervision 3,600 banks, 19 countries, one system

European banking supervision helps to rebuild trust and bolsters the safety and soundness of the banking system. The ECB directly supervises the biggest banks in the euro area.

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- **Guide to banking supervision**

On 30 September 2014 the ECB published a “Guide to banking supervision” in all euro area languages. The purpose of the Guide is to explain to banks, the general public and the media how the SSM functions and to give guidance on the SSM’s supervisory practices. It is a tool that will be updated regularly to reflect new experiences that are gained in practice. For more information, see Section 2.2.2.

- **Public consultations**

As provided for in the SSM Regulation, public consultations were held on three draft ECB regulations:

- (i) the draft ECB SSM Framework Regulation;
- (ii) the draft ECB Regulation on supervisory fees;
- (iii) the draft ECB Regulation on reporting of supervisory financial information.

The purpose of the consultations was to seek the views of interested EU citizens, market participants and other stakeholders. **Public hearings** were held in Frankfurt am Main as part of each consultation and transmitted as webcasts on the ECB’s website. The responses received were taken into account in the final wording of the relevant regulations.

- **Public enquiries**

The ECB’s new supervisory tasks have triggered a significant increase in the number of public queries. The ECB therefore increased the capacity of its public queries desk. Some of the queries received have fed into Frequently Asked

Questions (FAQs), which were published on the banking supervision website and are updated regularly.

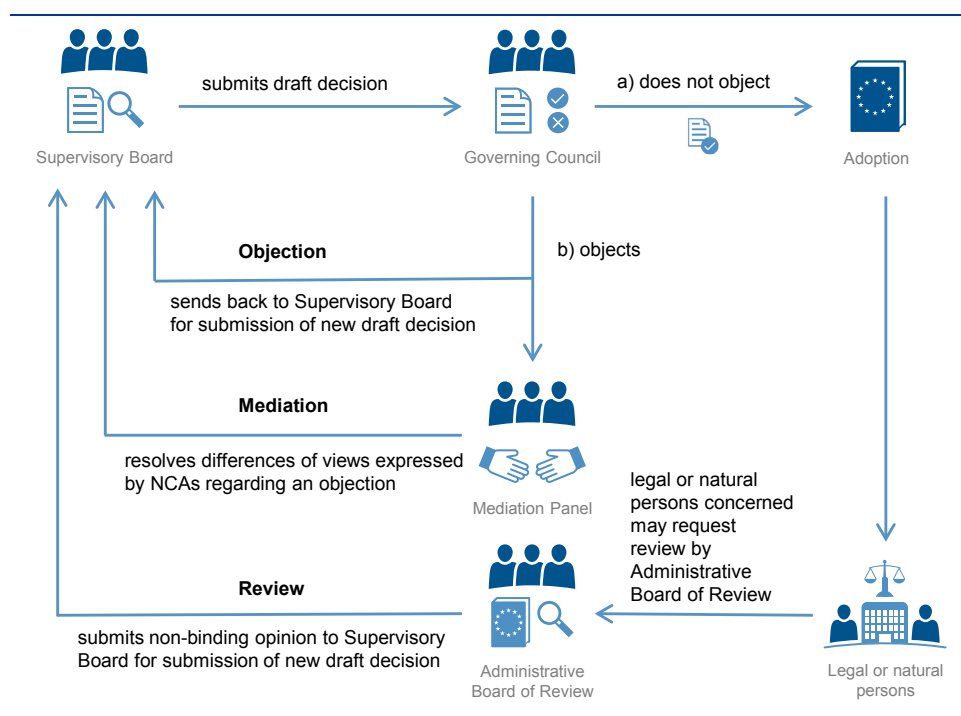
- **Educational material**  
Information tailored to the general public, including short videos and explanatory texts, is provided on the website to raise awareness and educate a broad audience about banking supervision. The material will be updated and enriched as warranted.

## 1.2 Supervisory Board and Steering Committee

### 1.2.1 Supervisory Board

In line with the SSM Regulation, the planning and execution of the tasks conferred on the ECB are fully undertaken by the Supervisory Board as an internal body of the ECB. The Supervisory Board takes draft decisions, which are adopted by the Governing Council under the **non-objection procedure** (see Figure 1). Decisions are deemed to be adopted unless the Governing Council objects within a defined period of time, not exceeding ten days. Apart from that, decisions on the general framework (e.g. the SSM Framework Regulation) are taken by the Governing Council outside the non-objection procedure.

**Figure 1**  
Non-objection procedure



The establishment of the [Supervisory Board](#), including the appointment of the Chair, Vice-Chair and three ECB representatives between late December 2013 and early 2014, was thus a key step in setting up the SSM.

**Ms Danièle Nouy** was appointed by the EU Council on 16 December 2013 as Chair of the Supervisory Board. The appointment was made, based on a proposal by the ECB's Governing Council on 20 November 2013, following an open selection procedure, and approval by the European Parliament on 11 December. While following the steps set out in the SSM Regulation and agreed with the European Parliament and the EU Council, the appointment was made under a fast-track procedure.

**Ms Sabine Lautenschläger** was appointed by the EU Council as Vice-Chair of the Supervisory Board with effect from 12 February 2014, following the approval of the European Parliament. As stipulated under the SSM Regulation, the Vice-Chair was chosen from among the members of the ECB's Executive Board.

On 6 March 2014 the ECB's Governing Council appointed three ECB representatives to the Supervisory Board: **Mr Ignazio Angeloni**, **Ms Julie Dickson** and **Ms Sirkka Hämmäläinen**. The fourth representative, **Mr Luc Coene**, was appointed on 18 February 2015.

Following the appointment of the Chair, the NCAs were requested to appoint one representative each. Where the competent authority is not a national central bank (NCB), the members of the Supervisory Board may decide to bring a representative from their respective NCB. In that case, the representatives are together considered as one member for the purposes of the voting procedure.

The SSM Regulation requires the Governing Council to adopt internal rules setting out in detail its relationship with the Supervisory Board. The Governing Council amended the [ECB's Rules of Procedure](#) accordingly on 22 January 2014. In particular, the revised rules establish the interaction between the Governing Council and the Supervisory Board within the non-objection procedure. Moreover, in order to properly reflect the Governing Council's responsibility for the internal organisation of the ECB and its decision-making process in accordance with the [Statute of the ESCB and the ECB](#), certain rules governing the Supervisory Board's procedures have also been incorporated in the [ECB's Rules of Procedure](#).

The Supervisory Board adopted its own [Rules of Procedure](#) on 31 March 2014; these are to be read in conjunction with the ECB's revised Rules of Procedure.

The [Code of Conduct](#) for the Supervisory Board was approved on 12 November 2014 and entered into force the following day. The purpose of the Code of Conduct is to provide a general framework of high ethical standards which the members and the other participants in Supervisory Board meetings are to observe and to set up specific procedures to deal, among other things, with potential conflicts of interest.



## Supervisory Board

Front row (from left to right):  
Robert Ophèle, Fabio Panetta,  
Danièle Nouy, Sabine  
Lautenschläger, Norbert Goffinet,  
Anneli Tuominen, Cyril Roux, Matej  
Krumberger (alternate for member  
Stanislava Zdravec Capriolo)

Middle row (from left to right):  
Mathias Dewatripont, Elke König,  
Ignazio Angeloni, Julie Dickson,  
Vassiliki Zakka, Claude Simon, Jan  
Sijbrand, Sirkka Hämmäläinen,  
Mariano Herrera (alternate for  
member Fernando Restoy Lozano)

Back row (from left to right):  
Andreas Ittner, Vladimír Dvořáček,  
Karol Gabarretta, Zoja Razmusa,  
Kristaps Zakulis, Yiángos  
Demetriou, Kilvar Kessler, Helmut  
Ettl, António Varela, Alexander  
Demarco



<b>Chair</b>	Danièle Nouy	<b>Cyprus</b>	Kyriacos Zingas (Central Bank of Cyprus) (until 31 October 2014) Yiángos Demetriou (Central Bank of Cyprus) (since 1 November 2014)
<b>Vice-Chair</b>	Sabine Lautenschläger	<b>Latvia</b>	Kristaps Zakulis (Finanšu un kapitāla tirgus komisija) Zoja Razmusa (Latvijas Banka)
<b>ECB representatives</b>	Ignazio Angeloni Luc Coene (since 11 March 2015) Julie Dickson Sirkka Hämmäläinen	<b>Lithuania</b>	Ingrida Šimonytė (Lietuvos bankas) (since 1 January 2015)
<b>Belgium</b>	Mathias Dewatripont (Nationale Bank van België/Banque Nationale de Belgique)	<b>Luxembourg</b>	Claude Simon (Commission de Surveillance du Secteur Financier) Norbert Goffinet (Banque centrale du Luxembourg)
<b>Germany</b>	Elke König (Bundesanstalt für Finanzdienstleistungsaufsicht) (until 28 February 2015) Felix Hufeld (Bundesanstalt für Finanzdienstleistungsaufsicht) (since 1 March 2015) Andreas Dombret (Deutsche Bundesbank)	<b>Malta</b>	Karol Gabarretta (Malta Financial Services Authority) Alexander Demarco (Bank Ċentrali ta' Malta/Central Bank of Malta)
<b>Estonia</b>	Kilvar Kessler (Finantsinspeksioon) Madis Müller (Eesti Pank)	<b>Netherlands</b>	Jan Sijbrand (De Nederlandsche Bank)
<b>Ireland</b>	Cyril Roux (Central Bank of Ireland/Banc Ceannais na hÉireann)	<b>Austria</b>	Helmut Ettl (Finanzmarktaufsicht) Andreas Ittner (Oesterreichische Nationalbank)
<b>Greece</b>	Vassiliki Zakka (Bank of Greece)	<b>Portugal</b>	Pedro Duarte Neves (Banco de Portugal) (until 10 September 2014) António Varela (Banco de Portugal) (since 11 September 2014)
<b>Spain</b>	Fernando Restoy Lozano (Banco de España)	<b>Slovenia</b>	Stanislava Zdravec Capriolo (Banka Slovenije)
<b>France</b>	Robert Ophèle (Banque de France)	<b>Slovakia</b>	Vladimír Dvořáček (Národná banka Slovenska)
<b>Italy</b>	Fabio Panetta (Banca d'Italia)	<b>Finland</b>	Anneli Tuominen (Finanssivalvonta) Pentti Hakkarainen (Suomen Pankki – Finlands Bank) (until 31 December 2014) Kimmo Virolainen (Suomen Pankki – Finlands Bank) (since 1 January 2015)

The Supervisory Board has been operational since January 2014, holding its first meeting on 30 January; in the course of 2014, 22 meetings took place (of which four were teleconferences).

The process initiated in March of preparing and adopting in all relevant official languages 120 decisions determining the significance of supervised institutions, as well as the approval of the results of the comprehensive assessment, represented first key achievements in terms of analytical, legal and logistical challenges.

Besides formal meetings, there were many informal exchanges between the members of the Supervisory Board, also in the course of visits by the Chair and Vice-Chair to the Member States. More specifically, in 2014, further to the commitment given at the selection procedure hearing before the European Parliament in November 2013, the Chair visited the Boards and staff of all the 24 national supervisory authorities and central banks across the euro area.

Between September and December 2014, a representative of Lietuvos bankas attended the Supervisory Board meetings, as an observer, in view of Lithuania's accession to the euro area on 1 January 2015.

In accordance with the Supervisory Board's Rules of Procedure, representatives of the European Commission and the European Banking Authority (EBA) were invited to some of the meetings to ensure an optimal interplay with the Single Market on a number of issues.

## 1.2.2 Steering Committee

The Steering Committee supports the activities of the Supervisory Board and prepares its meetings. The ECB's revised Rules of Procedure include rules for the selection of its members, which include the Chair and Vice-Chair of the Supervisory Board, one of the ECB representatives, and five NCA members appointed for one-year terms. To ensure a fair balance and rotation among NCAs, the NCAs have been allocated to four groups, according to a ranking based on the total consolidated banking assets in the relevant country. There must always be at least one member from each group on the Steering Committee.

The first meeting of the Steering Committee took place on 27 March 2014. A total of nine meetings were held during 2014.

## 1.3 Administrative Board of Review and Mediation Panel

### 1.3.1 Administrative Board of Review

The Administrative Board of Review ("Administrative Board") was established by virtue of [Decision ECB/2014/16](#) of 14 April 2014. It carries out internal administrative reviews of the ECB's supervisory decisions.

## Composition and main tasks

The Administrative Board is composed of five members and two alternates, all of whom are individuals of high repute with a sufficiently high level of experience in the fields of banking and other financial services. They were appointed by the ECB's Governing Council, following a public call for expressions of interest, for terms of five years, renewable once. The role of the two alternates is to temporarily replace members in the event of temporary incapacity or other circumstances as specified in Decision ECB/2014/16.

**Figure 2**

Composition of the Administrative Board of Review



The members of the Administrative Board act independently and in the public interest and are not subject to instructions by the ECB. The [public declarations of commitments and interests](#) made by all the members and alternates were published on the [ECB's banking supervision website](#).

A review of the supervisory decisions taken by the ECB can be requested by any natural or legal person to whom the decision is addressed or to whom the decision is of direct and individual concern.

The Administrative Board must adopt an opinion on the review no later than two months from the date of receipt of the request for review. Based on the opinion of the Administrative Board, which is not binding, the Supervisory Board decides whether to make a proposal to the Governing Council to abrogate the contested decision, to replace it with a decision of identical content or to replace it with an amended decision.

Due to its role in reviewing, upon request, supervisory decisions taken by the ECB, and the fact that, in each case, a review by the Administrative Board leads to the

adoption of a new decision by the Governing Council, the Administrative Board constitutes an important element of the ECB decision-making procedure as far as the exercise by the ECB of its supervisory tasks under the SSM Regulation is concerned.

To carry out its tasks, the Administrative Board is supported by the Secretariat to the Supervisory Board and other ECB business areas, as appropriate.

## Administrative Board of Review

Front row (from left to right):  
André Camilleri, Concetta Brescia  
Morra, Jean-Paul Redouin

Back row (from left to right):  
Kaarlo Jännäri, Edgar Meister, F.  
Javier Arístegui Yáñez, René Smits



## Activities

The Administrative Board began its activities in September 2014. So far, it has received **three requests for review** concerning the ECB decisions on significance that were notified to significant supervised entities in September 2014. The significant supervised entities argued, on different grounds, that they should not be considered significant and therefore asked the Administrative Board to review the ECB's assessment.

To carry out these reviews, the Administrative Board relied on the written submissions made by the applicants and also invited each of them to an oral hearing in Frankfurt am Main. The Administrative Board adopted an opinion on each request and sent them to the Supervisory Board. New draft decisions on significance were then submitted to the Governing Council for approval under the non-objection procedure, and notified to the three applicants once adopted.

Regarding the **costs of a review**, Decision ECB/2014/16 states that the amount must cover what has reasonably been incurred. The ECB has prepared a cost order methodology according to which applicants must, in principle, pay to the ECB a proportion of the costs as a lump sum. The ECB will publish this cost order

methodology on its website as soon as it is finalised in order to give potential applicants certainty about the amount of the costs that they will have to pay.

If, however, as a consequence of the notice of review, the Governing Council either abrogates or amends the initial ECB decision, the applicant does not have to bear the costs. In such cases, the ECB will reimburse the costs incurred by the applicant for the review, unless these costs are deemed to be disproportionate, in which case they are to be borne by the applicant.

### 1.3.2 Mediation Panel

The Mediation Panel was established by virtue of [Regulation ECB/2014/26](#) of 2 June 2014 with a view to ensuring the separation between monetary policy and supervisory tasks, as required under Article 25(5) of the SSM Regulation. The Mediation Panel shall deal – if so requested by an NCA – with an objection of the Governing Council expressed with respect to draft decisions prepared by the Supervisory Board.

The Mediation Panel comprises one member per participating Member State, chosen from among the members of the Governing Council and the Supervisory Board. The Chair of the Mediation Panel – who is the Vice-Chair of the Supervisory Board and not a member of the panel – is required to “facilitate the achievement of a balance between Governing Council and Supervisory Board members”.

To establish the Mediation Panel, in August 2014 the ECB proposed to the President of the EU Council an annual rotation procedure for the appointment of members. This proposal was discussed with the other ECOFIN ministers and subsequently agreed upon.

The **rotation arrangement** involves forming two groups of countries of as close to even size as possible, based on the protocol order of the countries in their national languages.

In the first year:

- group one countries appoint their Governing Council member;
- group two countries appoint their Supervisory Board member.

In the following year, the two groups swap around (i.e. a Supervisory Board member would replace a Governing Council member and vice versa).

If a non-euro area Member State chooses to participate in the SSM in close cooperation, its government would be invited to appoint its Supervisory Board member to the Mediation Panel.

Lithuania, which joined the euro area on 1 January 2015, is also represented on the Mediation Panel.

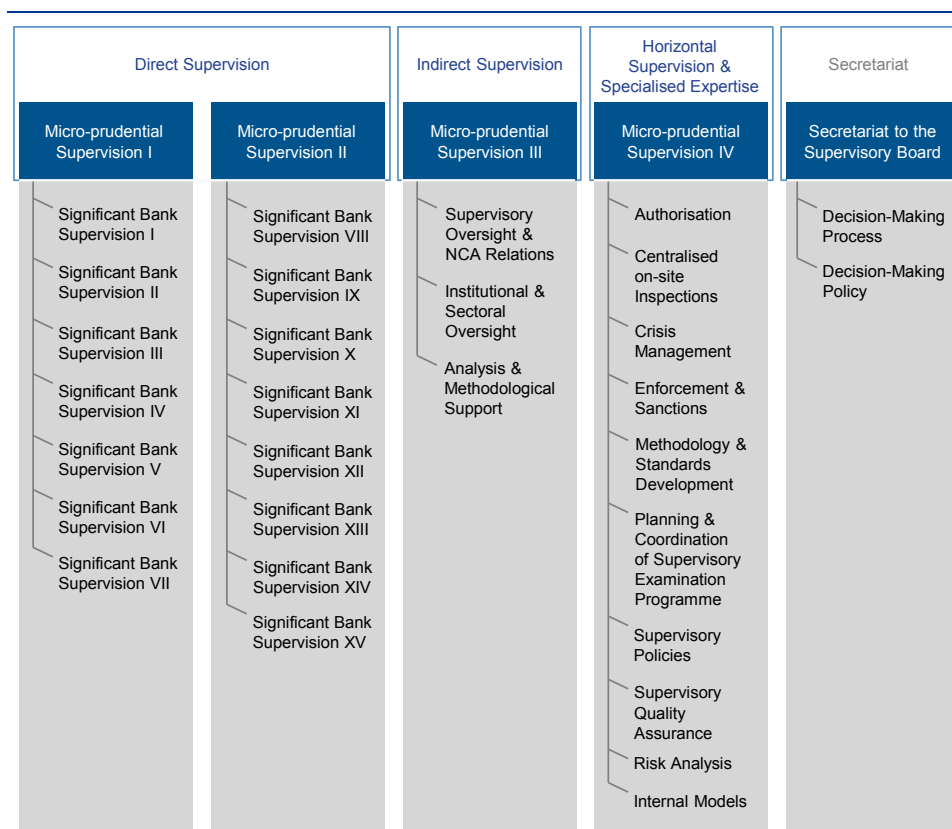
The Mediation Panel met for the first time at the end of November 2014. During the meeting, the Chair and members reached a common understanding on how to implement, in practice, some of the procedural steps set out in Regulation ECB/2014/26.

