



EUROPEAN CENTRAL BANK

EUROSYSTEM



SSM QUARTERLY REPORT

Progress in the operational implementation of the Single Supervisory Mechanism Regulation

In 2014 all ECB publications feature a motif taken from the €20 banknote.

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KEY MESSAGES

This is the first Quarterly Report to the European Parliament, the EU Council and the European Commission on progress in implementing the Regulation on the Single Supervisory Mechanism (SSM Regulation). The report, which is itself required under the SSM Regulation, not only covers the three months up to 3 February 2014, but also the preparatory work undertaken by the ECB in close cooperation with national supervisors and central banks since the euro area summit of 29 June 2012.

The transitory structures set up by the ECB to prepare for the start of the Single Supervisory Mechanism (SSM) have already made significant progress, thereby enabling a smooth entry into force of the SSM Regulation on 3 November 2013. Some notable achievements are set out below.

- The supervisory model of the SSM has largely been developed, as reflected in the draft Supervisory Manual of the SSM, which covers all the tasks and supervisory processes of the SSM, including the relations between the ECB and the national competent authorities (NCAs).
- The key concept of the Supervisory Manual is that Joint Supervisory Teams (JSTs) will directly supervise the approximately 130 banks considered “significant” in accordance with the SSM Regulation. The composition of the JSTs was defined in the first meeting of the Supervisory Board.
- The draft ECB SSM Framework Regulation has been finalised and will be submitted for public consultation before adoption. Under the SSM Regulation, the ECB is required to adopt and publish this Framework Regulation by 4 May 2014.
- The framework for supervisory reporting within the SSM, which specifies the data required for the SSM’s supervisory model, has largely been defined.
- The comprehensive assessment of the banks that are likely to be deemed significant (and will hence be subject to direct supervision by the ECB) was publicly launched in October 2013, and meetings were held with the CEOs of the 124 banking groups subject to the assessment. The main features of the stress test, one of the two complementary pillars of the comprehensive assessment, were defined under the coordination of the European Banking Authority (EBA).
- An initial mapping of the euro area banking system has been undertaken. To this end, a catalogue has been created of all supervised entities falling within the scope of the SSM, including the internal structure and composition of all euro area banking groups. The identification of significant institutions in line with the SSM Regulation will be undertaken once all relevant data become available.

- The recruitment process for the SSM structures is proceeding according to plan. Response to the public recruitment competitions opened thus far, including those for the senior and middle management of the SSM, has been excellent.
- The internal preparatory work at the ECB is well advanced in many areas, such as IT infrastructure, premises, internal and external communication, logistical organisation and legal and statistical services.

On 16 December 2013 the EU Council appointed Ms Danièle Nouy as the first Chair of the Supervisory Board.¹ Ms Nouy took up her appointment on 2 January 2014. The Supervisory Board held its first meeting on 30 January 2014 and adopted a first set of formal decisions related to the operational implementation of the SSM Regulation.

1 INTRODUCTION

The SSM Regulation² requires the ECB, as from 3 November 2013, to send a quarterly report to the European Parliament, the EU Council and the European Commission on progress in the operational implementation of the SSM Regulation.

Under the accountability arrangements with the European Parliament³ and the EU Council⁴, the quarterly reports should specifically cover:

- internal preparation, organisation and planning of work;
- concrete arrangements made to comply with the requirement to separate monetary policy and supervisory functions;
- cooperation with other national/EU competent authorities;
- any obstacles encountered by the ECB in the preparation of its supervisory tasks;
- any events of concern or changes to the Code of Conduct.

This first SSM Quarterly Report covers not only the period from 3 November 2013 to 3 February 2014, but also the preparatory work conducted since the euro area summit of 29 June 2012. The report was prepared by ECB staff and approved by the Supervisory Board following

¹ See the Council Implementing Decision of 16 December 2013 implementing Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 352, 24.12.2013, p. 50).

² Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

³ Interinstitutional Agreement between the European Parliament and the European Central Bank on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the single supervisory mechanism (OJ L 320, 30.11.2013, p. 1).

⁴ Memorandum of Understanding between the Council of the European Union and the European Central Bank on the cooperation on procedures related to the single supervisory mechanism, which entered into force on 12 December 2013.

consultation with the ECB's Governing Council. The second Quarterly Report will be published in May 2014.