## 1.4 Organisation of the supervisory function at the ECB

Setting up the Single Supervisory Mechanism (SSM) required some changes to the ECB's existing organisational structure.

The new micro-prudential function has been organised into five new business areas within the ECB: four directorates general (DGs) and a Secretariat to the Supervisory Board.

**Figure 3**  
Core SSM organisational structure



This organisational chart shows the first two layers of the organisational structure of the new business areas  
 ■ DG (Directorate General)

### 1.4.1 DGs Micro-Prudential Supervision I and II

DGs Micro-Prudential Supervision I and II (DGs MS I and II) deal with the **direct supervision of significant banks**. Both DGs are organised according to a risk-

based approach to supervision and are thus specialised by risk exposure, complexity and business models.

- DG MS I covers the supervision of the approximately 30 most systemic banking groups and is organised into seven divisions with about 200 full-time equivalent positions (FTEs).
- DG MS II covers the supervision of approximately 90 banking groups and is organised into eight divisions, also with about 200 FTEs.

Supervision of the significant banks is carried out in close cooperation with NCAs. A **Joint Supervisory Team** (JST) has been established for each entity or significant banking group supervised directly by the ECB. Each team operates under the coordination of a JST coordinator from DGs MS I and II of the ECB, supported by one or more local sub-coordinators from the NCAs and comprising a number of supervisors from both the ECB and the NCAs of the participating countries. Each of the 14 most complex banking groups has one dedicated JST coordinator; for all the other banking groups, JST coordinators are as a rule responsible for two or three banking groups.

In order to foster and emphasise neutrality, the JST coordinator is generally not from the home country of the bank under his or her supervision. In the same vein, a rotation principle will be applied, whereby, as a rule, JST coordinators must change banks every three to five years to prevent the establishment of overly close relationships with the supervised banks. For more information about the JSTs, see Section 2.2.3.

## 1.4.2 DG Micro-Prudential Supervision III

DG Micro-Prudential Supervision III (DG MS III) is responsible for the oversight function of the ECB regarding the direct supervision of **less significant institutions** by NCAs.

At any time, the ECB, after consulting the relevant NCA or at the request of the NCA, may take over the responsibility for the direct supervision of less significant institutions to ensure the consistent application of high supervisory standards and the consistency of supervisory outcomes.

DG MS III is organised into three divisions, with around 80 FTEs working on tasks pertaining to:

- (i) oversight of NCAs' supervisory practices for less significant institutions as well as relations with NCAs;
- (ii) institution-specific and sectoral oversight of less significant institutions;
- (iii) provision of analysis and methodological support.

### 1.4.3 DG Micro-Prudential Supervision IV

DG Micro-Prudential Supervision IV (DG MS IV) hosts all **horizontal and specialised expertise services** of supervision. It supports JSTs and NCAs in the conduct of supervision of both significant and less significant credit institutions.

About 250 FTEs are allocated to DG MS IV, which is organised into the following ten divisions:

- Planning and Coordination of Supervisory Examination Programmes;
- Authorisation;
- Enforcement and Sanctions;
- Supervisory Quality Assurance;
- Supervisory Policies;
- Methodology and Standards Development;
- Crisis Management;
- Centralised On-Site Inspections;
- SSM Risk Analysis;
- Internal Models.

Given the wide diversity hitherto in national supervisory frameworks (including policy, methodology, standards, processes) and practices, a critical objective of DG MS IV is to promote the development and implementation of a single, consistent and state-of-the-art supervisory approach, with a view to establishing a level playing field and delivering more effective supervision across Europe.

For all DGs, close cooperation and coordination between ECB Banking Supervision and the NCAs is key to achieving the SSM's objectives and, in particular, to truly working and acting as a single European supervisor. Mirroring to some extent the concept of the JSTs, networks pooling together ECB and NCA staff have been established by DG MS III as well as for all horizontal and specialised expertise services. For more information, see Chapter 3.

### 1.4.4 Secretariat to the Supervisory Board

The Secretariat to the Supervisory Board is responsible for:

- supporting the Supervisory Board and assisting its members in fulfilling their responsibilities and obligations, including the drafting and recording of its agendas, minutes and decisions;



- ensuring the completeness of the legal basis of decisions and their compliance with legal requirements;
- supporting the Chair and Vice-Chair in fulfilling their accountability obligations towards the European Parliament and EU Council;
- coordinating the preparation of the ECB Annual Report on supervisory activities and other regular reports on supervisory matters.

About 30 FTEs are allocated to the Secretariat.

#### 1.4.5 Shared services

Many other business areas of the ECB provided advisory, administrative, technical, logistical and other services to ECB Banking Supervision as they did for other ECB functions. These include, for example, Administration, Communications, Human Resources, Budget & Organisation, and Information Systems..

This “shared service” model was adopted to avoid the duplication of work and to benefit from the synergies with other business areas of the ECB.

The specific activities of these shared services are covered elsewhere in this report.

#### 1.4.6 Committees meeting in SSM composition

The existing structure of the Eurosystem/ESCB committees has been used for meetings in SSM composition (i.e. including members of NCAs for countries where supervision is not conducted by NCBs) to provide advice on SSM-related matters.

The [Rules of Procedure of the ECB](#) were amended accordingly. Committees meeting in SSM composition report to the Supervisory Board and, where appropriate, the Governing Council. In accordance with its own procedures, the Supervisory Board also mandates the Vice-Chair to report via the Executive Board to the Governing Council on all such activity.

##### Table 1

##### Eurosystem/ESCB committees meeting in SSM composition

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Eurosystem/ESCB Communications Committee (ECCO)
Financial Stability Committee (FSC)
Human Resources Conference (HRC)
Internal Auditors Committee (IAC)
Information Technology Committee (ITC)
Legal Committee (LEGCO)
Organisational Development Committee (ODC)
Statistics Committee (STC)

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### 1.4.7 Mission statements

To take account of the new supervisory function, a revised version of the [ECB's mission statement](#) and a [Mission statement of the SSM](#) stating, in particular, the aim to “develop a supervisory approach that meets the highest international standards” were approved by the Governing Council in January 2015.

## 1.5 Framework for close cooperation

EU Member States whose currency is not the euro may participate in the SSM under a regime of close cooperation. Whereas Article 7 of the SSM Regulation sets out the main conditions for the establishment of close cooperation between the ECB and the competent authorities of a requesting Member State, the procedural aspects are specified in [Decision ECB/2014/5](#), which entered into force on 27 February 2014.

In particular, [Decision ECB/2014/5](#) specifies that a formal request for close cooperation should be made at least five months before the date on which the non-participating Member State intends to participate in the SSM. Such a request needs to include an undertaking on the part of the requesting Member State to provide the information necessary for the ECB to conduct a comprehensive assessment of the credit institutions established in the requesting Member State. The requesting Member State also needs to undertake to amend its national legislation with a view to ensuring that: (i) legal acts adopted by the ECB in accordance with the SSM Regulation are binding and enforceable in the requesting Member State; and (ii) the national competent authority and the national designated authority of such a Member State adhere to any instructions, guidelines or requests issued by the ECB under the close cooperation framework.

To assess the request for close cooperation, the ECB may ask for additional information from the requesting Member State, while it may also take into account the outcomes of a comprehensive assessment of the domestic banking sector that may have been conducted by the NCA of this Member State, provided that the methodology of such comprehensive assessment corresponds to the ECB standards and the outcomes are still up to date.

Where the ECB concludes that the requesting Member State fulfils the criteria set out in the SSM Regulation for entering into close cooperation, and once the comprehensive assessment of such Member State's banking sector is concluded, the ECB will adopt a decision addressed to the Member State formally establishing the close cooperation. Where the criteria are not fulfilled, the ECB will adopt a decision rejecting the request to enter into close cooperation, explaining the reasons. Any case of close cooperation may under certain conditions be suspended or terminated by way of an ECB decision addressed to the Member State concerned, including at the request of the Member State concerned.

No formal requests for close cooperation were received in 2014, although some Member States have sought informal clarification on the procedure for entering into close cooperation.

## 1.6 The SSM as part of the European and global supervisory architecture

### 1.6.1 EU and international cooperation

As supervisor of the whole euro area banking system, the ECB, together with the NCAs, is in the best position to detect emerging risks and determine priorities. Consequently, it is able to raise policy concerns and identify the need for regulatory changes in EU and international fora, such as the:

- European Banking Authority (EBA);
- European Systemic Risk Board (ESRB);
- Basel Committee on Banking Supervision (BCBS).

ECB Banking Supervision participates actively in these fora, through which it can influence the regulatory debate.

The ECB, together with the NCAs, is also cooperating closely with the European Commission and the EBA in developing the single European rulebook. The single rulebook aims to provide a single set of harmonised prudential rules which both significant and less significant institutions throughout the EU must respect, as well as to minimise overlaps and maximise synergies.

One of ECB Banking Supervision's most important tasks is to develop a common set of methodologies and supervisory approaches to be employed consistently across the euro area. In this regard, the ECB follows Binding Technical Standards developed by the EBA and adopted by the European Commission, as well as the single supervisory handbook developed by the EBA.

### 1.6.2 Memoranda of understanding with non-EU countries

The ECB considers the sharing of information with selected counterparts essential for the efficient and effective execution of its supervisory tasks. The exchange of relevant information and assessments among supervisors, also in countries outside the EU, is facilitated by memoranda of understanding. Under Article 8 of the SSM Regulation, the ECB may “develop contacts and enter into administrative arrangements with supervisory authorities, international organisations and the administrations of third countries”.

To smooth the transition to the SSM, the ECB has been in contact with relevant third country host supervisors. The ECB has taken a two-step approach:

- In a first “transitional” phase, the ECB is participating in existing general and/or institution-specific memoranda of understanding concluded between euro area NCAs and third country supervisors.
- A second, more “steady state” phase will begin once the ECB starts to negotiate its own joint cooperation arrangements with these supervisors.

## 2 Laying the foundations of the SSM

### Preparatory work conducted before 3 November 2013

The preparatory work before the entry into force of the SSM Regulation on 3 November 2013 was initiated by the ECB, in close collaboration with national supervisors, following the euro area summit of 29 June 2012.

The preparations were steered by a **High-Level Group on Supervision**, chaired by the ECB President and comprising representatives from the NCAs and central banks of the euro area.

A **Task Force on Supervision**, including senior representatives of NCAs and NCBs and reporting to the High-Level Group, conducted the technical preparatory work. A project team was also created among the members of the Task Force to foster communication and cooperation among the supervisory authorities and provide direction to all staff involved in the preparations. The Task Force organised the technical work into five work streams (WS1 to WS5), focusing respectively on:

- an initial mapping of the euro area banking system (WS1);
- the SSM legal framework (WS2);
- the development of a supervisory model for the SSM (WS3);
- the development of a supervisory reporting framework for the SSM (WS4);
- the initial preparation of the comprehensive assessment of the credit institutions (WS5).

### The transitional year foreseen in the SSM Regulation

The SSM Regulation entered into force on 3 November 2013. Under the Regulation, the ECB was given one year in which to establish the SSM before formally assuming its supervisory tasks on 4 November 2014. These were months of highly intensive preparatory work, including, in particular, the:

- establishment of the SSM governance structures;
- finalisation of the legal framework for SSM supervision;
- development of the SSM supervisory model;
- organisational development and staffing of the ECB's supervisory function.

In parallel, the ECB carried out a comprehensive assessment of significant banks, subjecting them to an in-depth asset quality review and a stress test.

## 2.1 Legal framework

### 2.1.1 SSM Framework Regulation

Under Article 6(7) of the SSM Regulation, the ECB was required to adopt and make public a framework to organise the practical arrangements of the cooperation between the ECB and the NCAs within the SSM. This framework took the form of an ECB regulation (the [SSM Framework Regulation](#)), which was published on 25 April 2014 and entered into force on 15 May 2014.

The SSM Framework Regulation covers the aspects expressly referred to in Article 6(7) of the SSM Regulation, i.e.:

- (i) the methodology for the assessment of the significance of institutions;
- (ii) cooperation procedures for the supervision of significant credit institutions;
- (iii) cooperation procedures for the supervision of less significant institutions.

Moreover, the SSM Framework Regulation also deals with aspects that go beyond those expressly mentioned in Article 6 of the SSM Regulation, including: issues relating to the procedures for authorisations, qualifying holdings, and withdrawal of authorisations (known collectively in the SSM context as “common procedures” – see Section 3.4), as well as the procedures for investigatory powers, the regime for administrative penalties, macro-prudential supervision and close cooperation. The SSM Framework Regulation also lays down the main due process rules for the adoption of the ECB's supervisory decisions, for example the right to be heard and access to files.

The [SSM Framework Regulation](#) was adopted following a public consultation, which took place between 7 February and 7 March 2014. In addition, a public hearing was held at the ECB on 19 February 2014, which gave stakeholders a first opportunity to ask questions about the draft legal text. By the end of the consultation period, the ECB had received [36 sets of comments](#). Respondents included European and national market and banking associations, financial and credit institutions, (non-euro area) central banks and supervisory authorities, ministries of finance and lawyers. The [comments](#) were published on the ECB's website.

Most of the comments were of a technical nature, requesting clarifications and amendments to specific provisions, which indicated broad support for the general approach proposed in the draft SSM Framework Regulation. The topics most frequently raised included the procedural rules for the adoption of the ECB's supervisory decisions (e.g. the right to be heard, access to files and the language regime), the methodology for assessing the significance of supervised entities, passporting procedures, the regime of close cooperation, and the status of the less significant supervised entities.

Several respondents also raised questions about the functioning of the JSTs or the on-site inspections and, more generally, about how the SSM would operate as of November 2014.

A [feedback statement](#) was published on the ECB's website addressing the comments received during the public consultation in more detail and presenting an overview of the resulting amendments to the SSM Framework Regulation.

## 2.1.2 Decisions on the list of significant institutions

Under the SSM Regulation, and in accordance with the respective provisions of the SSM Framework Regulation, the ECB is required to determine which of the credit institutions across the euro area should be deemed significant. The individual credit institutions – after having had the opportunity to exercise their right to be heard – were to be notified of their status by 4 September 2014. On that date, the ECB published a [list of significant supervised entities and less significant institutions](#) on its website.

### Assessing significance

The assessment of significance, which was carried out by the ECB in close collaboration with the NCAs, was based on the criteria set out in the SSM Regulation and specified in the SSM Framework Regulation adopted in April 2014 (see Table 2).

In particular, for the criterion of significance based on cross-border activities, which is mentioned in general terms in the SSM Regulation, the three following conditions were introduced in Article 59 of the SSM Framework Regulation:

- The parent undertaking of the supervised group must have established subsidiaries which are credit institutions in more than one other participating Member State.
- The group's total assets must exceed €5 billion (a condition also introduced for significance based on the criterion of "importance at national level" to exclude small institutions, the possible failure of which would have no or little impact on the respective Member States or the EU).
- The ratio of the group's cross-border assets to its total assets, or the ratio of its cross-border liabilities to its total liabilities, is above 20%, a ratio deemed to indicate that cross-border exposures are likely to be spread over several participating Member States.

**Table 2**  
Significance criteria

<b>Size</b>	the total value of its assets exceeds €30 billion
<b>Economic importance</b>	for the EU economy as a whole or any participating Member State (in particular, total assets exceeding €5 billion and 20% of GDP of a Member State)
<b>Cross-border activities</b>	the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating country to its total assets/liabilities is above 20%
<b>Direct public financial assistance</b>	it has requested or received funding from the European Stability Mechanism or the European Financial Stability Facility
<b>Three most significant institutions</b>	it is one of the three most significant credit institutions in a participating Member State

The Supervisory Board initiated the assessment of significance in March 2014 by gathering and analysing the necessary information in close collaboration with the relevant NCAs. On the basis of this analysis, the ECB then notified the institutions concerned of its intention to consider them significant and invited them to submit comments. The ECB also published a preliminary draft list of significant institutions on its website.

After assessing the comments of the institutions that had been deemed significant, the ECB decided on the full list of significant institutions. The overall process – assessment of the institutions, preparation and adoption of the decisions and their notification in all relevant official languages to more than 120 institutions and groups – involved considerable analytical, legal and logistical challenges. Preparing the list of the more than 3,500 less significant institutions also entailed numerous exchanges with the NCAs. The ECB published the final [list of significant supervised entities and less significant institutions](#) on its website on 4 September 2014.

As a result of this assessment, 120 institutions or groups were considered significant. The relevant criteria for significance applied to these institutions are shown below.

**Table 3**  
Outcome of the significance assessment

Criteria for significance	Number of credit institutions/groups
Size	97
Importance for the economy	13
Cross-border activities	3
One of the three most significant credit institutions in a participating Member State	7

All but four of these institutions underwent the comprehensive assessment.

- Three of these were considered significant on the basis of the cross-border activities criterion, which had not been taken into account when defining the scope of the comprehensive assessment. These relatively small credit institutions will be subject to a comprehensive assessment in 2015, together with other institutions that are expected to meet the criteria for significance based on data as of year-end 2014.
- The fourth case was a branch of a non-SSM banking group and therefore fell beyond the scope of the comprehensive assessment.

Conversely, a total of 11 institutions covered by the comprehensive assessment were qualified as less significant, mainly owing to updated information regarding their size (also taking into account that, for the purposes of the comprehensive assessment, a buffer range of 10% below the formal size threshold was applied so as to capture all potentially significant institutions).

## Particular circumstances

Article 70 of the SSM Framework Regulation provides that, when assessing the significance of the institutions, particular circumstances may exist that justify the classification of a supervised entity as less significant, even though, formally, the criteria for classification as significant are fulfilled.

The ECB, jointly with the relevant NCAs, identified three such cases where institutions were classified as less significant, even though they comply with the formal significance criteria.

## Consequences of Lithuania joining the euro area

With a view to the formal approval by the EU Council for Lithuania to join the euro area on 1 January 2015, the ECB notified in December 2014 the three Lithuanian institutions concerned of its intention to consider them significant (on the basis of the criterion of the “three most significant credit institutions in a participating Member State”). In the absence of any comments from these institutions, the ECB decided in January 2015 to consider them significant.

## Updating the list

The ECB must review, at least annually, the status of a supervised entity as significant or less significant. This will be carried out later in 2015, as the relevant data needed for the assessment (e.g. total assets for 2014) become available. In addition, after 4 September 2014, the ECB was notified of changes to the group structure of some significant and less significant institutions. Following these notifications, the ECB adopted several amended significance decisions (with changes relating to relevant list of subsidiaries). The [list of significant supervised entities and less significant institutions](#) was updated on the basis of these amendments in February 2015. The ECB will continue to update these lists on a regular basis.

### 2.1.3 Separation between monetary policy and supervisory tasks

The SSM Regulation requires the ECB to perform a supervisory function, the objective of which is to protect the safety and soundness of credit institutions and the stability of the financial system, in compliance with the separation principle.



Supervisory tasks should be carried out in full separation from monetary policy, in order to avoid conflicts of interest and to ensure that each function is exercised in accordance with the applicable objectives. The separation principle covers, among other things, the separation of objectives, the separation of decision-making processes and tasks, including the organisational and procedural separation at the level of the Governing Council.

## Implementing the separation principle

In early 2014 the ECB implemented a series of measures to achieve organisational and procedural separation, particularly regarding the separation of decision-making for the two policy functions. An independent Supervisory Board was established – separate from the ECB’s Governing Council – to draft and implement decisions. Moreover, the ECB’s Rules of Procedure were amended to regulate organisational and procedural aspects related to the Supervisory Board and its interaction with the Governing Council. This included the rule that the Governing Council’s deliberations on supervisory matters would be kept strictly apart from those on other issues, with separate agendas and meetings.

Separation at the staff level has also been ensured by the establishment of four directorates general and a Secretariat to the Supervisory Board, which report functionally to the Chair and Vice-Chair of the Supervisory Board. For more information, see Section 1.4.

## ECB Decision on separation between the monetary policy and supervision functions

The SSM Regulation furthermore requires the ECB to adopt and publish any necessary internal rules to ensure the separation between the supervisory function on the one hand and monetary policy functional areas and other tasks of the ECB on the other, including rules regarding professional secrecy and information exchanges. On 17 September 2014 the ECB adopted a Decision on the implementation of separation between the monetary policy and supervision functions of the ECB ([Decision ECB/2014/39](#)), which entered into force on 18 October 2014.

The Decision focuses on general principles, allowing for further specific arrangements with regard to internal procedures. It contains, in particular, provisions relating to organisational aspects and the exchange of information between the two policy areas.

With regard to the **organisational separation**, the Decision provides that the ECB may establish shared services providing support to both the monetary policy and the supervisory function to ensure that these support functions are not duplicated, thus helping to guarantee the efficient and effective delivery of services, provided that such support will not lead to conflicts of interest.

As regards the **exchange of information**, the rules on information sharing between the functions set out in the Decision allow the ECB to fulfil its multiple tasks in an effective and efficient manner while at the same time avoiding undue interference from one function to another and sufficiently protecting confidential information. In particular, the Decision states that the ECB's confidentiality regime constitutes the main framework for classifying and sharing information within the ECB.

The sharing of confidential information must always be conducted on a need-to-know basis and must ensure that the policy objectives of the two policy areas are not compromised. In the event of a conflict of interest, the Executive Board should decide on access rights to confidential information.

In respect of the exchange of confidential information between the monetary policy and supervisory functions, the Decision stipulates that anonymised FINREP and COREP data<sup>2</sup>, as well as confidential aggregated information (containing neither individual bank information nor policy-sensitive information), may be shared in accordance with the confidentiality regime. In respect of raw data, such as individual supervisory banking data and assessments (particularly with regard to individual institutions or policy-sensitive information), access will be more restricted and subject to approval by the Executive Board.

The ECB is implementing the internal framework for the exchange of information.

All in all, the ECB now has a very solid framework for preventing conflicts of interest between its monetary policy and micro-prudential tasks.

## 2.2 The SSM supervisory model

Important efforts have been made in developing an SSM model of supervision, building on the experience acquired by the national supervisors. Joint Supervisory Teams (JSTs) were established, which clearly represent a cornerstone of the SSM supervisory organisation. A Supervisory Manual, which describes to SSM staff the processes to be applied in the supervision of banks was drafted and has already been updated. A “**Guide to banking supervision**”, aimed at explaining the SSM supervisory model to supervised institutions and the general public, was published in September 2014. Finally, the operational framework for the supervisory oversight and indirect supervision of less significant institutions was developed.

### 2.2.1 Supervisory Manual

The Supervisory Manual is an internal document for staff which describes the processes, procedures and methodology for the supervision of significant and less

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<sup>2</sup> FINREP (FINAncial REPorting) and COREP (COmmon REPorting) form part of the EBA's Implementing Technical Standards (ITS). FINREP deals with the collection of financial information from banking institutions; it represents a standardised format of their annual accounts (balance sheet, profit and loss and detailed annexes). COREP deals with the collection, also in a standardised format, of information relative to the Pillar 1 calculation, i.e. details on own funds, deductions and capital requirements (credit, market and operational risk) as well as large exposures.

significant institutions. It also describes the procedures for cooperation with NCAs from participating Member States and NCAs from other countries.

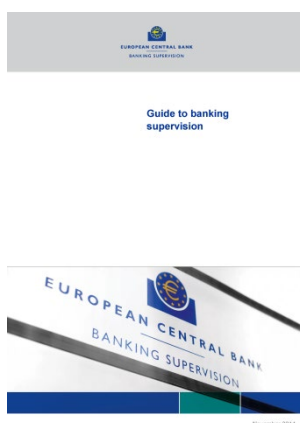
The Manual covers, among other topics, the methodology for the Supervisory Review and Evaluation Process (SREP), off-site and on-site reviews, risk assessments and model validations.

The Supervisory Manual is pivotal to ensuring that the same supervisory standards are applied across the banking union. The efforts involved in its development are complementary to the EBA's work in fostering harmonisation within the EU.

The Manual was developed on the basis of the best supervisory practices of participating Member States. It needs to be implemented in all participating Member States to foster the necessary convergence of supervisory practices.

A revised version of the Supervisory Manual, focusing on the SREP, was endorsed by the Supervisory Board in September 2014 and has been used to support the planning of the 2015 activities. The Manual is subject to continuous review and improvements on the basis of internal evaluations, internationally accepted benchmarks and international regulatory developments. As such, it is a living document that is updated to reflect new market developments and supervisory practices.

## 2.2.2 Guide to banking supervision



On 29 September 2014 the ECB published a “Guide to banking supervision”. This was one of the critical implementation steps for the ECB in 2014, as required under the Interinstitutional Agreement between the European Parliament and the ECB.

The Guide explains the overall functioning of the SSM in a user-friendly way and gives an overview of the main supervisory processes, procedures and methodologies applied to significant and less significant credit institutions. For example, it describes the work of the JSTs and sets out how ECB Banking Supervision's business areas are to interact in the various supervisory processes. The aim of the Guide, which will be updated as needed, is to help the supervised entities to better understand the key SSM supervisory processes.

The Guide builds on the SSM Regulation and the SSM Framework Regulation and has been made available in all official euro area languages, including Lithuanian. It is not a legally binding document.

## 2.2.3 Joint Supervisory Teams

The Joint Supervisory Teams (JSTs) are responsible for the ongoing supervision of the significant banking groups and the implementation of the related ECB supervisory decisions. The JSTs, the ECB component of which is established in DGs MS I and II, are the key operational tool of the SSM for the supervision of significant entities.

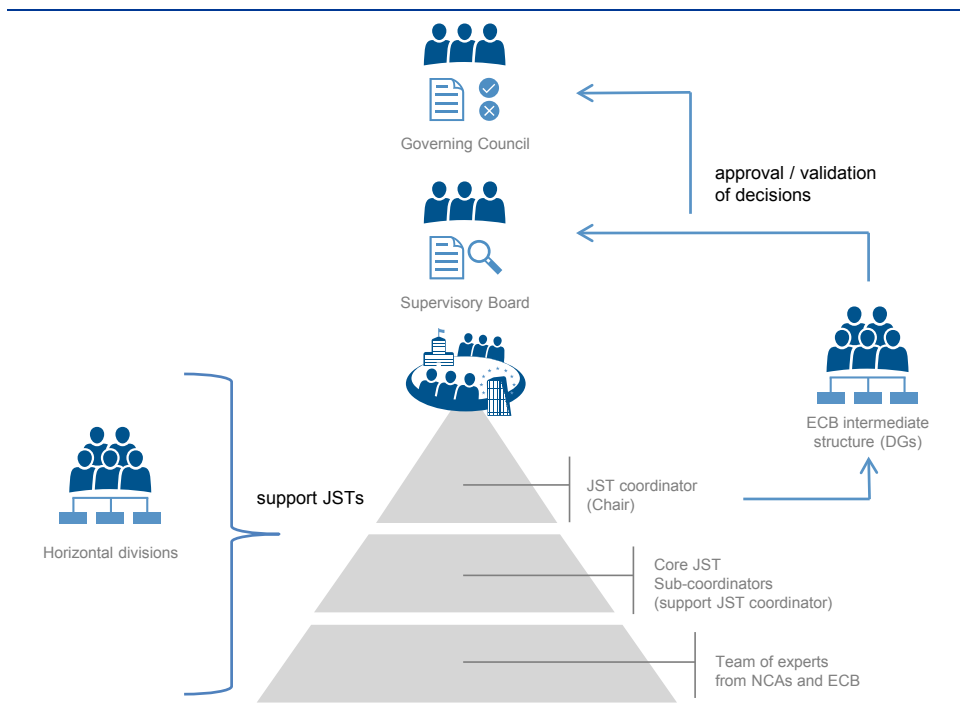
They are composed of staff members from the ECB and the NCAs and work under the coordination of a designated ECB staff member (JST coordinator) and one or more NCA sub-coordinators.

JSTs started operating formally on 4 November 2014. The preparatory work, however, began prior to that, and involved the compilation and assessment of the supervisory history and risk profile of each institution in specific dossiers sent by the NCAs. It also involved kick-off and follow-up meetings with the NCAs and the supervised groups, as well as the participation of ECB JSTs members as observers in the meetings of supervisory colleges and crisis management groups. For each supervised group, this work helped identify the supervisory priorities, charting the main risks, assessing solvency and planning supervisory activities for 2015.

At the current stage, processes are being made more efficient and the teams are converging and evolving to become more integrated and ensure closer interaction among the members.

The intrusiveness of the supervisory approach takes the form, among other things, of close interaction not only with the banks' management but also their boards and the committees established within these bodies (in particular risk and audit committees) to provide JSTs with an overview of the entity's strategy and risk profile and a better understanding of the way strategic decisions are taken. This includes an assessment of the risk appetite framework and risk culture, drilling down from the governing structures into the business units.

**Figure 4**  
Functioning of the Joint Supervisory Teams



The JSTs were involved in the final stages of the comprehensive assessment process, communicating the preliminary results to the banks (as part of the “supervisory dialogue”) prior to their publication on 26 October 2014. In addition, the JSTs were responsible for the monitoring of the follow-up actions regarding both quantitative and qualitative measures. This monitoring – which started in 2014 – is also included in all the Supervisory Examination Programmes for 2015 (see Section 3.2.2).

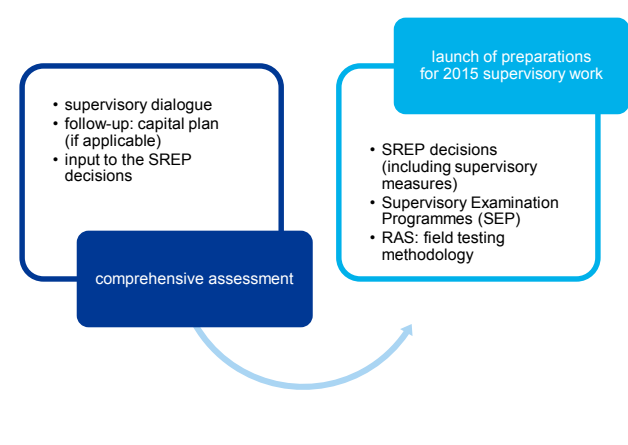
The most important follow-ups to the comprehensive assessment exercise were the monitoring of the:

- (i) accounted provisions, credit risk reclassifications and other quantitative adjustments in light of the AQR results;
- (ii) implementation of proposals regarding internal processes, IT findings, and other qualitative findings;
- (iii) adequacy of the capital plans that institutions needed to provide in the event of a shortfall;
- (iv) compliance with the proposed capital plans.

Finally, and more generally, JSTs were in charge of drafting the SREP decisions to be implemented in 2015, which reflect the outcomes of the comprehensive assessment.

A detailed overview on the follow-up to the comprehensive assessment can be found under Section 3.1.

**Figure 5**  
JST: supervisory activities in 2014



As Figure 5 shows, the second major strand of work for the JSTs was the launch of the preparations for the supervisory activities in 2015 (see Section 3.2). This included three main elements: the SREP (Supervisory Review and Evaluation Process) decisions to be implemented in 2015, the Supervisory Examination Programme (SEP) for 2015, and the conduct of a field test of the risk assessment system (RAS):

- **SREP decisions**

The SREP decisions prepared in 2014 for implementation in 2015, and the related supervisory measures, were largely based on the outcome of the annual review and evaluation conducted by the NCAs and on the results of the comprehensive assessment, including the assessment of the institutions’ capital plans. This process also represented an important element in fostering the integration of the teams,

sharing information and exchanging views, as well as enhancing the supervisory knowledge and assessment of the risk profile of each bank.

Supervisory colleges, with the participation of the EBA, were convened where appropriate.

- **SEP**  
The preparation of the SEP, which defines 2015 supervisory activities concerning ongoing supervision, on-site inspections and internal models, benefited significantly from the conclusion of the SREP. The planning exercise was carried out in close cooperation with the horizontal services in DG MS IV and the NCAs, ensuring that the top priorities identified by the JSTs for 2015 are covered.
- **RAS**  
The RAS provides a methodology for analysing and a framework for capturing outcomes from risk assessments performed throughout the year. The JSTs have been collaborating extensively with DG MS IV in carrying out ongoing field-testing of each aspect of the RAS to fine-tune the methodology and to identify and correct problematic methodological issues.

#### 2.2.4 Framework for the supervision of less significant institutions

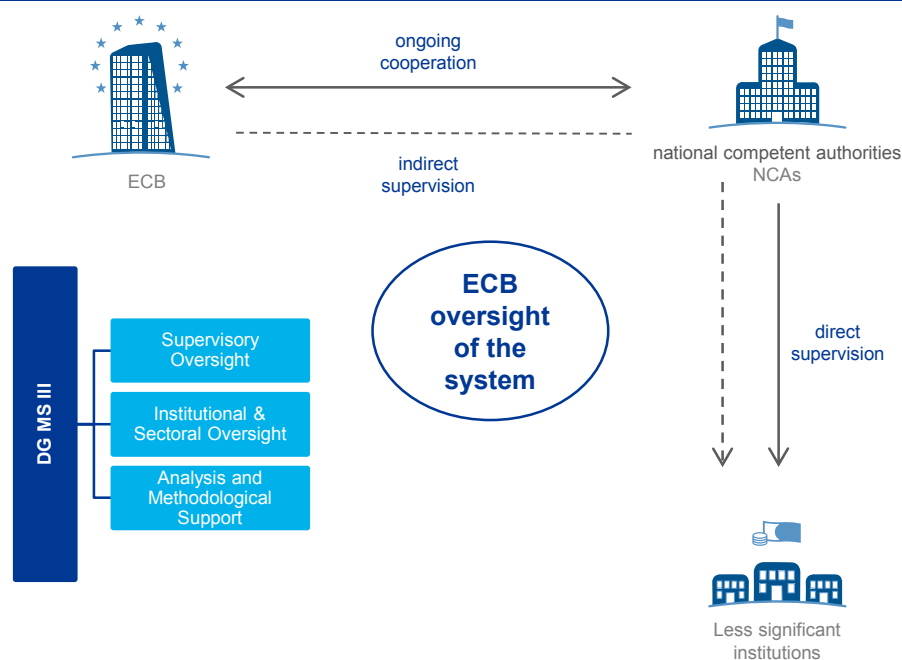
Thanks to the work carried out jointly by the ECB – in particular DG MS III – and the NCAs, significant achievements were made in 2014 in establishing the operational framework for the supervisory oversight and indirect supervision of less significant institutions (LSIs). The overall objective is to ensure the integrity of the SSM as one supervisory system, characterised by the consistent application of high supervisory standards and effective collaboration between the ECB and the NCAs. While the ECB exercises oversight over the functioning of the system, NCAs retain full responsibility for the direct supervision of LSIs.

The total number of LSIs in SSM countries amounts to approximately 3,500, encompassing a wide variety of banks in terms of size, business models and specific local characteristics. This calls for supervisory approaches that combine local knowledge with common methodologies and for a set of best practices for the SSM.

It is also essential to prioritise supervisory activities, ensuring an adequate focus on institutions deemed to have a high inherent risk level and significant systemic impact. Indeed, the SSM has identified an initial list of 108 high-priority LSIs, selected by their size in the relevant jurisdiction, riskiness and interconnectedness (e.g. due to their function as financial market infrastructure or payment system providers). For these institutions, the supervisory activity is more intense, as outlined in Section 3.8. The principle of proportionality is thus enshrined in the framework for LSI supervision and concretely reflected in the way the different tools for indirect supervision are applied.

Well-functioning information flows between the ECB and NCAs at all levels, ranging from the technical aspects of day-to-day supervision to policy discussions at senior management level, are the backbone of cooperation on LSI supervision. Accordingly, significant work has been conducted to establish the relevant fora and processes to develop an appropriate cooperation framework within the SSM.