2 GOVERNANCE

2.1 GOVERNANCE OF THE PREPARATORY WORK SINCE SUMMER 2012

The preparatory work for the establishment of the SSM was initiated by the ECB in close cooperation with national supervisors following the euro area summit of 29 June 2012. The preparations have been steered by a High-Level Group on Supervision, chaired by the ECB President and comprising representatives from the national competent authorities (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, has 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 the staff involved in preparations, including the supervisory staff who have since been seconded from the NCAs to the ECB. 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).

2.2 ESTABLISHMENT OF THE SSM GOVERNANCE STRUCTURES

2.2.1 APPOINTMENT OF THE CHAIR AND VICE-CHAIR

On 16 December 2013 the EU Council appointed Ms Danièle Nouy as the first Chair of the Supervisory Board. Ms Nouy's appointment was based on a proposal made by the ECB's Governing Council on 20 November 2013, following a public selection procedure, and approved 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.

The Vice-Chair of the Supervisory Board is to be chosen from among the members of the ECB's Executive Board. On 22 January 2014 the ECB's Governing Council proposed the

appointment of Ms Sabine Lautenschläger, who was recently appointed as a Member of the Executive Board, as Vice-Chair of the Supervisory Board. Ms Lautenschläger is scheduled to appear before the European Parliament's Committee on Economic and Monetary Affairs (ECON) at a hearing on 3 February 2014. The European Parliament and the EU Council will decide on the approval of the candidate proposed by the ECB.

2.2.2 SUPERVISORY BOARD AND STEERING COMMITTEE

In line with the SSM Regulation, the planning and execution of the tasks conferred on the ECB will be fully undertaken by the Supervisory Board as an internal body of the ECB. 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 will be 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. Under this procedure, draft decisions by the Supervisory Board will be deemed adopted unless the Governing Council objects within a defined period of time, not exceeding ten working days. Moreover, in order to properly reflect the Governing Council's responsibility for the internal organisation of the ECB and its decision-making bodies in accordance with the ESCB Statute, certain rules governing the Supervisory Board's procedures have also been incorporated in the ECB's Rules of Procedure.

The SSM Regulation also requires the Supervisory Board to adopt its own Rules of Procedure, which will have to be read in conjunction with the ECB's revised Rules of Procedure. They will include rules for the selection of the members of the Steering Committee which will support the Supervisory Board. The Steering Committee should have no more than ten members, including the Chair, the Vice-Chair and one ECB representative, and its composition should ensure a fair balance and rotation between NCAs. These rules were drafted by ECB staff and discussed with the members of the Task Force on Supervision and the High-Level Group on Supervision in December 2013. A preliminary discussion took place at the first meeting of the Supervisory Board on 30 January 2014. The Steering Committee is expected to be established in the course of February 2014.

Although the SSM Regulation does not explicitly provide a code of conduct for the members of the Supervisory Board, it refers to some ethical rules that will specifically apply to them (such as those concerning conflict of interests resulting from subsequent employment). As codes of conduct are in place for both the Executive Board and the Governing Council, it was decided that a separate one was also required for the Supervisory Board. To best reflect the distinct nature of the Supervisory Board within the organisational framework of the ECB, the Supervisory Board discussed a preliminary draft *Code of Conduct for the Members of the Supervisory Board* at its first meeting on 30 January 2014.

2.2.3 ADMINISTRATIVE BOARD OF REVIEW AND MEDIATION PANEL

The SSM Regulation provides that the ECB should establish an Administrative Board of Review charged with carrying out internal administrative reviews of the decisions taken by the ECB when conducting its supervisory tasks. This internal body, to be composed of five individuals with sufficient experience in the fields of banking and other financial services, will review supervisory decisions at the request of the bank concerned. The scope of the review is defined as pertaining to the procedural and substantive conformity of the challenged decision with the SSM Regulation. The Administrative Board of Review's operating rules will set out details of the procedures to be followed in this context. A draft legal instrument for consideration by the Governing Council was discussed with the members of the Task Force and High-Level Group on Supervision in December 2013.

With a view to ensuring the separation between monetary policy and supervisory tasks, the SSM Regulation provides for a further internal body, the Mediation Panel, to 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 will include one member per participating Member State, chosen from among the members of the Governing Council and the Supervisory Board. The draft rules of procedure of the Mediation Panel for consideration by the Governing Council were discussed with the members of the Task Force and the High-Level Group on Supervision in December 2013.

3 LEGAL FRAMEWORK

The ECB's assumption of the tasks conferred on it by the SSM Regulation requires the adoption of a number of ECB legal acts in advance of 4 November 2014.