**Figure 6**  
 Framework for LSI supervision within the SSM



## 2.3 Staffing

### 2.3.1 The SSM recruitment process

The recruitment process for the SSM (involving around 1,000 budgeted positions) was carried out successfully.

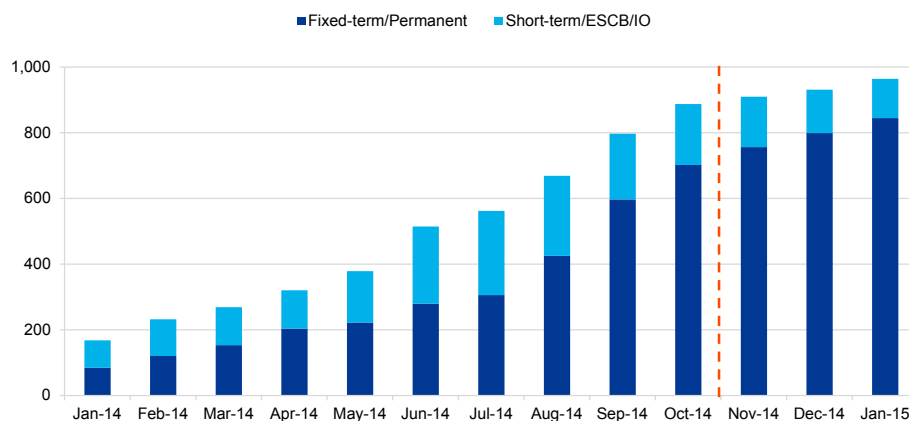
From the second quarter of 2013 and during the entire preparatory phase, the ECB benefited from the support of up to 200 colleagues that were seconded from NCAs to the ECB on a temporary basis. Shortly after the summer of 2014, a critical mass of highly qualified managers and supervisory staff joined the ECB so that, in particular, the JSTs could become operational in time.

Overall, the ECB received around 22,000 applications for the positions in the core supervisory functions. The recruitment campaign was organised in a transparent, competitive and top-down fashion in order to allow managers to recruit their own teams. The selection of candidates aimed at recruiting employees with the highest level of ability, efficiency and integrity. In the very demanding recruitment process, all candidates had to demonstrate not only the required sound technical competencies, but also their behavioural competencies and managerial skills, as appropriate. A variety of tools and techniques were used to assess the skills and competences required for the job(s) at stake, including online testing, written exercises, presentations and structured interviews.

By the beginning of January 2015 more than 960 staff, representing all EU nationalities, had been recruited out of the roughly 1,000 total budgeted positions in ECB Banking Supervision and the related shared services<sup>3</sup>. Recruitment efforts will continue in 2015 to fill the remaining positions.

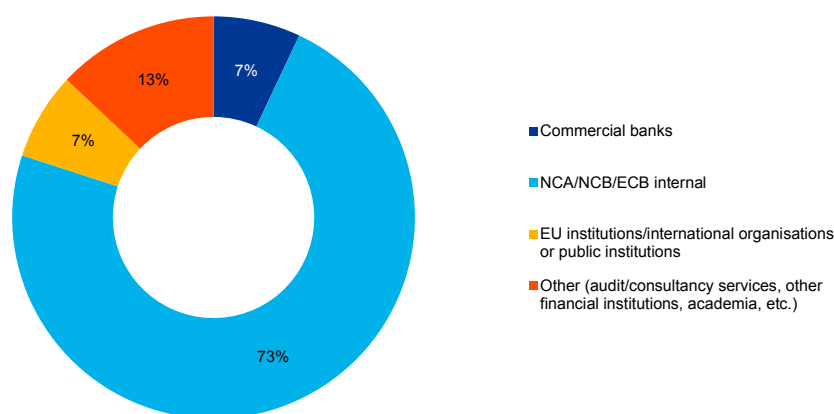
**Chart 1**  
SSM recruitment (including shared services)

The red line marks the operational start of the SSM



The recruitment process ensured an adequate mix of nationalities, age, gender and backgrounds. Of the colleagues recruited, 42% were female and 58% were male. The new staff have brought with them a variety of professional experience, with the majority coming from a central banking/supervisory environment.

**Chart 2**  
Professional background of newly hired ECB staff for supervisory tasks



<sup>3</sup> More specifically 1,073.5 FTEs were budgeted for SSM purposes for 2014, out of which 984.5 are permanent positions and 89 are limited positions.



### 2.3.2 Code of Conduct for ECB staff and management

Under the SSM Regulation, the Governing Council is required to publish a Code of Conduct for ECB staff and management involved in banking supervision. In 2014 the ECB prepared draft rules of ethical standards as part of a general review of the Ethics Framework, which applies to all ECB staff. The related Decisions amending the ECB's Conditions of Employment and the Staff Rules were adopted on 27 November and 3 December 2014, respectively. Prior to adoption, the ECB informed the European Parliament's Committee on Economic and Monetary Affairs on 31 October 2014 about the main elements of the revised Ethics Framework, in accordance with the Interinstitutional Agreement.

The [revised Ethics Framework](#) was published on the ECB's website and in the Official Journal of the EU, and entered into force on 1 January 2015. It strengthens, in particular, the rules on avoiding conflicts of interest (including post-employment restrictions), as well as the rules governing gifts and hospitality, private financial transactions and professional secrecy. It also establishes a Compliance and Governance Office, which advises all ECB staff and monitors compliance.

## 2.4 Data reporting framework

In 2014 the ECB set up the organisational and technical structures, as well as the necessary processes, for regular and ad hoc data collections of statistics relating to supervisory tasks.

A dedicated Supervisory Statistics Division was established within the ECB's Directorate General Statistics to manage the different data streams required for the quantitative risk reports. The Division's work covers the governance framework for the management of data from all supervised groups and individual institutions, including the coordination, receipt, quality management and reconciliation of these supervisory data. In this respect, the entry into force of the EBA's Implementing Technical Standards (ITS) on supervisory reporting significantly increased the amount of comparable information.

### Sequential approach

EBA Decision EBA/DC/090 requires competent authorities to transmit to the EBA the full ITS data at the highest level of consolidation for a sample of banks. In the case of the SSM, following a "sequential approach", the institutions report to the NCAs, as the entry point of supervisory reporting, which then submit the data to the ECB. For the significant institutions, the ECB will submit the data to the EBA.

Under this approach, the ECB receives, stores and disseminates the relevant data on the directly and indirectly supervised entities. Moreover, it produces derived statistics or indicators for the quantitative risk assessment system and meets other statistical and analytical needs of the ECB. Overall, the work of the supervisory statistical

function supports ECB Banking Supervision and contributes to the further development and harmonisation of supervisory information in close collaboration with the EBA.

## ECB Regulation on reporting of supervisory financial information

The draft [ECB Regulation on reporting of supervisory financial information](#) was developed in the course of 2014. This Regulation, which was adopted on 17 March 2015, aims to permanently close some of the data gaps still existing in supervisory reporting and to increase harmonisation across participating Member States. For example, reporting of supervisory financial information is only mandatory for institutions applying International Financial Reporting Standards (IFRS) at the consolidated level.

The ECB Regulation aims to extend regular reporting to the consolidated reports of banks under national accounting frameworks, as well as to reports at the solo level (i.e. including single legal entities) in accordance with the CRR. The principle of proportionality has been duly taken into account by distinguishing between different groups of reporters depending on whether they are significant or less significant, reporting on a consolidated or individual basis and whether their total assets are above or below a materiality threshold of €3 billion.

The ECB Regulation does not affect the accounting standards applied by supervised groups and entities in their consolidated accounts or annual accounts, nor does it change the accounting standards applied to supervisory reporting. Furthermore, in accordance with the CRR, the EBA has been notified that the ECB – as the competent authority – will exercise its discretion to collect supervisory financial reports also on a solo level and for non-IFRS banks, as provided for in the ITS on supervisory reporting, from significant supervised groups.

The draft Regulation was submitted for public consultation between 23 October and 4 December 2014, during which time a total of 21 responses were received. SUBA data system

The supervisory statistical services use the tools provided by the Supervisory Banking data system (SUBA) to fulfil their tasks. With this new system, developed in close collaboration with the NCAs, the ECB established the corresponding data flows and developed a set of procedures for supervisory banking data and metadata collection, storage, processing (including validation and consistency checks), confidentiality protection and basic dissemination.

## Ad hoc data collections

Another important task in 2014 was the design of the reporting framework for non-harmonised data categories, i.e. those that are not in the scope of the ITS on Supervisory Reporting under the CRR, developed by the EBA, and are compatible with the principle of maximum harmonisation under the CRR. Additional ad hoc

supervisory reporting requirements are aimed at complementing ITS datasets to ensure that the SSM has all the data on supervised entities that it requires.

As part of the preparatory work conducted before November 2014, one of the main challenges was to test the overall availability of data across jurisdictions and provide a test case for the SSM risk assessment methodology. For this purpose, pilot exercises were launched, which became the building blocks of the current non-standardised data-gathering functions performed by the Supervisory Statistics Division.

The designed transmission standards and procedures for the processing, validation and dissemination system of ad hoc data collections were gradually upgraded.

## 2.5 Information technology

IT solutions developed for the establishment of the SSM included:

- **Information Management System (IMAS)**  
IMAS is the main tool for the JSTs and on-site inspection teams, providing the technical basis for harmonised processes and consistency in the supervision of credit institutions. Especially in the initial phase of the SSM, it has been a crucial element in ensuring that the common methodology and standards are applied by all JSTs. A major activity for the go-live of IMAS in November 2014 was a training programme for all supervisors working under the SSM framework, both in the ECB and the NCAs, which amounted to more than 3,000 users. Given the wide range of information to be collected, this tool is still being implemented.
- **Data collection, data quality management and analytics**  
The Supervisory Banking data system (SUBA) first release went live at the end of July 2014 (see Section 2.4). The key objective of SUBA is to enable the ECB to receive specific supervisory data from all SSM countries based on the XBRL format, in line with the EBA's ITS framework.
- **Support to feeing framework**  
IT requirements for the fee collection process were defined, also taking into account the outcome of the public consultation on the draft ECB Regulation on supervisory fees. A self-service portal for banks to maintain their own feeing (accounting) data was developed, allowing for the first collection of fee debtor data in the first quarter of 2015. Work was also initiated on the fee calculation solution, with development starting early in 2015, in order to support the production and processing of the first invoices, which are due in the third quarter of 2015.
- **Collaboration, workflow and information management**  
The IT project for managing the contact data of supervised institutions and handling their possible queries is currently being implemented; significant progress has already been made, with the first set of functionalities going live in August 2014. In anticipation of the expected load increase on account of the

SSM, assessments of the infrastructure and the capacity of the document management system are also under way.

- **Shared IT services**

The ECB's capacity had to be adjusted, as the user traffic increased substantially.

The connectivity of all NCAs to the ESCB/Eurosystem IT infrastructure (CoreNet) was a key element. Different solutions were put in place including permanent or temporary connectivity to the corresponding NCBs, or a direct connectivity link, which will only be possible after the roll-out of the new version of the CoreNet infrastructure, which is taking place in the first quarter of 2015.

For the exchange of confidential e-mails and documents between significant institutions and the ECB, given the time constraints, the approach chosen was to use e-mail via the "Transport Layer Security" (TLS<sup>4</sup> protocol). The implementation of this protocol is taking place in close coordination with the significant institutions.

## 2.6 Comprehensive assessment

### 2.6.1 General scope, objectives and organisation

The comprehensive assessment provided for in the SSM Regulation for the 130 banks expected to qualify as significant was a prudential exercise of unprecedented scope and depth, which started in the autumn of 2013 and was finalised with the publication of the results on 26 October 2014. It constituted an important milestone at the start of the SSM, proving that the new system can cope with a project of enormous magnitude and bring it to a successful end within a very demanding time frame (see also the [Aggregate report on the comprehensive assessment](#) published in October 2014).

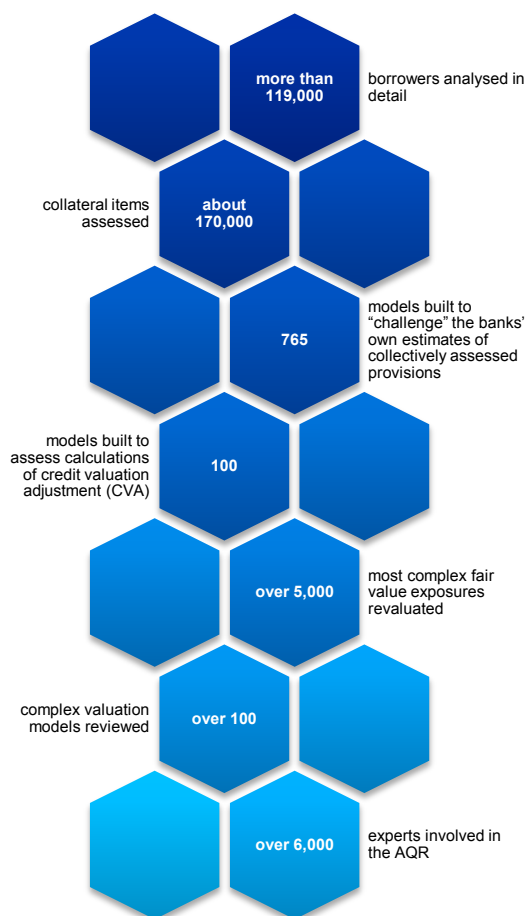
The exercise consisted of an **asset quality review (AQR)** and a **stress test**, with three main objectives:

- establishing transparency by enhancing the quality of information available on the condition of banks;
- identifying and implementing corrective actions if and where needed;
- building confidence by assuring all stakeholders that banks are fundamentally sound and trustworthy.

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<sup>4</sup> The Transport Security Layer (TLS) is a security mechanism designed to protect e-mail messages when transferred over a public network such as the internet.

**Figure 7**  
Key figures on the scope of the asset quality review



The **AQR** was a point-in-time assessment of the accuracy of the carrying value of banks' assets as of 31 December 2013 and provided a starting point for the stress test. The AQR was undertaken by the ECB and NCAs and was based on a uniform methodology and harmonised definitions. Under the AQR, banks were required to have a minimum Common Equity Tier 1 (CET1) ratio of 8%. Figure 7 provides an indication of the scope of the exercise.

Within the AQR, a detailed asset-level review was performed for over 800 specific portfolios making up 57% of the banks' risk-weighted assets.

The **stress test** provided a forward-looking examination of the resilience of banks' solvency to two hypothetical scenarios, also reflecting new information arising from the AQR. The stress test was undertaken by the participating banks, the ECB and NCAs, in cooperation with the EBA, which also designed for the entire EU a common methodology along with the ECB and the European Systemic Risk Board (ESRB). Under the baseline scenario, banks were required to maintain a minimum CET1 ratio of 8%; under the adverse scenario, they were required to maintain a minimum CET1 ratio of 5.5%.

In order to maintain consistency and equal treatment across both the AQR and stress test, central ECB teams independently performed quality assurance on the work of the banks and NCAs. The ECB was in

close contact with NCAs, responding to over 8,000 methodology and process questions.

The ECB reviewed and challenged outcomes from an SSM-wide perspective using comparative benchmarking, as well as engaging with NCAs to investigate specific issues that arose. Where necessary, quality assurance adjustments to banks' stress test submissions were undertaken by the ECB in order to ensure adequately conservative outcomes in line with the common methodology and maintain a level playing field. Over 100 experts from the ECB along with external support professionals were involved in this quality assurance activity.

## 2.6.2 Outcome of the comprehensive assessment

The AQR resulted in aggregate adjustments of €47.5 billion to participating banks' asset carrying values as of 31 December 2013.

These adjustments originated primarily from accrual accounted assets, particularly adjustments to specific provisions on non-retail exposures. Additionally, non-performing exposure (NPE) stocks were increased by €135.9 billion (corresponding to an 18% addition) across the in-scope institutions, as NPE definitions were moved onto a harmonised and comparable basis, including the examination of forbearance as a trigger of NPE status. In addition to adjustments made directly to current carrying values, the AQR result was also reflected in the projection of banks' capital adequacy under hypothetical scenarios performed in the stress test.

Overall, the comprehensive assessment identified a capital shortfall of €24.6 billion. Between 1 January and 30 September 2014, participating banks raised a total of €57.1 billion in capital, which reduced the identified capital shortfall accordingly. After such capital measures had been accounted for, the shortfall was reduced to €9.5 billion, distributed across 13 banks.

The capital needs for each of the 25 banks with a shortfall are presented in Table 4.

**Table 4****Banks with a capital shortfall after the comprehensive assessment**

DGMSI/II Bank name	CET1 ratio starting point	CET1 ratio post AQR	CET1 ratio baseline scenario	CET1 ratio adverse scenario	Aggregate report capital shortfall		Aggregate report net eligible capital raised until Q3 2014 (€ millions)
					% (RWAs as in the adverse scenario)	(€ millions)	
Banks <sup>1</sup> with a capital shortfall at year-end 2013 covered at Q3 2014							
Cooperative Central Bank	-3.7%	-3.7%	-3.2%	-8.0%	-13.5%	1,169	1,500
Bank of Cyprus	10.4%	7.3%	7.7%	1.5%	-4.0%	919	1,000
Veneto Banca	7.3%	5.7%	5.8%	2.7%	-2.8%	714	740
Banco Popolare	10.1%	7.9%	6.7%	4.7%	-1.3%	693	1,760
Piraeus Bank	13.7%	10.0%	9.0%	4.4%	-1.1%	660	1,000
Banca Popolare di Sondrio	8.2%	7.4%	7.2%	4.2%	-1.3%	318	340
Münchener Hypothekbank	6.9%	6.9%	5.8%	2.9%	-2.6%	229	410
AXA Bank Europe	15.2%	14.7%	12.7%	3.4%	-2.1%	200	200
C.R.H. - Caisse de Refinancement de l'Habitat	5.7%	5.7%	5.7%	5.5%	-2.3%	130	250
Banca Popolare dell'Emilia Romagna	9.2%	8.4%	8.3%	5.2%	-0.3%	130	760
Liberbank	8.7%	7.8%	8.5%	5.6%	-0.2%	32	640
Credito Valtellinese <sup>2</sup>	8.8%	7.5%	6.9%	3.5%	-2.0%	377	415
<b>TOTAL</b>						<b>5,571</b>	<b>9,015</b>
Banks <sup>1</sup> with a capital shortfall at year-end 2013 that have the means to mitigate without having to raise capital, also according to the aggregate report on the comprehensive assessment							
National Bank of Greece	10.7%	7.5%	5.7%	-0.4%	-5.9%	3,433	2,500
Dexia <sup>3</sup>	16.4%	15.8%	10.8%	5.0%	-0.6%	340	-
Nova Ljubljanska banka	16.1%	14.6%	12.8%	5.0%	-0.5%	34	-
Nova Kreditna Banka Maribor	19.6%	15.7%	12.8%	4.4%	-1.1%	31	-
Eurobank	10.6%	7.8%	2.0%	-6.4%	-11.9%	4,630	2,860
<b>TOTAL</b>						<b>8,468</b>	<b>5,360</b>
Banks <sup>1</sup> with a capital shortfall that has to be covered within 6 or 9 months by eligible measures detailed in the capital plans							
Banca Popolare di Milano	7.3%	6.9%	6.5%	4.0%	-1.5%	684	520
Banca Popolare di Vicenza	9.4%	7.6%	7.5%	3.2%	-2.3%	683	460
Monte dei Paschi di Siena	10.2%	7.0%	6.0%	-0.1%	-5.6%	4,250	2,140
Banca Carige	5.2%	3.9%	2.3%	-2.4%	-7.9%	1,835	1,020
Banco Comercial Português	12.2%	10.3%	8.8%	3.0%	-2.5%	1,137	-10
Oesterreichischer Volksbanken-Verband	11.5%	10.3%	7.2%	2.1%	-3.4%	865	-
permanent tsb	13.1%	12.8%	8.8%	1.0%	-4.5%	855	-
Hellenic Bank	7.60%	5.20%	6.20%	-0.50%	-5.99%	277	100
<b>TOTAL</b>						<b>10,586</b>	<b>4,230</b>
<b>OVERALL TOTAL</b>						<b>24,625</b>	<b>18,605</b>

1 Data from the Comprehensive Assessment Aggregate Report (ECB), October 2014.

2 Banca Piccolo Credito Valtellinese, Società Cooperativa ("Credito Valtellinese") is considered a less significant institution and is indirectly supervised by the ECB under the SSM. The shortfall has already been addressed by eligible measures.

3 Taking into account the orderly resolution plan of this institution, which benefits from a State guarantee, there is no need to proceed with capital raising following the comprehensive assessment results.

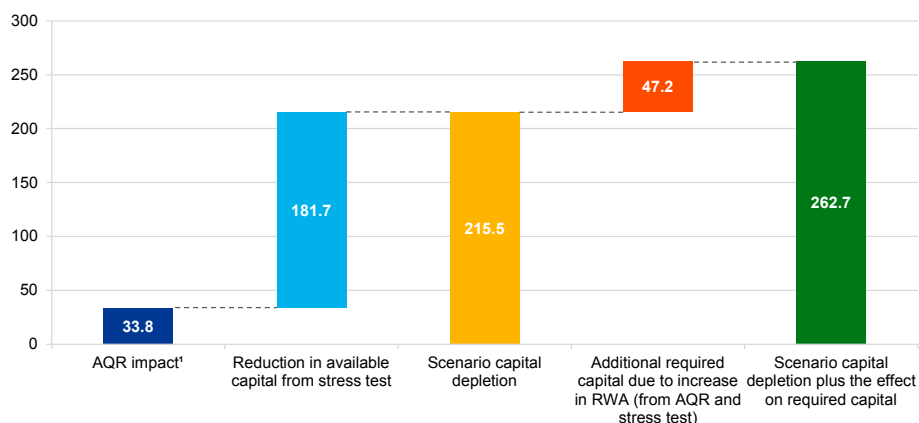
The shortfall figure alone provides only a partial perspective of the exercise's overall outcome. The projected capital change under the whole comprehensive assessment (arising from both the AQR and the stress test) also needs to be taken into account. Under the adverse scenario of the stress test, the banks' aggregate available capital was projected to be depleted by €215.5 billion (22% of capital held by participating banks) and risk-weighted assets (RWA) to increase by about €860 billion by 2016; including this as a capital requirement at the threshold level brings the total capital impact to €262.7 billion in the adverse scenario. This capital impact led to a decrease

of the CET1 ratio for the median participating bank by 4.0 percentage points, from 12.4% to 8.3% in 2016.

### Chart 3

#### Comprehensive assessment total impact on capital (AQR + adverse scenario)

(CET1 in € billion)



<sup>1</sup> AQR adjustment after tax effects and portfolio guarantee offsets

Note: Effect on available as well as required capital is calculated as of 2016 under the adverse stress test scenario.

These results show that the adverse scenario was the most severe scenario of all EU-wide stress tests conducted so far. The macro-financial stress covered three years, not two as in previous exercises, which added to its relative severity.

The comprehensive assessment succeeded in substantially increasing the level of transparency on banks' balance sheets through the publication of bank-level results in very granular disclosure templates. The requirement for banks facing capital shortfalls to fill those within six or nine months, depending on the source of the shortfall, constitutes a strong driver for the process of balance sheet repair. Both should contribute to enhancing the confidence of all stakeholders in the fundamental soundness of the euro area banking system.

For more information about the follow-up to the comprehensive assessment, see Section 3.1.



## 3 Putting the SSM into practice

The ECB formally took on its supervisory tasks on 4 November 2014, one year after the entry into force of the SSM Regulation. The follow-up to the results of the comprehensive assessment, which were announced on 26 October 2014, was the natural starting point, but other important steps were also taken in this operational phase in terms of preparing the supervisory work for 2015, developing the methodologies for all horizontal and specialised services and establishing the framework for cooperating with the NCAs in the supervision of less significant institutions.

### 3.1 Follow-up to the comprehensive assessment

The comprehensive assessment provided the SSM with a very rich set of data and qualitative information on the institutions falling under direct ECB supervision. The JSTs thus had a sound foundation for taking up supervisory responsibility on 4 November 2014.

A top priority for JSTs in the months following the publication of the final results of the comprehensive assessment was to incorporate the full spectrum of relevant findings into their regular activities. During this period, the JSTs held in-depth discussions with the institutions on the granular findings.

#### 3.1.1 Incorporation into the SREP decisions to be implemented in 2015

For banks under direct ECB supervision, the comprehensive assessment's outcomes were reflected in the Supervisory Review and Evaluation Process (SREP), the process used to guide the supervisory review of credit institutions. The outcome of the SREP is the basis for determining whether additional supervisory measures should be applied, such as imposing additional requirements on the supervised entity with respect to specific own funds, disclosure or liquidity (see also Section 3.2).

Pillar 2 measures required from banks under SREP decisions were thus related to two sets of findings: (i) issues identified in ongoing supervision throughout the year and (ii) findings stemming directly from the comprehensive assessment. The findings were complementary, given that the comprehensive assessment was not designed to cover all types of risk; liquidity risk, for instance, was addressed in ongoing supervision only.

The follow-up to the comprehensive assessment went beyond its quantitative findings. For example, in a number of cases, banks' difficulties in producing the data requested in the AQR revealed structural weaknesses in their data systems, in particular for institutions that had recently merged with or acquired other banks. The

JSTs consequently factored the urgent need to improve those banks' systems into their planning.

### 3.1.2 Implications for banks' financial statements over 2014

Quantitative findings from the AQR needed to be reflected in the banks' financial statements to the maximum extent possible. The main AQR findings were related to:

- reclassifications from "performing" to "NPE" and provision levels for individual credit files reviewed during the exercise;
- collective provisioning approaches and underlying provisioning models or processes;
- credit valuation adjustment (CVA) models and processes.

To ensure a common understanding, the ECB held in-depth discussions with the major audit firms on the approach to appropriately addressing the range of findings in banks' financial accounts; the JSTs then followed up on certain issues with the banks themselves.

In December 2014 the JSTs met with the relevant banks to discuss the implementation of remedial actions and prudential or accounting adjustments. All institutions that participated in the AQR were given a summary of the complete AQR findings by type and portfolio and further details on the outcome of the individual credit file review.

For all required remedial actions, banks submitted a written response to the ECB by the end of January 2015, indicating how they intended to comply. In January 2015 the JSTs also contacted the external/statutory auditor to obtain an independent view on any issues and proposed actions. Finally, JSTs carried out supervisory reviews enabling them to closely monitor the banks' implementation of the AQR findings and to apply supervisory measures or other disclosure requirements where appropriate.

### 3.1.3 Capital plans

The comprehensive assessment found that the capital ratios of 25 banks fell short of the relevant thresholds (8% CET1 ratio for the AQR and for the baseline scenario of the stress test and 5.5% CET1 ratio for the adverse scenario of the stress test). These banks were requested to submit capital plans within two weeks of publication of the results detailing how the shortfalls would be filled.

Banks have to cover the identified capital shortfalls within six months from the release of the results for those shortfalls resulting from the AQR or from the baseline stress test scenario, and within nine months for those shortfalls identified in the adverse stress test scenario. The periods of six or nine months are counted from the release of the comprehensive assessment results in October 2014.

As communicated during the comprehensive assessment, the banks' capital plans are expected to draw on private sources of funding to strengthen their capital positions so as to meet the required targets, including:

- retained earnings;
- reduced bonus payments;
- new issuances of common equity;
- suitably strong contingent capital;
- sales of selected assets at market prices or reductions of risk-weighted assets (RWAs) associated with restructuring plans agreed with the European Commission.

All banks submitted the required capital plans within two weeks of the publication of the results. The JSTs assessed whether the measures detailed in the capital plans met the criteria of mitigating measures and were sufficient to cover the shortfall; where needed, they asked for additional measures.

In December 2014, the Supervisory Board took note of the final set of capital plans from the banks at which a capital shortfall had been detected as well as of the related proposals presented by the JSTs. These fed into the SREP decisions. ECB Banking Supervision will continue to closely follow the implementation of the capital plans during the six/nine-month periods allowed to the banks.

### 3.1.4 Monitoring of remedial actions

JSTs assessed all planned capital measures in terms of their feasibility, viability and credibility. In many cases, several rounds of discussions took place with the banks. Where needed, the capital plan measures included in the SREP decisions have been communicated to the institutions. The follow-up started as part of the ongoing supervision of the entity. JSTs monitored the implementation of these measures by way of a continuous dialogue with the banks, involving existing colleges of supervisors where appropriate.

As well as monitoring the implementation of the capital plan measures, the JSTs also closely tracked the incorporation of the AQR findings into banks' financial accounts. Where relevant, additional accounting provisions were discussed with the auditors and the management of the banks, and prudential provisions were incorporated either in the banks' financial accounts or in the SREP decisions. Finally, JSTs discussed with the banks the possible measures to cover all the identified weaknesses.

### 3.1.5 Work on national options and discretions

Another important aspect highlighted by the results of the comprehensive assessment was the impact of national options and discretions in the CRD IV package, which were found to have important implications for the quality of individual banks' CET1 capital and the consistency of its definition across Member States.

These options and discretions grant certain choices regarding the application of regulatory rules either to the Member States or to the relevant competent authorities. This implies that, until November 2014, these choices were made at the national level. Given that the comprehensive assessment was carried out under the then prevailing legal framework, the discretions applied by NCAs were reflected in the calculations of the capital ratios, which were eventually compared with the defined thresholds to detect shortfalls. Previous national decisions (e.g. when setting the phase-in percentages for deductions from CET1 capital) thus had, and still have, implications for the composition and quality of capital. They lead to significant divergences, particularly in the degree to which individual banks benefit from transitional adjustments to their CET1 calculation.

A dedicated work stream has now been set up to carefully review the implications of options and national discretions applied by NCAs and report back to the Supervisory Board.

## 3.2 Preparations for supervisory activities in 2015

By the end of 2014, two essential milestones in the preparations for the supervisory work for 2015 had been successfully completed:

- the draft SREP decisions to be implemented in 2015;
- the strategic and operational planning for 2015, including the key priorities for the SSM.

### 3.2.1 SREP decisions

The SREP is an overarching process conducted on an annual basis, with the key purpose of ensuring that not only banks' capital and liquidity, but also their internal governance, strategies and processes, are adequate to ensure a sound management and coverage of their risks.

The SREP is the main supervisory instrument for addressing the whole array of such risks based on the findings of ongoing supervision, on-site inspections and other supervisory activities. Under the SREP, supervisors have the power to impose a wide range of measures, including additional capital and liquidity requirements and changes to risk management practices. These measures are communicated to the banks in the SREP decision.

Since the ECB did not take on its supervisory tasks until 4 November 2014, the SREP decisions prepared in 2014 (for implementation in 2015) are the result of an exceptional, one-off procedure:

- As part of the general handover, the conclusions from the SREP carried out by the NCAs were largely incorporated into the ECB SREP decisions.
- SREP decisions were largely based on the comprehensive assessment quantitative and qualitative results, together with the assessment of the banks' capital plans where applicable.

The SREP decision on capital sets the amount which, taking into account the nature, scale and complexity of the institution's activities, ensures a sound coverage of risks consistent with the minimum required in the comprehensive assessment exercise. One of the challenging elements for the definition of the SREP decisions prepared in 2014 (for implementation in 2015) was the need to combine the diversity of capital requirements based on the different national methodologies with an adequate degree of consistency in the required levels and quality of capital across the SSM.

In determining whether to include specific liquidity requirements in the SREP decisions (to be implemented in 2015), JSTs reviewed and scrutinised the NCAs' proposed decisions and their evaluation of liquidity and funding risks and decided to add specific quantitative or qualitative requirements in cases where material risks warranted such an approach. One of the challenges in detailing the liquidity decision is that minimum liquidity requirements vary significantly at the national level, with some NCAs having enacted binding requirements and others not.

Discussions on the SREP decisions to be implemented in 2015 started well before 4 November 2014 and were prepared by the JSTs. From an organisational point of view, the process for preparing the SREP decisions represented an important element in fostering the integration of the teams, sharing information, exchanging views and enhancing each JST's supervisory knowledge and perspective. Supervisory colleges, with the participation of the EBA, were convened where applicable.

For the preparation of the SREP decisions to be implemented in 2016, the process will be different. ECB Banking Supervision has developed a common methodology, which benefits from the NCAs' previous experience and best practices. This methodology is covered in the Supervisory Manual and described in the Guide to banking supervision; it is currently being "field-tested" with a view to testing its robustness and identifying areas for fine-tuning (see also Section 3.3).

The SSM SREP, in line with the EBA's Guidelines on common procedures and methodologies for the SREP, encompasses:

- the risk assessment system (RAS), which evaluates credit institutions' risk levels and controls and for which JSTs have been cooperating extensively with the horizontal services by carrying out ongoing field testing of each aspect to identify and fine-tune potentially problematic methodological issues;

- 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.

### 3.2.2 Strategic and operational planning for 2015

The result of the SREP is also a key input for the 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.

The supervisory priorities for the SSM in 2015, as approved by the Supervisory Board in November 2014, foster the interplay between vertical and horizontal supervisory approaches, granting also an important role for thematic reviews. Building on the supervisory priorities and taking due account of the credit institution's risk profile and systemic relevance, the Supervisory Examination Programme (SEP) for each significant bank defines the main supervisory activities that will be carried out to monitor risks and address identified weaknesses. SEPs cover:

- ongoing supervisory activities by the JSTs;
- on-site inspections;
- internal model investigations.

Work on drawing up the SEPs for 2015 started during the preparatory period and was finalised in December 2014. This joint exercise between the JSTs and the ECB's horizontal services was coordinated by the ECB's Planning and Coordination of SEP Division (see Section 3.3.1).

From September 2014 onwards, JSTs held intensive team discussions to plan the SEP for each significant institution. Thanks to the NCAs' thorough supervisory experience and knowledge of the significant institutions' risks, the SEPs have benefitted from the input of bottom-up information. To ensure an efficient allocation of resources and a tough and consistent approach towards supervision across significant institutions, the intensity of the supervision varies across credit institutions, depending on the likelihood of risks becoming material and their impact on the entity and the system as a whole.

All of the SEPs include regular activities that will be performed every year, irrespective of the economic environment. The SEPs for 2015 encompass:

- thematic activities reflecting the supervisory priorities for 2015;
- JST activities tailored to specific institutions.

These activities are conducted following a risk-based and proportionate approach. Significant institutions are classified into risk categories, broken down by an

engagement level that depends on the risk score, size and complexity of the institution. For each risk category, depending on the engagement level, a set of activities and respective frequency has been defined and included in the SEPs; this set constitutes the minimum engagement level of supervision for each significant institution.

### 3.3 Establishing methodologies for all horizontal and specialised services

The establishment of a level playing field in the supervisory and regulatory treatment of banks across all participating Member States is an important goal for the SSM. The ECB's horizontal and specialised divisions are responsible for:

- fostering harmonisation of supervisory approaches;
- promoting an intrusive approach to banking supervision;
- intensifying cooperation and communication inside and outside the SSM.

The drive towards harmonisation focuses on areas of divergent national rules and practices. In this respect, ECB Banking Supervision is stocktaking existing national supervisory practices; developing standards; testing and further refining harmonised supervisory methodologies; conducting quality assurance reviews; and measuring the effectiveness of actions implemented and measures taken.

For an easy exchange of information and smooth coordination between ECB Banking Supervision and the NCAs, networks of experts were established for each division within the horizontal and specialised services, comprising experts from both ECB Banking Supervision and the NCAs of participating Member States. Such networks enhance access to the knowledge available within NCAs and ensure best practices, high standards and consistent adoption of policies.

#### 3.3.1 Planning

The ECB's Planning and Coordination of SEP Division takes care of the overall strategic and operational planning for the SSM and monitors the implementation of its strategic objectives and its supervisory work, cooperating closely with other ECB Banking Supervision colleagues.

With regard to **strategic planning**, the division guides the process for determining the SSM's supervisory priorities for the year ahead and sets the annual minimum levels of engagement for supervisory work, bearing in mind the institutions' risk profile and their systemic impact as well as the thematic focus areas chosen in the supervisory priorities.

As part of **operational planning**, the division supports the JSTs in the creation of the SEP for each significant banking group directly supervised by the ECB, thereby

translating the supervisory priorities into tangible supervisory tasks in line with the appropriate minimum engagement levels. The division also coordinates the planning process for ongoing supervision (off-site), on-site inspections and internal model investigations.

The Planning Division is also tasked with **monitoring the implementation** of the SSM's strategic objectives and the defined annual supervisory tasks. To this end, it has begun to develop monitoring tools, such as progress reports geared to different audiences within ECB Banking Supervision, as well as management information systems such as a strategic management dashboard. These instruments provide vital information for informed management decision-making and for the support of JSTs and ECB Banking Supervision staff carrying out on-site examinations and internal model investigations as part of the SEP.