3.1 THE ECB SSM FRAMEWORK REGULATION

The SSM Regulation provides that the ECB must adopt, in consultation with the NCAs and on the basis of a proposal from the Supervisory Board, the framework which will set out the practical arrangements for the implementation of Article 6 of the SSM Regulation (concerning the cooperation between the ECB and the NCAs within the SSM). This framework will take the form of an ECB regulation (the Framework Regulation), a draft of which will be subject to public consultation in early 2014. The ECB must adopt and publish this Framework Regulation by 4 May 2014. As mentioned above, a dedicated work stream (WS2) composed of legal experts of the ECB and of NCAs and NCBs has been established to facilitate these legal preparations and to provide legal advice concerning the other preparatory work.

The main purpose of the Framework Regulation is to lay down the procedures governing the cooperation between the ECB and the NCAs.

The Framework Regulation will cover the aspects expressly referred to in Article 6(7) of the SSM Regulation, which provides that the framework will at least include:

- the methodology for the assessment of the significance of institutions;
- cooperation procedures for the supervision of significant credit institutions;
- cooperation procedures for less significant institutions.

Moreover, the Framework Regulation will also deal with aspects that go beyond those expressly mentioned in Article 6 of the SSM Regulation. Such aspects include, for example, issues relating to the procedures for investigatory powers, authorisations, qualifying holdings, withdrawal of authorisations, the regime for administrative penalties, macro-prudential supervision and close cooperation. The Framework Regulation will also lay down the main due process rules for the adoption of the ECB's supervisory decisions, e.g. the right to be heard, access to files, language regime.

Before adopting the Framework Regulation, the ECB has to conduct an open public consultation.⁵ The public consultation will be launched on 7 February 2014 following the endorsement of the draft Framework Regulation by the Supervisory Board during its first meeting. Before launching the public consultation, the draft Framework Regulation was transmitted to the European Parliament's Committee on Economic and Monetary Affairs (ECON), in accordance with the relevant provisions of the Interinstitutional Agreement between the European Parliament and the ECB.

In addition, on 19 February 2014, a public hearing will be held at the ECB in Frankfurt am Main, at which stakeholders will be able to ask questions on the draft Framework Regulation.

⁵ Under Article 4(3) of the SSM Regulation.

3.2 INTERNAL RULES REGARDING SEPARATION FROM THE MONETARY POLICY FUNCTION

The SSM Regulation requires the ECB to adopt and make public any necessary internal rules to ensure the separation between the supervisory and monetary policy functional areas and other tasks of the ECB, including rules regarding professional secrecy and information exchanges.

Accordingly, the drafting has begun of internal rules to ensure the separation, namely through a combination of organisational separation and the segregation of information flows.

As described above, an independent Supervisory Board – separate from the Governing Council – has been established to draft and enforce decisions. The Governing Council’s deliberations on supervisory matters will be kept strictly apart from those on other issues, with separate agendas and meetings.

Concerning the segregation of information flows, the ECB has experience in developing and delivering institutional and operational arrangements that securely segregate information (e.g. to ensure Chinese walls are in place between the ECB and ESRB-related information). For the separation between monetary and supervisory policy, the internal rules will draw in particular on the ECB’s document and records management systems, which provide security features (such as access groups/rights) to grant/restrict access to documents and folders, as well as the ECB’s confidentiality regime, which defines how to classify and handle sensitive ECB information.

3.3 REGULATION ON THE LEVYING OF SUPERVISORY FEES

For details on the ECB Regulation on fees, see Section 7.3.

3.4 DECISION ON CLOSE COOPERATION

While the Framework Regulation lays down the operational arrangements between the ECB and NCAs of a Member State whose currency is not the euro, once a regime of close cooperation has been established, the procedure for the establishment of close cooperation will be set out in a specific ECB decision, providing more detail than in the SSM Regulation. A draft ECB decision on close cooperation has been prepared, setting out the procedural aspects relating to:

- requests to enter into a close cooperation;
- the assessment of those requests by the ECB;
- the potential suspension and termination of a close cooperation.

In addition, the draft ECB decision specifies the list of accompanying documents for a request to enter into a close cooperation, provides templates for a notification of that request and a statement regarding compliance of national legislation. The ECB is expected to adopt this draft decision in the course of February 2014. So far, the ECB has not received any indication of interest in establishing a regime of close cooperation from Member States whose currency is not the euro. The uncertainty as to the new issues that would be likely to arise from the possible activation of close cooperation agreements represents one additional challenge for the ECB as part of its preparations.

4 THE SSM SUPERVISORY MODEL

One of the main priorities of the preparatory work has been the development of the main features of the operational model for supervision which will guide the functioning of the SSM. This work was carried out by a dedicated work stream (WS3) and is reflected in the SSM Supervisory Manual.

4.1 THE SSM SUPERVISORY MANUAL

The SSM Supervisory Manual covers 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. While the Supervisory Manual is in the first instance an internal SSM staff document, it is the intention to prepare a comprehensive public version.

A significant part of the Supervisory Manual is dedicated to the SSM Supervisory Review and Evaluation Process (SSM SREP), which was developed in order to guide the supervisory review of significant and less significant credit institutions and the requirement of specific additional own funds, disclosure, liquidity requirements, or other measures from them if needed.⁶ The SREP encompasses:

- a risk assessment system (RAS);
- a methodology for the quantification of capital and liquidity buffers (SREP quantification);
- an approach to integrate the RAS, the SREP quantification and the stress test outcomes.

⁶ Article 4(1)(f) of the SSM Regulation.

The SSM SREP will take an integrated approach that relies on an extensive set of information provided by the RAS, the quantifications for capital and liquidity buffers – including the banks’ internal capital adequacy assessment process (ICAAP) and internal liquidity adequacy assessment process (ILAAP) – and the top-down stress test outcomes; it will combine them in a meaningful way to quantify the adequate capital and liquidity levels and to devise the Supervisory Examination Plan, given the broader assessment of risks under Pillar 2 of the Basel framework, as implemented in the EU by the Capital Requirements Directive IV/Capital Requirements Regulation (CRD IV package).

The integration of these dimensions is achieved at the risk-by-risk level and at the overall level.

4.2 JOINT SUPERVISORY TEAMS

Within the SSM, the operational supervision of each significant banking group or credit institution will be carried out by one Joint Supervisory Team (JST). Each JST will be headed by an ECB coordinator and will comprise a number of highly qualified supervisors from both the ECB and the NCAs of participating Member States. Its responsibilities will include the planning and execution of the annual supervisory programme for its assigned institution and the enactment and implementation monitoring of decisions made by the Supervisory Board and the Governing Council. JSTs can also propose topics for on-site examinations and follow up on their findings.

The JST concept, as the operational instrument of supranational supervision, has been developed specifically for the SSM. Compared with the existing approach of the Supervisory Colleges – which so far has been the only means, other than bilateral cooperation, of conducting supervision on a transnational basis – the JST concept provides a number of genuine improvements.

Both in terms of size and expertise, each JST will be set up and staffed in a way that is tailored specifically to suit its supervised institution’s business model, risk profile and geographical distribution, involving all of the ECB and NCA supervisors working on the supervision of a specific bank. This allows for a highly integrated approach to the supervision of cross-border banks, enabling the JST to conduct its activities with a view to the institution’s specific risk profile and to ensure that the institution complies with the legal and prudential framework on an ongoing and forward-looking basis.

The operational management of the JSTs will be effective. The JST coordinator will be able to react to ad hoc events by adjusting supervisory priorities, re-targeting the JST’s activities, alerting ECB management or requesting further guidance or support from the Supervisory

Board or Governing Council when needed. In addition, JST coordinators will manage their teams on a personal level, providing motivation, guidance and leadership as appropriate.

To assist the JSTs and ensure consistency in supervision, the SSM will provide an extensive network of specialised expertise and support. The annual planning processes for supervisory activities and the organisation of on-site inspections, for example, will be managed centrally. For support on specific thematic areas such as model or risk-related issues, legal questions or policy and methodological support, JSTs will be able to ask for additional assistance from ECB horizontal functions at any time.

With this combination of unique features, the JSTs are set to become the most integrated tool of supranational supervision. However, it must be emphasised that the success of the recruiting process is of key importance for the overall project, as the JSTs need highly qualified staff for optimum performance. This applies in particular for the JST coordinators, whose requirements profile includes high levels of professional expertise in supervision and experience in supranational management.

4.3 SSM RISK ASSESSMENT SYSTEM

The SSM risk assessment system (RAS) is rooted in a combination of quantitative indicators and qualitative inputs; it is not a mere mechanistic approach, but rather leaves room for judgement guided by clearly defined principles, i.e. “constrained judgement”. It is conceived to apply to all SSM banks – not only the significant ones – and thus requires proportionality in its implementation.