### 3.3.2 Methodology and standards development

Up-to-date supervisory methodologies and standards are indispensable for efficient and effective supervisory outcomes. Supervisory methodologies are constantly evolving – not least because of the work of international standard-setting bodies to globally harmonise financial regulation as well as the ongoing efforts within the EU to advance the single rulebook. The ECB aims not only to keep its methodologies aligned to the leading supervisory practices, but also to act as a driving force in this area.

Besides developing supervisory methodologies and standards, the ECB's Methodology and Standards Development Division facilitates and contributes to their harmonised application across the NCAs of participating Member States.

This division also cooperates with the EBA and other international standard-setters, such as the Basel Committee on Banking Supervision, to avoid overlap and maximise synergies. Another of the division's responsibilities is the development and maintenance of the Supervisory Manual (see Section 2.2.1).

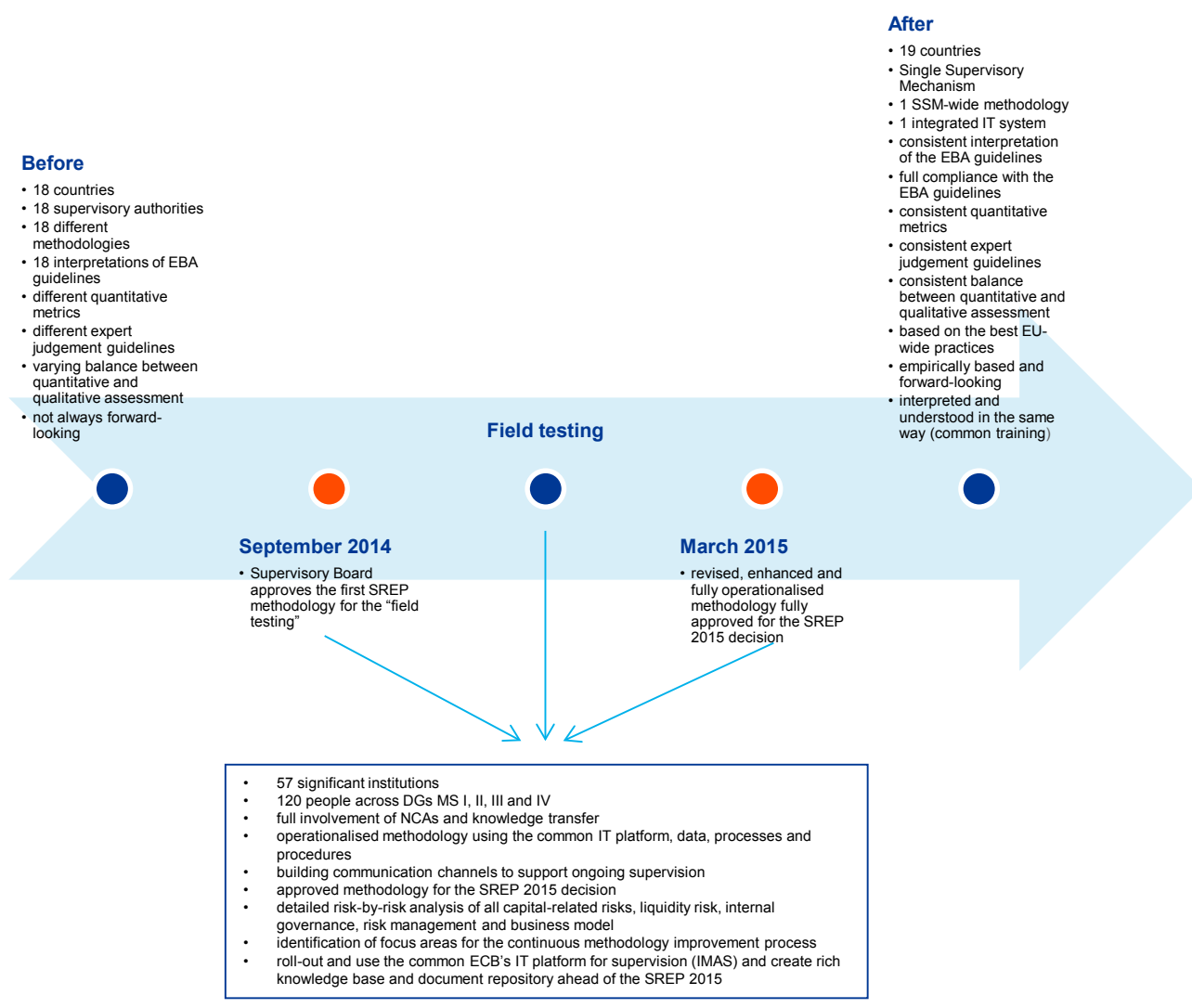
#### Refining the SREP methodology

The SREP methodology is currently being field-tested in order to gather practical input and identify areas for further refinements.



**Figure 8**

Field testing programme for significant institutions for the SREP methodology<sup>5</sup>



The programme covers almost half of all supervised significant institutions and directly involves more than 120 ECB Banking Supervision staff.

The main objectives of the **field testing programme** are to:

- calibrate and fine-tune methodology and put the processes underlying the 2015 SREP into operation;
- enable supervisors to become familiar with their banks, take ownership and adopt the new methodology, system and reports (learning by testing);
- promote usage of the Information Management System (IMAS) and reports;
- identify further best practices with the help of JSTs/NCAs;

<sup>5</sup> Lithuania was not covered by the field-testing programme.

- implement efficient and sustainable communication channels and processes between the horizontal divisions, JSTs and NCAs.

The field testing programme puts the Supervisory Manual (which devotes a full chapter to the SREP) to the test, not only from a technical and methodological perspective but also in practical terms. To this end, the Methodology and Standards Development Division fully aligned the IMAS to the SREP, provided SREP methodology training to several hundred ECB and NCA supervisors and integrated high quality data into IMAS to facilitate efficient implementation of the methodology.

The 2015 programme for this division includes the implementation of the SREP Methodology, and, more generally, updating the Supervisory Manual to the highest standards.

### 3.3.3 Risk analysis

The Risk Analysis Division:

- monitors changes in the overall risk environment of participating Member States;
- conducts further in-depth risk analysis activities covering a broad range of risk categories and topics;
- supports the JSTs in their supervisory activities;
- identifies ECB Banking Supervision's needs for supervisory reporting;
- administers the process of transposing such needs into legal acts or changes thereof;
- conducts quantitative impact studies.

#### Identification of trends and new developments in the risk landscape

The Risk Analysis Division conducts regular in-depth risk analysis and supports other services by providing up-to-date information on the current risks and vulnerabilities affecting the banking sector of participating Member States. It identifies trends, developments and emerging risks affecting multiple banks on a timely basis for further supervisory review. Working closely together with the NCAs, this division conducted its first assessment of the key bank-specific and horizontal risks in participating Member States.

This assessment was a fundamental input for the supervisory priorities for the SSM in 2015. It was then broken down into specific priorities and areas of focus for the JSTs when performing their regular risk assessment. It was also integrated into the Risk Analysis Division's work plan for 2015, which envisages further analysis of specific areas of risks.

## Factsheets on significant institutions

In 2014 the Risk Analysis Division, working together with other ECB Banking Supervision staff, developed factsheets on significant institutions for the Supervisory Board and coordinated the implementation and quality assurance of these reports. The factsheets are designed to inform and support the Supervisory Board in making decisions. These concise two-page reports for each significant institution combine quantitative data from the regulatory reporting framework and market data providers with the most recent qualitative supervisory assessment by JSTs of banks' practices and their risks.

Before the first factsheets for all significant institutions were provided to the Supervisory Board, the Risk Analysis Division drew on ECB statistical expertise to coordinate an application test aimed at identifying and eliminating weaknesses in the production process and remedying data issues. The division also provided some 50 training sessions to familiarise ECB Banking Supervision management and JSTs with the factsheets and their roles in the respective production process.

To give the Supervisory Board a helicopter view of the significant institutions as a whole, the Risk Analysis Division drew up an aggregated factsheet, calculating an aggregated balance sheet, profit and loss statement as well as risk indicators and their trends.

As real estate lending has proved to be a source of systemic risk in previous financial crises, the Risk Analysis Division liaised with NCAs to produce concise factsheets on national mortgage markets and related products.

## Ad hoc analysis on specific country risk

The Risk Analysis Division provided the Supervisory Board and ECB Banking Supervision's senior management with several ad hoc analyses on the risks posed to significant institutions by their exposures to specific countries (e.g. Russian Federation, Ukraine). It also performed investigations of participating Member States banks' exposures to their home sovereigns.

### 3.3.4 Internal models

The Internal Models Division is generally responsible for harmonising and ensuring the consistency of methodologies and processes for the review of internal models for the calculation of minimum capital requirements (Pillar I). The key projects completed by this division in 2014 are described below.

#### Stocktake of internal models

A stocktaking exercise was launched in September 2014 in order to collect the key qualitative and quantitative data needed for:

- prioritising and planning the Internal Models Division's tasks over the coming years (e.g. assessing the roll-out plans of significant institutions);
- allocating internal models into different categories, according to the available qualitative information on the methodologies used;
- performing a preliminary comparison of the supervisory approaches across countries (e.g. different practices in supervisory add-ons) and identifying potential outliers at an early stage.

From a broader point of view, the stocktake also provided a comprehensive inventory of the banks currently using internal models and showed the share of internal models in the total capital requirements.

**Table 5**  
Share of internal models (IM) in banks' own funds requirements (OFR)

Indicative numbers calculated from COREP and SPE data

Type of risk	Number of banks using Internal Models	% of total OFR	% of OFR computed with IM per risk category
Credit	68	84.1%	53.3%
Operational	21	9.4%	46.4%
Market	37	5.1%	59.8%
CVA	9	1.4%	39.2%

## Model approval process

One of the Internal Model's Division's main objectives is to ensure that the supervisory approaches to the credit institutions' internal models are sound and consistent.

In 2014 it developed the model approval process setting out the steps to be followed when granting permission to the institutions, in line with the CRR, to apply their internal models for calculating minimum capital requirements. A harmonised approval process will help to obtain a higher degree of consistency and, hence, a level playing field.

## Benchmarking

CRD IV requires competent authorities to assess the consistency of supervisory and banking practices related to internal models (except for operational risk) at least annually. In addition, the BCBS will conduct a biennial voluntary monitoring exercise; although initially limited to wholesale exposures, this formalised and regular exercise may be extended to retail/SME portfolios and trading book exposures once the [BCBS Fundamental Review](#) of the trading book capital standards has been completed.

ECB Banking Supervision has already been involved in the EBA and the BCBS exercises; in future, the SSM as a whole will contribute to these exercises. The

results of these benchmarking exercises may trigger supervisory actions, such as model investigations, the recalibration of parameters, and the imposition of specific add-ons or capital floors. They are also an essential input into the ongoing model monitoring process, which informs the SREP decision on at least an annual basis.

The main responsibilities of the different stakeholders within the SSM are described in Table 6.

**Table 6**  
Distribution of main responsibilities in the benchmarking exercises

	NCA	JST	Internal Models Division (INM)
1. Data quality check	Performs the data quality checks together with EBA/BCBS	Follows results through teleconferences with NCA	
2. Preliminary assessment / EBA bank specific report	Provides feedback to the JST/INM on the first results	Receives feedback from NCA on the first results	Computes and shares first results / Receives feedback from NCA
3. Interviews/on-site visits			
4. Competent authority assessment			
5. Corrective actions			
6. Final report			Contributes to the final report

### 3.3.5 Crisis management

The Crisis Management Division has several responsibilities, both before and during the deterioration of an institution's viability. It is systemically involved in:

- reviewing the recovery plans of significant institutions;
- setting standards and ensuring consistency in the assessment of recovery plans;
- applying early intervention measures.

The division provides expert support and information to JSTs on crisis management issues and more specifically on the viability of the supervised institutions. If a supervised significant institution is deemed failing or likely to fail, the division becomes the entry point for cooperation with resolution authorities. The division also provides advice and support to ECB Banking Supervision colleagues regarding issues at less significant institutions.

### Crisis prevention methodology

In developing a crisis prevention methodology for ECB Banking Supervision, this division is closely involved in the EBA's standard-setting and regulatory work to complement the Bank Recovery and Resolution Directive and the Single Resolution

Mechanism Regulation. Division staff also participate actively in other fora, such as the FSB.

### 3.3.6 Supervisory policies

The ECB strongly influences regulatory debates through its active participation in European and international fora. The Supervisory Policies Division follows and actively contributes to the international regulatory and supervisory agenda and coordinates the SSM positions regarding internal and international policies, drawing on practical supervisory experience.

This division supports the JSTs' supervision of significant institutions and liaises with other ECB staff in supporting the NCAs' direct supervision of less significant institutions; it advises on the correct application of relevant European regulations and international supervisory standards and principles with a view to enhancing their harmonised application across the banking union. To this end, the division has developed an internal SSM FAQ database, which provides supervisors with the ECB's staff guidance to similar or new practical questions relating to internal supervisory methodology and relevant European legislation; this complements the EBA's public "Single Rulebook Q&A" tool. The division is also involved in EU and international cooperation. It assists the JSTs in setting up and updating cooperation agreements within the supervisory colleges. It also establishes and coordinates collaboration with non-participating Member States and with countries outside the EU, for example by concluding Memoranda of Understanding.

### 3.3.7 Macro-prudential tasks

Article 5 of the SSM Regulation has attributed to the ECB specific tasks relating to the macro-prudential instruments foreseen by European legislation (CRD IV and CRR).

The primary responsibility for the implementation of macro-prudential measures lies with the national competent or designated authorities. The ECB can apply higher requirements for capital buffers and more stringent measures than those applied by national competent or designated authorities; in this case the latter should be consulted. When the first move is undertaken by the national authority, the ECB should be consulted.

Appropriate procedures have been set up by the ECB to deal with the cases that may arise. Regardless of whether the initiative starts from the ECB or at the national level, the Supervisory Board should prepare a proposal, taking into account the input of the relevant ECB structures and committees (including the Financial Stability Committee in SSM composition). The Governing Council decides on such proposal within a strict time deadline, by endorsing, objecting to or amending the proposal made by the Supervisory Board. The Governing Council can also, acting on its own initiative, request the Supervisory Board to submit a proposal to apply higher requirements for the macro-prudential instruments.

In order to ensure that the micro-prudential and macro-prudential perspectives are effectively combined and that appropriate analytical elements are provided, quarterly macro-prudential discussions are held between the Governing Council and the Supervisory Board in joint sessions (Macro-Prudential Forum). The first meeting of such Forum was held in November 2014.

To coordinate the micro-prudential and macro-prudential tasks within the ECB and to discuss any policy proposals, an internal committee was created (Macro-Prudential Coordination Group). This Group benefits from analytical and judgemental input from the relevant ECB business areas from both the central banking and supervisory sides. DG Micro-Prudential Supervision IV and DG Macro-prudential Policy and Financial Stability jointly provide secretariat assistance to this Group.

## 3.4 Authorisations

On 4 November 2014 the ECB became the competent authority for all credit institutions in participating Member States for granting or withdrawing banking licenses and assessing the acquisition of qualifying holdings (known collectively in the SSM context as “common procedures”). The ECB is also responsible for the fit and proper assessment of members of the management body of significant credit institutions and passporting procedures.

Many of the decisions to be taken by the Supervisory Board are likely to concern authorisations, fitness and propriety. The ECB is responsible for ensuring that authorisation decisions comply with the single rulebook. The ECB’s Authorisation Division prepares such decisions together with NCAs. The ECB seeks to harmonise the application of the common procedures and the conduct of the fit and proper assessments.

### Methodologies and workflows

The Authorisation Division, in consultation with the NCAs and other business areas, developed detailed methodologies on authorisation processes, clarifying all the steps and roles involved. The authorisation processes draw on the expertise and resources of NCAs while at the same time benefiting from centralised processes and procedures to ensure consistent outcomes.

A dedicated authorisation portal in IMAS facilitates the information exchange between the NCAs and the ECB. The workflows – through which all authorisation procedures are initiated – provide common interfaces and workspaces to prepare proposals on draft decisions for the Supervisory Board and the Governing Council. The workflows serve to ensure the integrity of the process and the management of the tight timelines.

## Assessment of pending procedures

Prior to the ECB taking over its supervisory tasks, NCAs were required to inform the ECB, by 4 September 2014, of all formally initiated supervisory procedures unlikely to be completed by 4 November 2014, including authorisation procedures. The information provided on such pending procedures was regularly updated between 4 September and 4 November 2014.

In total, about 220 pending authorisation procedures were reported to the ECB. On the basis of criteria defined in advance, the Authorisation Division assessed all of the reported pending procedures in order to be prepared should the ECB decide to take over these procedures. The Supervisory Board decided to take over only one of the authorisation pending procedures, owing to the importance and complexity of the assessment of a qualifying holding involved. All of the other authorisation pending procedures reported will be completed by the relevant NCAs under the SSM legal framework.

## Authorisation procedures submitted in 2014

Between 4 November 2014 and the beginning of 2015, 21 common procedures (seven relating to licensing, nine to qualifying holdings, three to withdrawals of banking licenses and two to the lapsing of the authorisation) were formally notified to the ECB, as were 149 other procedures (115 fit and proper and 34 passporting procedures).

**Table 7**

Authorisation procedures since 4 November 2014

	Licensing	Lapsing	Withdrawal (NCA)	Withdrawal (ECB)	Qualifying holdings	Fit and proper	Passporting
Common procedures submitted to ECB	7	2	3	-	9	115	34
Pending (as per 2 January 2015)	7	2	2	-	8	76	1

The seven notified licensing procedures were initiated by NCAs from different participating Member States. Most licensing procedures related to the same restructuring operation of one significant supervised institution with a presence in a large number of countries in Europe and abroad. Licensing procedures are expected to have a long lead time of, on average, up to one year.

The two lapsing and three withdrawal procedures were initiated by NCAs from different participating Member States. All of the withdrawal procedures related to the restructuring of credit institutions, while both lapsing cases related to small less significant institutions (one sold its banking activities to another entity and one restructured its operations).

The qualifying holding procedures submitted to the ECB relate in part to the restructuring of operations of the same significant supervised institution for which most of the licensing procedures were initiated.



A significant number of fit and proper procedures were notified to the ECB. During the reporting period, 115 fit and proper files were initiated by NCAs of 15 different participating Member States. The ECB is bound by the national laws transposing the European provisions and minimum requirements regarding the suitability of management board members. Therefore, a great variety of practices and applicable deadlines apply to fit and proper procedures, implying a significant challenge to the ECB to impose a uniform and harmonised process. The first steps towards an action plan for achieving further harmonisation in this area were launched in close collaboration with the NCAs.

## 3.5 Enforcement, sanctioning procedures and reporting of breaches

### 3.5.1 Enforcement and sanctioning powers

Under the SSM Regulation and the SSM Framework Regulation, the allocation of **enforcement and sanctioning powers** between the ECB and the NCAs depends on the nature of the alleged breach, the person responsible and the measure to be adopted.

The ECB is competent to impose administrative penalties on, and to adopt enforcement measures against, significant supervised entities in case of breaches of relevant directly applicable EU law (including ECB regulations or decisions). In the case of less significant supervised entities, it is competent to do so in case of breaches of ECB regulations or of decisions that impose obligations on less significant institutions vis-à-vis the ECB. In addition, the ECB can request NCAs to open proceedings to ensure that appropriate penalties are imposed in other cases (e.g. penalties on natural persons, non-pecuniary penalties, breaches of national law transposing relevant EU directives) or to make use of their enforcement powers under national law.

NCAs remain fully competent to impose sanctions and to use their enforcement powers regarding less significant supervised entities (except for breaches of ECB regulations or decisions imposing obligations vis-à-vis the ECB) and in case of breaches of national law not implementing EU directives or implementing EU directives not related to ECB's supervisory tasks.

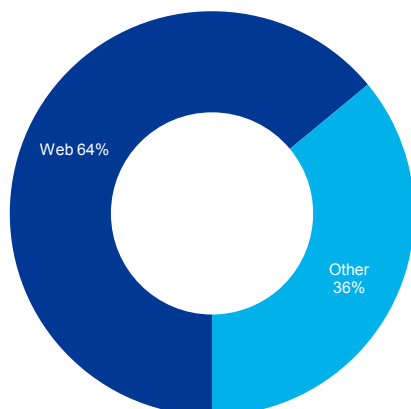
No enforcement or sanctioning proceedings were started between 4 November 2014 and the beginning of 2015.

### 3.5.2 Reporting of breaches

The SSM Regulation and the SSM Framework Regulation require the ECB to ensure that effective mechanisms are put in place for the reporting by any person of breaches of relevant EU law within the scope of the ECB supervisory tasks by supervised entities or competent authorities (including the ECB itself).

**Chart 4**

Submission channel for reporting of breaches



The ECB has set up a breach reporting mechanism that meets the necessary data protection and confidentiality standards. The main breach reporting channel is a [pre-structured web platform](#) accessible on the ECB's banking supervision website.

Between 4 November 2014 and the beginning of 2015, eleven breach reports were received, seven of which came through the web platform (with the other reports being received by post or e-mail).

Three of the assessed reports were considered relevant for the ECB's supervisory tasks. The remainder were found to be not relevant as they concerned national issues outside the ECB's supervisory tasks. The three relevant reports were related to alleged breaches by significant supervised entities and were forwarded to the corresponding JSTs for appropriate follow-up.

## 3.6 On-site inspections

The ECB's Centralised On-site Inspections Division aims to improve on-site supervision through an enhanced cooperation between the ECB and NCAs' inspection teams. The division's goals and the actions undertaken in 2014 to reach them are presented below.

- **Promote tougher supervision**  
As on-site inspection is the most intrusive way to carry out supervision, a first on-site inspection plan was already prepared for 2015 in close cooperation with NCAs, which are providing most of the staff. This plan envisages inspection teams made up of ECB and NCA staff as well as the conduct of cross-border missions. The ECB will lead a significant number of on-site inspections on top of those performed by NCAs.
- **Foster harmonisation**  
The division has drafted a single on-site inspection methodology that has been tested by the NCAs. Consistency checks on all inspection reports will be carried out to ensure a homogeneous application of the on-site methodology.
- **Develop methodologies, support tools and strengthen specialised expertise**  
Several working groups coordinated by the ECB developed on-site methodologies in order to implement the Supervisory Manual. Several training sessions on the single on-site methodology were organised, with a specific focus on NCAs that did not have extensive experience with on-site inspections. Templates for on-site inspection reports were shared with NCA teams. An IT

support tool is under development with the support of NCAs to support the ECB in its ongoing monitoring of on-site inspections.

## 3.7 Supervisory quality assurance

The ECB's Supervisory Quality Assurance Division strives to promote the excellence and homogeneity of ECB Banking Supervision. It seeks to contribute to the equal treatment of banks across JSTs and between significant and less significant institutions, taking into account the proportionality principle, by:

- ensuring the proper use and continuous enhancement of the SSM's methodological framework;
- identifying and expanding best practices across the SSM;
- detecting emerging risks and deficiencies in the SSM's internal supervisory processes.

During 2014 great efforts were made in defining the basis of the quality assurance strategy, processes and methodology – as a part of the Supervisory Manual – to ensure a homogeneous implementation of quality assurance across ECB Banking Supervision and the NCAs.

## 3.8 ECB oversight and indirect supervision of less significant institutions

As noted in Section 2.2.4, significant achievements were made in 2014 in establishing the operational framework for the supervisory oversight and indirect supervision of less significant institutions (LSIs).

### 3.8.1 Framework for cooperation on LSI supervision

The framework for cooperation between the ECB and NCAs, which is essential for the effective functioning of the system, has been well-developed in 2014.

A senior management network, comprising members from all NCAs and DG MS III acts as a sounding board for central proposals and a platform for discussing overarching topics emerging from day-to-day LSI supervision by NCAs. Based on regular meetings, two of which already took place in 2014, this network assists the Supervisory Board in the fulfilment of its tasks related to oversight and LSI supervision. These multilateral meetings were complemented by bilateral country visits and other contacts, which allow ECB management to discuss country-specific matters with individual NCAs.

Interaction at the expert level also forms a key aspect of cooperation, facilitating the build-up of country-specific expertise within DG MS III and allowing NCAs to share their experiences. Dedicated country desks have been set up to allow for bilateral cooperation with the NCAs. Other activities included NCA visits with a technical focus, the establishment of working groups and the organisation of workshops involving various NCAs. Looking ahead, technical cooperation and staff exchanges between the ECB and an NCA, or between two NCAs, will be used as a tool to further strengthen working relationships, share best practices and build a common supervisory culture.

### 3.8.2 Supervisory oversight

The ECB's Supervisory Oversight Division focuses on the consistency of supervisory practices and outcomes. Its efforts build on the fora and processes for cooperation with NCAs described above. Concrete legal instruments at the disposal of the ECB in this context include the issuance of guidelines, regulations or general instructions to NCAs. If necessary to ensure a consistent application of high supervisory standards, the ECB may also decide to assume direct supervision of one or more LSIs.

The review of notifications received from NCAs forms an important part of the supervisory oversight activities. Since 4 November 2014 the ECB receives ex ante notifications from NCAs on material procedures and material draft decisions relating to high-priority LSIs. The ECB has an advisory role and may request an NCA to further assess specific aspects of a draft material procedure.

A central notification point has been set up which receives the notifications and ensures that they are processed in a structured and timely manner, involving the relevant supervisory experts. This process has already been successfully applied since the operational start of the SSM on 4 November.

As part of the preparations for the start of the SSM, DG MS III also organised the collection of important information on the LSI sector and on NCAs' supervisory practices. This collection of ex post reports (as opposed to the ex ante notifications) will be implemented in 2015 on an ongoing basis. In combination with information from ad hoc requests, country visits and the notification procedure, these reports constitute important inputs for assessments of whether high supervisory standards are applied in a consistent way and whether comparable situations lead to comparable outcomes across the SSM.

With respect to draft decisions related to common procedures (i.e. granting and withdrawal of authorisations, qualifying holdings) for LSIs, DG MS III contributes to the internal processing of such decisions.

Going forward, the ECB will also conduct targeted benchmarking exercises to identify best practices across NCAs, as well as thematic reviews of supervisory practices. Their findings will be used to develop joint supervisory standards and recommendations to NCAs, which will be in line with the common SSM methodologies, and applied in a proportionate manner for LSI supervision. NCAs will

be closely involved in drawing up such methodologies via the framework for cooperation mentioned above. The joint standards and recommendations are a complement to the instruments of guidelines, regulations and general instructions.

### 3.8.3 Oversight of LSIs and LSI sectors

The ECB has also built a framework for the institution-specific oversight of LSIs, as well as the oversight of LSI sectors, both conducted via the NCAs. The institution-specific oversight is based on a prioritisation of institutions, thus reflecting a direct application of the principle of proportionality. For those banks which have been assigned a high-priority rank based on their riskiness and systemic impact, the ECB's institution-specific oversight may refer to elements such as governance, business models, risks and risk controls, while for medium- and low-priority banks a proportionate assessment of the above-mentioned points is conducted, based on available data. Oversight is not limited to individual LSIs, but is also conducted from a sectoral and inter-sectoral perspective, which is of particular relevance given that LSIs in some Member States show a high level of interconnectedness, despite not formally belonging to one single group.

Thematic reviews, focused on strategically relevant themes in line with the supervisory planning cycle, and on defined topics such as specific risk areas, constitute another important activity within the remit of the institution-specific and sectoral oversight of LSIs. The nature of the review can be quantitative and/or qualitative. Two reviews – one dealing with institutional protection schemes and one on the impact of different accounting standards in the LSI prioritisation methodology – began in 2014.

The monitoring of NCAs' crisis management activities is another area where the ECB has a role to play. While responsibility for the organisation and implementation of all crisis management activities lies with the NCAs and other relevant national authorities, the ECB's role in this context is to monitor and assist in the NCA-led proceedings, where relevant, in a way that is proportionate to the expected impact of a disorderly failure and to ensure that crisis management meets high supervisory standards.

In addition, the ECB is informed on an ongoing basis of the significant deterioration of the financial situation of LSIs. DG MS III activities in this field started in 2014. They involve:

- providing views and expertise as needed;
- facilitating effective communication and information exchange;
- supporting the successful implementation of national crisis management measures, where relevant.

The ECB will also participate in on-site inspections at LSIs where this is deemed relevant. The decision to join an inspection can be based on different objectives, such as increasing the knowledge of a specific LSI or reviewing the effectiveness of

the supervisory approach in place. The ECB may also request the involvement of staff from NCAs other than the home authority of the LSI concerned. The process is thus also linked to the staff exchanges mentioned above. ECB Banking Supervision will work closely with the NCAs concerned, aiming to establish coherent teams of staff with the most adequate profiles with respect to the focus of the inspection, and avoiding any duplication of expertise.

### 3.8.4 Analytical and methodological support

The Analysis and Methodological Support Division of DG MS III develops methodologies which apply the general SSM approach in a way which is proportionate to the LSIs and takes account of their specificities. It also conducts LSI-focused analysis as an input into sectoral and macro-prudential monitoring and risk identification. In 2014, its tasks included contributing to the:

- management of the list of LSIs and the relevant data collection exercises;
- development of methodological standards applicable to LSIs;
- conduct of LSI analyses aimed at identifying risks and vulnerabilities;
- organisation of data exercises supporting these tasks.

These tasks will continue in 2015.

The first [list of less significant institutions](#) (together with the list of significant supervised entities) was published on the ECB's website in September 2014 and will be updated periodically. The process of managing the list of LSIs starts with assessing the significance of all institutions (directly or indirectly) supervised by the SSM. A review of the significance status of all supervised entities is conducted each year. Ad hoc assessments are carried out in the case of exceptional substantial changes in circumstances relevant for determining significance, for example due to mergers and acquisitions or sales of business units.

A key area of work has been the development of processes to identify high-priority LSIs. These LSIs require more intensive supervisory attention due to either their level of riskiness or the high impact their failure would cause to the domestic financial system. As noted above, an initial list of high-priority LSIs was identified in 2014 and has formed the basis for the ECB's proportionate approach to its tasks. At the same time, work was undertaken to develop a more refined methodology, based on both the intrinsic riskiness and the impact on the economy of each LSI, and a supervisory dialogue to take account of NCAs' expert judgement on individual institutions. This methodology will be finalised and applied in 2015 in order to derive the list to be applied in 2016. The prioritisation framework for LSIs is also a key input for the ongoing efforts in developing harmonised RAS/SREP methodologies for LSIs.

Another important pillar of the Analysis and Methodological Support Division is the analysis of risks of LSIs and vulnerabilities of sectors. Work on this was already conducted in 2014, both from a general perspective and with a focus on particular

risks. A first comprehensive overview of the significance and risks of LSIs across countries and business models has been conducted, based on the data available. This analysis focused on the key risks being faced by LSIs and the development and evolution of such risks. Furthermore, it aimed at establishing the link between a micro-prudential and a macro-prudential view on the LSI universe. Looking ahead, another key piece of work will be the development of an early warning system to ensure the timely detection and correction of risks.

For all the above-mentioned tasks, data availability is a necessity. To be able to exercise its supervisory tasks, such as prioritising LSIs, developing RAS methodologies, identifying common risks in the LSI universe or in particular sectors, the ECB must receive the required supervisory data on LSIs, while also taking into account the principle of proportionality and subsidiarity. As far as possible, the ECB will draw on supervisory information in FINREP and COREP, as well as other available sources (e.g. from exercises already conducted). However, as regulatory reporting for LSIs is only in its early days, it will have to fall back on ad hoc data exercises to deliver on its supervisory tasks. These data collections are also managed by the Analysis and Methodological Support Division.

### 3.9 Further integrating the SSM: system-wide human resources policy issues

The establishment of the SSM has substantial human resources implications, well beyond the initial staffing requirements of the ECB. The required intensive cooperation between the ECB and the NCAs, in particular through the JSTs and the on-site inspection teams, as well as the success of the selected “matrix-based management model”, depends heavily on sufficient alignment among the contributors at all levels. This calls, in turn, for the alignment of some key human resources policies, while, in general, the conditions of employment will continue to differ among the various institutions within the SSM.

Important steps have already been made in a number of areas.

- **Training programme**

In order to successfully pass on knowledge and develop skills and to support the change to, and promotion of, a common SSM culture, a dedicated training curriculum has been developed, covering the following topics: governance, methodology, managerial and soft skills, IT, and training for newcomers. Besides an e-learning offer for all staff, which provides a general overview of the SSM, classroom training sessions for supervisors on ten different topics are already available and further ones are currently being developed. The general training concept was developed with the help of supervision and HR experts from the ECB and several NCAs. The ECB then generated the detailed content for the technical training courses and presented it to nominated NCA representatives at train-the-trainer sessions. These NCA representatives subsequently trained the supervisory staff members in their respective NCAs.

The train-the-trainer sessions started with IT-related training sessions on IMAS (see Section 2.5), followed by sessions on SSM governance and methodology.

- **Performance feedback**

A feedback framework is being developed (jointly by the ECB and the NCAs) to assess and recognise the contributions of employees working for joint supervisory or on-site inspection teams; the resulting feedback may be used by NCAs as an input into their local appraisal procedures. The underlying aim of this is to provide a system-wide approach, while leaving enough scope for discretion (e.g. to comply with national legal frameworks). Information sessions for the respective staff members took place in several institutions and more have been scheduled for 2015. With regard to the data protection of the feedback provided, the ECB is in consultation with the European Data Protection Supervisor.

- **Intra-SSM mobility**

The SSM Regulation requires the ECB to “establish, together with all NCAs, arrangements to ensure an appropriate exchange and secondment of staff with and among NCAs”. The exchange and secondment of staff is indeed important in creating a common supervisory culture. The predominant focus during the set-up phase of the SSM is on intra-JST mobility (i.e. for JST coordinators, national sub-coordinators and professional staff). A group of human resources representatives has been mandated to analyse further options for intra-SSM mobility and its implementation. Furthermore, the ECB and NCAs are exploring a traineeship programme within the SSM, which would enable students or recent graduates to become familiar with SSM supervision from different perspectives. A decision on this is expected in the course of 2015.

### 3.10 Language policy

The legal framework for the language policy of the SSM is primarily determined by Council Regulation No 1 of 1958 on the languages to be used by the institutions of the EU. The SSM Framework Regulation lays down the language regime to be adopted for communication between the ECB and the NCAs, and between the SSM and the supervised entities.

As far as communications within the SSM are concerned, English is used as part of the arrangements between the ECB and the NCAs, as laid down in Article 23 of the SSM Framework Regulation.

With regard to communication with the supervised entities, any document sent to the ECB by a bank may be drafted in any one of the official languages of the EU, and the bank has the right to receive a response in that same language. The ECB and the banks may agree to exclusively use one official language of the EU in their written communication, including with regard to ECB supervisory decisions. Banks may decide at any given time to revoke this agreement and the change will only affect the parts of the ECB supervisory procedure that have not yet been carried out. In



addition, where participants in an oral hearing request to be heard in an official language of the EU other than the language of the ECB supervisory procedure, sufficient advance notice must be given to the ECB so that the necessary arrangements can be made.

Most significant banks have accepted English as their language of communication with the ECB, while 33 significant banks from Austria, Belgium, Cyprus, Finland, France, Germany, Italy and Slovenia have expressed a preference for using their respective national language for communication.

## 4 Reporting on budgetary consumption

The SSM Regulation provides that the ECB must be able to dispose of adequate resources to carry out its supervisory tasks effectively. It further requires that these resources are to be financed via a supervisory fee that will be borne by the entities subject to the ECB's supervisory tasks. Prior to the entry into force of the ECB Regulation on supervisory fees, which coincided with the date when the ECB assumed operational responsibility for supervision, i.e. the beginning of November 2014, the resources necessary were financed in full by the ECB. Thus, for the year 2014, the supervisory fee payable by the supervised banks will cover expenditure incurred in the last two months.

The expenditures for supervisory tasks are separately identifiable within the budget of the ECB as prescribed by the SSM Regulation. The budgetary authority of the ECB is vested in its Governing Council. This body adopts the ECB's annual budget following a proposal of the Executive Board after consultation with the Chair and the Vice-Chair of the Supervisory Board for matters related to the SSM. The Governing Council is assisted in matters related to the budget by the Budget Committee (BUCOM), consisting of members from all NCBs of the Eurosystem and the ECB. BUCOM evaluates the ECB's reports on budget planning and monitoring and reports on them directly to the Governing Council.