The methodology for assessing the risk of the supervised institutions is developed by individual categories (business risk and profitability, credit and counterparty risk including residual risk, interest rate risk in the banking book, market risk, securitisation risk, operational risk, insurance risk, concentration risk (inter-risk), internal governance and risk management, liquidity risk and capital position).

A key objective of the RAS is to take into account the widest possible range of both quantitative and qualitative indicators (including forward-looking ones) when assessing a bank’s intrinsic risk profile, its position vis-à-vis its peers, and its vulnerability to a number of exogenous factors. For most dimensions, the assessment distinguishes between risk level and risk control. These aspects are then combined to provide the assessment of a particular category and the assessments of individual categories are subsequently integrated into an overall assessment.

4.4 SSM SUPERVISORY REVIEW AND EVALUATION PROCESS

The second component of the methodological development covers the supervisory review and evaluation process (SREP) capital assessment, the related liquidity buffer quantification, the role of stress testing, and the supervisory measures and communication.

The SREP quantification for capital and liquidity smoothly integrates all the relevant information available. Such an approach is a continuum, whereby risk assessment and ICAAP/ILAAP analysis feed into each other to produce a consistent assessment of the banks' risk profile.

The objective of the integrated approach is to make the four perspectives (i.e. risk assessment, SREP capital and liquidity quantification, top-down stress testing and definition of supervisory examination programmes) coherent parts of the SSM's supervisory strategy, avoiding any loophole, duplication or overlap of tasks or assessments, but rather merging all the activities within a unique workflow. This consistency is also necessary across JSTs, as each of them will be in charge of the day-to-day supervision of significant institutions and will be responsible for the four components.

The integrated approach builds on the RAS under the assumption that, for all relevant risk categories, it will provide an indication of the supervised institution's vulnerabilities. This assessment of the combined riskiness of the bank's activities, prior to the consideration of the capital and liquidity position, is important when judging the level of capitalisation and liquidity, as the supervisor should expect higher levels of risk to be backed by higher own resources.

4.5 PROCESSES AND PROCEDURES OF SUPERVISION AND CASE STUDIES

The processes and procedures of supervision are detailed in the Supervisory Manual. Below is an outline of the issues covered.

- **Cooperation within the SSM:** the role and responsibilities of the JSTs for the day-to-day supervision of significant institutions; the procedures for supervision on a consolidated and solo level (i.e. on a parent company and on individual/sub-consolidated level with respect to the components of the groups established in countries of the euro area other than that of the parent company); and procedures to fulfil the cooperation requirements with Member States whose currency is not the euro, but where a close cooperation has been established between the ECB and the NCA.

- **Roles, responsibilities and procedures for decision-making within the SSM:** the legal setting; the stages of the decision-making process (including fast-track decision-making procedures); and the SSM language regime governing the communication between the ECB and NCAs of participating Member States.
- **Detailed SSM processes and procedures:** for the supervision of significant and less significant institutions following a typical life cycle of an institution; the enforcement of the supervision in the Member States in close cooperation, ensuring execution of the supervision programmes for credit institutions according to ECB standards and with quality of supervision assured as adequate.

In order to fine-tune the Supervisory Manual and to test the methodology and the design of the JSTs, case studies were conducted with a view to assessing the impact of policy alternatives on the actual implementation. For the various aspects of the methodology, the case studies were applied on a constant set of financial institutions.

4.6 SSM APPROACH TO ON-SITE INSPECTIONS

The Supervisory Manual also describes the approach to on-site inspections. Besides defining on-site inspections and explaining their objectives, the Supervisory Manual details the types and scope of on-site inspections as well as their organisation, techniques and typical life cycle.

4.7 LANGUAGE POLICY

The legal framework for the language regime 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. There are 15 official languages in the euro area, and 24 official EU languages in the 28 EU Member States.

For the communication between the ECB and supervised entities, as a general rule, the supervised entities may address the ECB in any one of the official languages of the EU and the ECB will respond in that language. Decisions addressed to supervised entities or other persons (e.g. board members, qualified shareholders) will be adopted by the ECB in English and the official language of the Member State in which each addressee has its head office or is domiciled. If a decision is taken upon application of a supervised entity, the decision will be adopted in English and in the language used in the application. However, the ECB expects that a number of credit institutions, particularly the larger ones, will agree to use English between themselves and the ECB. When an ECB legal act is adopted in English and in any other official languages of the EU, all language versions are equally authentic. For the communication between the ECB and the NCAs, English will be used as a rule.

4.8 TRANSITION PERIOD

The functions and tasks to be performed during the transition period are laid down in a specific calendar that is updated on a monthly basis. A more detailed master plan, describes, and regularly tracks the progress of, all the activities, initiatives and coordination efforts relating to the preparations for the SSM. All of the areas concerned contribute, and are accountable, to this master plan.

In addition, a dedicated chapter of the Supervisory Manual describes how the SSM will operate in the period between the SSM Regulation's entry into force and the date upon which the SSM fully assumes the supervisory tasks, and the scope of tasks to be accomplished during that period.

5 COMPREHENSIVE ASSESSMENT OF THE CREDIT INSTITUTIONS

The ECB and the participating NCAs are carrying out a comprehensive assessment, in line with the SSM Regulation. More specifically, the ECB is conducting the exercise, detailing its design and strategy, monitoring its execution in close cooperation with the NCAs, performing quality assurance on an ongoing basis, collecting and consolidating the results and finalising and disclosing the overall assessment. The ECB is assisted, in exercising this coordination role, by an international consulting firm specialised in banking sector analyses, Oliver Wyman. The NCAs are executing the exercise at the national level, on the basis of the centrally developed data requirements and methodology, thereby effectively harnessing local knowledge and expertise. NCAs are also assisted by independent auditors or consultants. To ensure consistency of execution across both countries and banks, quality assurance measures have been put in place.

The ECB expects to publish the results of the comprehensive assessment prior to assuming its new supervisory responsibilities in November 2014.

5.1 GOALS AND SCOPE OF THE COMPREHENSIVE ASSESSMENT

The goals of the comprehensive assessment are threefold:

- first, to foster transparency, that is, enhancing the quality of information available concerning the condition of banks;
- second, where needed, to repair balance sheets, by identifying and implementing necessary corrective actions;

- third – and resulting from the first and second – to foster confidence in the banking sector.

Information on the general approach to the comprehensive assessment is available on the ECB's website⁷.

The assessment involves 128 credit institutions in 18 Member States, covering approximately 85% of euro area bank assets. These are the banks that could plausibly be regarded as significant under the SSM Regulation. However, the full and final list of significant banks, which will be compiled later in 2014 when up-to-date statistics have become available, may be shorter (see also Section 7.1).

5.2 MAIN ELEMENTS OF THE COMPREHENSIVE ASSESSMENT

The ECB will ensure that the comprehensive assessment is rigorous and encompasses the main sources of risk. It comprises two main complementary pillars, implemented under a centralised structure at the ECB.

- First, an **asset quality review**, whereby the ECB will review the quality of banks' assets and enhance the transparency of bank exposures. This review will be broad and inclusive, comprising credit and market exposures, on and off-balance sheet positions and domestic and non-domestic exposures. All asset classes, including non-performing loans, restructured loans and sovereign exposures, will be covered. The results of the review will be based on a capital threshold of 8% Common Equity Tier 1, using the 2014 definition given in the CRD IV package.
- Second, a **stress test** that will be performed in close cooperation with the EBA. The ECB and the EBA recently communicated further details on the stress test, the methodology and the corresponding capital adequacy thresholds (8% and 5.5% Common Equity Tier 1 for the baseline scenario and adverse scenario respectively). As the stress test for the banks subject to the comprehensive assessment will incorporate capital requirements that may result from the asset quality review, the end result will be more demanding.

In addition, a supervisory risk assessment, depending on the availability of data, could support the comprehensive assessment through a control/consistency check for the results of the two main pillars. It would aim at addressing the banks' key risks, including liquidity, leverage and funding. It would embody a quantitative and qualitative analysis based on backward and

⁷ <http://www.ecb.europa.eu>

forward-looking information aimed at assessing a bank's intrinsic risk profile, its position in relation to peers and its vulnerability to a number of exogenous factors.

5.3 ORGANISATION OF THE COMPREHENSIVE ASSESSMENT

To achieve the goals of the comprehensive assessment, the exercise must be centrally organised, providing rigour and consistency across the participating Member States. The comprehensive assessment has been organised in a way that ensures the consistent execution of a robust methodology, an efficient governance and suitably rapid decision-making process.

The central structure for governing and implementing the comprehensive assessment consists of three different layers, complemented by corresponding local national structures in each of the 18 participating Member States.