### 4.1 Supervisory fee framework

#### 4.1.1 ECB Regulation on supervisory fees

The [ECB Regulation on supervisory fees](#) was published on 30 October 2014 and entered into force on 1 November 2014. The Regulation was adopted by the Governing Council following a public consultation, which included a public hearing. It sets out the arrangements under which the ECB will levy an annual supervisory fee for the expenditures incurred by the ECB in relation to its new supervisory role, from November 2014 onwards. Together with the SSM Regulation, the ECB Regulation on supervisory fees provides the legal framework on charging of fees in the context of the SSM, without prejudice to the right of NCAs to levy fees under national law, including those expenses incurred by NCAs in the context of the assistance provided by them to the ECB.

The Regulation establishes the methodology for:

- determining the total amount of the annual supervisory fee;
- calculating the amount to be paid by each supervised bank or banking group;
- collecting the annual supervisory fee.

## Public consultation on the draft ECB Regulation on supervisory fees

On 27 May 2014 the ECB launched a public consultation on a draft regulation that laid down the rules and procedures for a fair and proportionate SSM-related fee policy. The public consultation ended on 11 July 2014. Besides inviting written comments, the ECB gave the general public an opportunity to provide further input at a public hearing held in Frankfurt am Main on 24 June 2014.

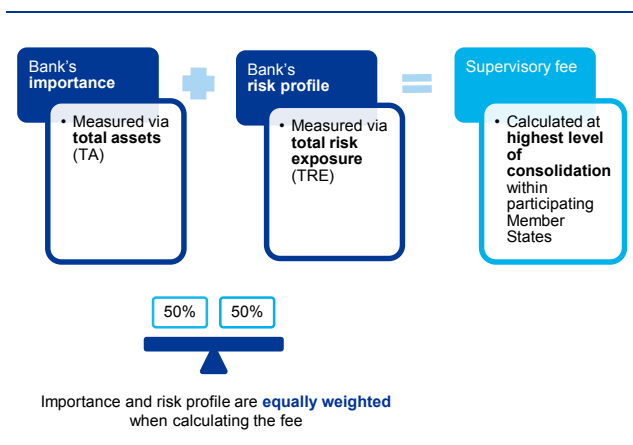
By the closing date of the public consultation, the ECB had received 31 sets of comments, stemming from market and banking associations, credit and financial institutions, central banks, supervisory as well as other authorities and individuals. The ECB analysed and gave due consideration to all comments received. This evaluation established that the key elements of the proposed fee framework were well supported. Nonetheless, on the basis of the feedback received, the ECB amended a number of features of its approach. Detailed information on how the comments received in the context of the public consultation were addressed is given in the [feedback statement](#), which was published on the ECB's banking supervision website.

### Key features of the ECB fee framework

The ECB is responsible for the effective and consistent functioning of the SSM in respect of significant and less significant supervised entities. In recognition of this principle, all supervised entities which are supervised within the SSM have to pay an annual supervisory fee.

The main features of the methodology can be summarised as follows:

**Figure 9**  
What determines the variable fee component?



The amount to be recovered via annual supervisory fees is based on the ECB's annual expenditure in relation to its supervisory tasks, which comprises all operating expenses, including those related to support functions. This amount will be split into two parts, i.e. the amount to be recovered from significant supervised entities and the amount to be recovered from less significant supervised entities, reflecting the varying degrees of supervisory scrutiny by the ECB.

The supervisory fee will be set at the highest level of consolidation within participating Member States and will be based on objective criteria relating to the importance and risk profile of the bank concerned, including its risk-weighted assets.

The annual supervisory fee to be paid by each supervised bank will be the sum of a minimum fee component for all banks, based on 10% of the amount to be recovered, and a variable fee component. For the smallest

significant banks, with total assets below €10 billion, the minimum fee component will be halved.

For the allocation of the variable fee component, the bank's total assets will serve as the indicator for the importance of a supervised bank and its total risk exposure for the measurement of its risk profile, incorporating its risk-weighted assets. For banks or banking groups that are classified as less significant under the SSM Regulation, even though, according to their size, they would qualify as significant, total assets are capped at €30 billion, i.e. the threshold specified in the SSM Regulation for the size criterion used for assessing significance.

The ECB fee will be charged via an annual payment payable in the final quarter of each financial year. The fee will cover an advance payment based on the approved budget for the expenditures in the current year. Any surplus or deficit between the amount collected in advance and the actual expenditures incurred in the previous year will be refunded or charged by the ECB.

## 4.2 Preparations for the first fee invoicing cycle

### 4.2.1 Technical preparations

For the period ahead, the ECB will continue to implement the supervisory fee framework, building its capability in terms of systems and the collection of data necessary to issue the first supervisory fee notice.

Over recent months, the ECB provided all banks and banking groups with some information to support the preparation of the invoicing and payment process, as well as requests for the information to facilitate the initial set-up of the fee debtor database. The banking groups were requested to provide fee debtor information to the ECB by the end of December 2014. By 1 March 2015 all fee paying banks and fee paying branches were obliged to provide the ECB with the contact details for the submission and payment of the fee notice.

On 11 February 2015 the ECB adopted a Decision (Decision ECB/2015/7) on the methodology for the calculation of the fee factors required for the annual supervisory fee. The decision lays down the methodology and the procedures for the determination of the fee factors required for the calculation of the ECB supervisory fees and the procedures concerning the submission of the fee factors reported by the fee debtors. For the calculation of the annual supervisory fees payable in respect of each supervised entity and each supervised group, the fee debtors submit the information on the fee factors for the preceding calendar year to NCAs by 1 July of the next, based on the templates available on the ECB's banking supervision website.

The first fee notice will be issued in late 2015. It will cover the advance payment for 2015 and the actual expenditures incurred for November and December 2014.

More information on [supervisory fees](#) is available on the ECB's banking supervision website. These pages are updated regularly with useful, practical information and are published in all official EU languages.

## 4.2.2 Expenditure for 2014

The expenditure incurred by the ECB for the conduct of supervisory related tasks primarily consists of the direct expenses of the new business areas that have been established (see Section 1.4), namely the four ECB Banking Supervision directorates general and the Secretariat to the Supervisory Board.

The new supervisory function also relies on shared services provided by the existing functions of the ECB, including premises, human resources management, administrative services, budgeting and controlling, accounting, legal, internal audit, statistical and information technology services. A fair share of the related expenses is incorporated in the separately identifiable part of the ECB budget for supervisory tasks.

Continuing efforts initiated in late 2013, the ECB built up its resources for supervisory tasks throughout 2014. This trend can be expected to continue into 2015 – albeit at a slower pace – as the ECB continues to build its supervisory capacity.

For the full year 2014, total costs of €156.9 million were incurred by the ECB in relation to its new role. This amount can be broken down into €68.9 million (or 45%) for salaries and benefits, €13.2 million (or 8%) for rent and building maintenance and €74.8 million (or 48%) for other operating expenditures.

**Table 8**  
Costs of the supervisory function in 2014

	2014 € millions
Salaries and benefits	68.9
Rent and building maintenance	13.2
Other operating expenditure	74.8
Total expenditure from banking supervision tasks	156.9

## Salaries and benefits

Salaries and benefits comprise all salary-related expenditures, including overtime, allowances and costs in relation to post-employment benefits. As a result of the recruitment campaign, overall, around 960 professional staff out of the approximate total of 1,000 budgeted positions were recruited by the end of December 2014 in the five banking supervision business areas and the shared services.

## Rent and building maintenance

Staff of the four new directorates general and the new Secretariat to the Supervisory Board are being housed temporarily in a rented building in the centre of Frankfurt am Main. In the course of 2014 the ECB steadily increased its leased office space to meet the needs of the progressive recruitment of supervisory staff.

In late 2015 the supervisory functions will be relocated to the Eurotower premises, recently vacated for refurbishment when the ECB successfully completed the move to its new headquarters in Frankfurt's Ostend district.

## Other operating expenditure

The category "other operating expenditure" includes costs such as consultancy, statistical services, IT services, depreciation for fixed assets, business travel and training. As the ECB was building up resources, the expenses recorded in this category mainly relate to preparatory tasks, such as the comprehensive assessment, before it assumed operational responsibility for supervision and the provision of services necessary to support the incoming supervisors such as information technology and recruitment services.

## Annual supervisory fee for 2014

The ECB will levy the supervised banks (both significant and less significant) for expenditures incurred by the ECB as of the point in time when it assumed operational responsibility for supervision, i.e. November 2014. Expenditures incurred in the transitional phase prior to this date, such as the SSM start-up costs and the ECB's costs for the comprehensive assessment, will not be charged to the supervised banks.

Expenditures incurred during the period November-December 2014 amounted to €30 million and can be broken down into 62% for salaries and benefits, 7% for rent and building maintenance and 31% for other operating expenditure. This amount is recorded as income from fees in the ECB's profit and loss account in 2014 on an accrual basis, but will be collected from the supervised entities in 2015.

The first fee notice to be issued in 2015 will cover both the advance payment for 2015 and payment for the first fee period, i.e. expenditures incurred in November and December 2014. The ECB decision on the total amount that will be collected, for each category of supervised entities and groups, will be published on the ECB's banking supervision website by 30 April 2015.

# Annex

## List of the legal instruments concerning the general framework of banking supervision adopted by the ECB

The following tables list the legal instruments concerning banking supervision that were adopted by the ECB in the period under review (4 November 2013 to 31 December 2014) and published in the Official Journal of the EU and on the ECB's websites. It covers legal instruments adopted under Article 4(3) of Council Regulation (EU) No 1024/2013 and other relevant legal instruments.

### ECB regulations

Number	Title
ECB/2014/17	Regulation (EU) No 468/2014 of the ECB 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 (SSM Framework Regulation) (OJ L 141, 14.5.2014, p. 1)
ECB/2014/26	Regulation (EU) No 673/2014 of the ECB of 2 June 2014 concerning the establishment of a Mediation Panel and its Rules of Procedure (OJ L 179, 19.6.2014, p. 72)
ECB/2014/41	Regulation (EU) No 1163/2014 of the ECB of 22 October 2014 on supervisory fees (OJ L 311, 31.10.2014, p. 23)

### ECB legal instruments other than regulations

Number	Title
ECB/2014/1	Decision of the ECB of 22 January 2014 amending Decision ECB/2004/2 adopting the Rules of Procedure of the ECB (OJ L 95, 29.3.2014, p. 56)
ECB/2014/3	Decision of the ECB of 4 February 2014 identifying the credit institutions that are subject to the comprehensive assessment (OJ L 69, 8.3.2014, p. 107)
ECB/2014/4	Decision of the ECB of 6 February 2014 on the appointment of representatives of the ECB to the Supervisory Board (OJ L 196, 3.7.2014, p. 38)
ECB/2014/5	Decision of the ECB of 31 January 2014 on the close cooperation with the national competent authorities of participating Member States whose currency is not the euro (OJ L 198, 5.7.2014, p. 7)
ECB/2014/16	Decision concerning the establishment of the Administrative Board of Review and its Operating Rules (OJ L 175, 14.6.2014, p. 47)
ECB/2014/19	Recommendation for a Council Regulation amending Regulation (EC) No 2532/98 concerning the powers of the ECB to impose sanctions (OJ C 144, 14.5.2014, p. 2)
ECB/2014/29	Decision of the ECB of 2 July 2014 on the provision to the ECB of supervisory data reported to the national competent authorities by the supervised entities pursuant to Commission Implementing Regulation (EU) No 680/2014 (OJ L 214, 19.7.2014, p. 34)
ECB/2014/39	Decision of the ECB of 17 September 2014 on the implementation of separation between the monetary policy and supervision functions of the ECB (OJ L 300, 18.10.2014 p. 57)
2013/694/EU	Interinstitutional Agreement between the European Parliament and the ECB 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)
--	Memorandum of Understanding of 11 December 2013 between the Council of the European Union and the ECB on the cooperation on procedures related to the Single Supervisory Mechanism (SSM)
--	Rules of Procedure of the Supervisory Board of the ECB (OJ L 182, 21.6.2014, p. 56)
--	Code of conduct of 12 November 2014 for the members of the Supervisory Board of the ECB
--	Amendment 1/2014 of 15 December 2014 to the Rules of Procedure of the Supervisory Board of the ECB

## Glossary

**Banking union:** one of the building blocks for completing Economic and Monetary Union, which consists of an integrated financial framework with a single supervisory mechanism, a single bank resolution mechanism, and a single rulebook, including for harmonised deposit guarantee schemes, which may evolve into a common European deposit guarantee.

**Binding Technical Standards (BTS):** as part of its role in building up the single rulebook in banking, the EBA is mandated to produce a number of BTS for the implementation of the CRD IV package. BTS are legal acts which specify particular aspects of an EU legislative text (directive or regulation) and seek to ensure consistent harmonisation in specific areas. BTS are finally adopted by the European Commission by means of regulations or decisions. They are legally binding and directly applicable in all Member States.

**Comprehensive assessment:** an assessment of the banks in the Member States participating in the Single Supervisory Mechanism to be carried out by the ECB in cooperation with the NCAs of the participating Member States, and concluded before the ECB assumes its supervisory responsibilities for these institutions. A comprehensive assessment of the 130 banks of the euro area expected to qualify as significant was carried out by the ECB together with the NCAs before the ECB assumed its supervisory tasks in November 2014.

**Credit institution:** an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account.

**CRR/CRD IV:** [Capital Requirements Regulation and Directive: Regulation \(EU\) No 575/2013 on prudential requirements for credit institutions and investment firms \(CRR\)](#) and [Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms \(CRD IV\)](#). They are often jointly referred to as CRD IV.

**ECB supervisory decision:** a legal act adopted by the ECB in the exercise of the tasks and powers conferred on it by the SSM Regulation. It is addressed to one or more supervised entities or supervised groups or one or more other persons and is not a legal act of general application.

**European Banking Authority (EBA):** the EBA is an independent EU authority established on 1 January 2011 to ensure effective and consistent prudential regulation and supervision across the EU banking sector. Its main task is to contribute to the creation of the European single rulebook in banking, the objective of which is to provide a single set of harmonised prudential rules throughout the EU. The EBA also plays an important role in promoting convergence of supervisory practices across the EU and is mandated to assess risks and vulnerabilities in the EU banking sector.

**SSM Framework Regulation:** the regulatory framework setting out the practical arrangements concerning the cooperation between the ECB and the national



competent authorities within the Single Supervisory Mechanism, as provided for in the SSM Regulation.

**Guide to banking supervision:** a guide aimed at explaining to banks, the general public and the media how the SSM operates and detailing the SSM's supervisory practices. A first issue was published in September 2014.

**Joint Supervisory Team (JST):** a team of supervisors composed of ECB and NCA staff in charge of the supervision of a significant supervised entity or a significant supervised group.

**National competent authority (NCA):** a public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned.

**Passporting procedures:** procedures concerning the freedom of establishment and the freedom to provide services in other Member States by any credit institution authorised and supervised by the competent authorities of another Member State, provided that such activities are covered by the authorisation (as regulated by Articles 33 to 46 of CRD IV).

**SSM Regulation:** the legal act creating a single supervisory mechanism for credit institutions in the euro area and, potentially, other EU Member States, as one of the main elements of Europe's banking union. The SSM Regulation confers on the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions.

**Significance:** the criterion that determines the allocation of supervisory responsibilities to the ECB or the NCAs within the Single Supervisory Mechanism. The level of significance of credit institutions is based on criteria set out in the SSM Regulation, and specified in the SSM Framework Regulation.

**Significant supervised entity:** both a significant supervised entity in a euro area Member State and a significant supervised entity in a participating non-euro area Member State.

**Single Resolution Mechanism (SRM):** a mechanism establishing uniform rules and a uniform procedure for the resolution of credit institutions established in the banking union. It is backed by a Single Resolution Board, which is the European resolution authority for the banking union, operational since 1 January 2015, working in close cooperation with the national resolution authorities of participating Member States. For the purposes of resolution, the SRM will have at its disposal a single resolution fund, which is being set up. The SRM is a necessary complement to the Single Supervisory Mechanism to achieve a well-functioning banking union.

**Single supervisory handbook:** a common framework developed by the EBA to provide guidance for supervisory assessment, intervention and corrective action. The handbook represents a non-binding collection of supervisory best practices for methodologies and processes applied in the EU.

**Single rulebook:** the single rulebook in banking aims to provide a single set of harmonised prudential rules which banks must respect throughout the EU. Beyond the legislation elaborated by the European Parliament and the EU Council with the assistance of the European Commission, the EBA has the competence to further develop this single rulebook and monitor its implementation.

**Single Supervisory Mechanism (SSM):** a mechanism composed of the ECB and national competent authorities in participating Member States for the exercise of the supervisory tasks conferred upon the ECB. The ECB is responsible for the effective and consistent functioning of this mechanism, which forms part of the banking union.

**Supervisory Manual:** a manual detailing the general principles, processes and procedures as well as the methodology for the supervision of significant and less significant institutions, taking into account the principles for the functioning of the SSM. It describes the procedures for cooperation within the SSM and with authorities outside the SSM. The Supervisory Manual is an internal SSM staff document; a shorter Guide to banking supervision, explaining how the SSM operates and detailing the SSM's supervisory practices, was published in September 2014.

**Supervisory Review and Evaluation Process (SREP):** the process used to guide the supervisory review of significant and less significant credit institutions and to determine whether (on top of minimum requirements) possible additional requirements should be applied with respect to own funds, disclosure or liquidity, or whether any other supervisory measures should be applied.

## Abbreviations

### Countries

BE	Belgium	LT	Lithuania
BG	Bulgaria	LU	Luxembourg
CZ	Czech Republic	HU	Hungary
DK	Denmark	MT	Malta
DE	Germany	NL	Netherlands
EE	Estonia	AT	Austria
IE	Ireland	PL	Poland
GR	Greece	PT	Portugal
ES	Spain	RO	Romania
FR	France	SI	Slovenia
HR	Croatia	SK	Slovakia
IT	Italy	FI	Finland
CY	Cyprus	SE	Sweden
LV	Latvia	UK	United Kingdom

### Others

AQR	asset quality review
BCBS	Basel Committee on Banking Supervision
COREP	common reporting
CRD IV	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
ECB	European Central Bank
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
EU	European Union
FINREP	financial reporting
FSB	Financial Stability Board
ICAAP	Internal Capital Adequacy Assessment Process
ILAAP	Internal Liquidity Adequacy Assessment Process
JST	Joint Supervisory Team
LSI	less significant institution
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

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