The comprehensive assessment is governed by a Comprehensive Assessment Steering Committee (CASC), which reports to the Supervisory Board.⁸ The CASC is chaired by the Chair of the Supervisory Board and the Vice-President of the ECB and is composed of four ECB representatives and high-level representatives from eight NCAs.

The overall project is headed by Mr Jukka Vesala, who is also Director General of DG Micro-Prudential Supervision III. As Project Manager of the comprehensive assessment, Mr Vesala oversees the technical preparatory work prepared by two technical structures, the Central Project Management Office (CPMO) and the Comprehensive Assessment Stress Test Team (CAST), ensuring a liaison between this technical work and the CASC, as well as ensuring a close relationship with the EBA and any non-SSM countries involved in the comprehensive assessment.

The CPMO is responsible for implementing quality assurance, defining methodological standards and providing content guidance to NCAs to ensure comparability and consistency. It is composed of ECB staff members (and supported by external consultants) and liaises with, and monitors the work conducted by, the local national structures to ensure the implementation is on track. Country teams composed of ECB staff have been established to carry out in-country quality assurance, provide technical assistance and ensure the consistent implementation of the comprehensive assessment at the country level.

The CAST is composed of one additional ECB representative, two EBA representatives and two NCA representatives. It is responsible for ensuring a close cooperation with the EBA, as well as the necessary interlinkage between the balance sheet assessment exercise and the stress test.

⁸ The CASC reported to the High-Level Group on Supervision until the Supervisory Board was formally established.

6 ORGANISATION OF THE SUPERVISORY FUNCTION AT THE ECB

To perform the new supervisory function, the ECB is creating four new DGs and a Secretariat, with a total headcount estimate of around 770 full-time equivalents (FTEs):

- DGs Micro-Prudential Supervision I and II will deal with the **direct day-to-day supervision of significant banks**;
- DG Micro-Prudential Supervision III will look after the **indirect supervision** of less significant banks;
- DG Micro-Prudential Supervision IV will handle **horizontal** and specialised services and will also support the other DGs in the performance of their functions;
- A dedicated Secretariat will support the Supervisory Board and related sub-structures.

The SSM recruitment follows the ECB's existing recruitment rules and procedures, which provide that staff and managers are generally selected following a competitive procedure carried out by selection panels. The SSM recruitment procedure has been organised in a top-down fashion, i.e. the vacancy for the Chair of the Supervisory Board was published first, directly followed by the vacancy notices for senior managers at the end of September 2013, whereas the bulk of the middle management positions were advertised at the beginning of December 2013. This approach aimed to ensure that the selected senior managers would be able to participate in the selection panel set up for the middle management, and middle managers in the selection panels for the staff.

Progress has been achieved as follows: the Chair of the Supervisory Board was appointed in mid-December 2013 and participated fully in the final decisions regarding the appointment of the four Directors General at the beginning of January 2014. It is expected that decisions regarding the six Deputy Directors General will be made in the course of February 2014. Recruitment for the majority of the middle managers (around 100 positions) is underway and campaigns for the majority of professional staff positions were launched by the end of 2013. All remaining vacancies (around 20 middle managers and 280 professionals – all in DGs Micro-Prudential Supervision III and IV) are expected to be published by the end of February 2014. Recruitment for DGs Micro-Prudential Supervision I and II were prioritised in view of the formation of the JSTs and the comprehensive assessment.

Staff of the four new DGs and the new Secretariat will be housed temporarily in a rented building close to the Eurotower. When the ECB moves to its new headquarters, currently under construction in Frankfurt's Ostend district, the supervisory staff will be relocated to the

Eurotower. The ECB's new premises were designed at a time when the supervisory tasks had not yet been envisaged and will not have sufficient space to accommodate the supervisory staff.

On top of additional staffing, to support this increase in scope and tasks, a number of business units are being created within the existing structure, with a total headcount estimate of around 200 permanent FTEs. New divisions have been formed in DG Legal Services, DG Statistics and DG Financial Stability (which has been renamed DG Macro-Prudential Policy and Financial Stability to reflect its new functions under the SSM Regulation). In addition, new sections have been established in DG Human Resources, Budget and Organisation and DG Administration.

Under the SSM Regulation, the ECB's Governing Council will establish and publish a *Code of Conduct for the ECB staff and management involved in banking supervision*. The ECB is currently examining a draft of such a code of conduct and will submit, in due course, a proposal to the Supervisory Board and the ECB's decision-making bodies.

7 PREPARATION OF OTHER RELEVANT STRANDS OF WORK

7.1 MAPPING OF THE EURO AREA BANKING SYSTEM

As mentioned in Section 2.1, a work stream (WS1) was mandated to map the euro area banking system; in other words, to compile a catalogue of all supervised entities falling within the scope of the SSM, including the internal structure and composition of all euro area banking groups.

WS1 carried out several data collections as a basis for analyses and reports which have fed into policy discussions on various aspects relevant for the classification of supervised entities as significant or less significant. The data collections and analyses have focused on those entities potentially falling within the scope of the SSM. The approach in gathering data on those entities has been developed so as to allow for an assessment of their significance in line with the criteria set out in the SSM Regulation. The methodological details concerning the assessment and determination of significant banks will be disclosed in a dedicated section of the SSM Framework Regulation. Besides the size criterion, the structure and composition of supervised groups are particularly relevant for determining an institution's significance, given that the respective criteria are to be assessed at the highest level of consolidation.

The dataset created by WS1 has served as a basis for the ECB's selection of the institutions subject to the comprehensive assessment (see Section 5.1) and will form the basis of the initial list of significant institutions to be drawn up before the SSM assumes fully its supervisory tasks.

7.2 SUPERVISORY DATA REPORTING FRAMEWORK

A further work stream (WS4) was established to:

- take stock of the availability of comparable information at the euro area level;
- initiate the development of the supervisory reporting framework of the SSM.

This exercise included the implementation of the EBA templates on Financial Reporting (FINREP) and on Common Reporting (COREP).

Although some variation in comparability was found across jurisdictions, it is expected that the adoption of the EBA Implementing Technical Standards (ITS) will further improve the level of comparability. For the preparatory phase, however, it was decided that the amount of information needed for supervisory purposes should not be constrained by the requirement of perfect comparability.

The design of the future supervisory reporting framework has been driven by the data needed to run a centralised RAS. Accordingly, the variables included in the reporting framework are categorised according to the different risk profiles of a bank, and the system is seen as a flexible one, given that progress in the methodologies for assessing the various risk profiles will continue to inform the design of the data templates.

Before the adoption of the SSM Regulation, two data collections were conducted, neither of which involved requesting data directly from banks. Instead, data were collected by NCAs through existing national reporting schemes. A relatively large amount of information was collected, which helped to fine-tune the design of the centralised RAS.

Once the SSM Regulation had been approved, the ECB and the NCAs agreed on a specific data collection that includes information relevant for the centralised RAS and is also tailored to those risk profiles (e.g. liquidity and interest rate risk). Data that were not readily available from NCAs have been requested directly from banks. Detailed guidance has been provided and help desks and FAQ documents are available for NCAs at the ECB and for banks at the national level. For data collections, every effort is being made to coordinate the requests efficiently and avoid duplications.

The timely availability of statistical datasets is necessary for the ECB to undertake its supervisory tasks. The ECB is, therefore, working on enhancing the relevant datasets that will serve the specific needs of the SSM.

In parallel, it is also preparing the data system required for supervisory banking data and metadata reception in the ECB, their storage, processing (including validation and consistency

checks), confidentiality protection and dissemination. This data system will comprise two main components:

1. data based on the ITS on supervisory reporting, as published by the EBA in July 2013;
2. other regular supervisory data which have not been harmonised by the EBA.

The data system is expected to be put in place in phases, with the first phase scheduled for completion by July 2014. It will be linked to the Register of Institutions and Affiliates Database (RIAD), which is expected to contain institutional information and key business data on the banks and the composition of banking groups (i.e. reference data). The system will also be able to host both individual and consolidated (group) banking data.

7.3 SUPERVISORY FEE FRAMEWORK

Under the SSM Regulation, the ECB will levy annual fees on credit institutions established in the participating Member States and on branches established in a participating Member State by a credit institution established in a non-participating Member State. These fees should cover, but not exceed, the expenditure that the ECB incurs in relation to its supervisory tasks. The fees are to be set at the highest level of consolidation within participating Member States and based on objective criteria relating to the importance and risk profile, including risk weighted assets, of the credit institution concerned.

Work in this area has so far focused on:

- **initiating the design of the supervisory fee calculation mechanism** – in 2013 the ECB examined the different fee systems and approaches used in Europe and internationally, particularly in the United States, with a view to identifying best practices;
- **drafting an ECB Regulation on fees** – this Regulation will include the modalities and criteria for determining the amount of the annual supervisory fees to be levied (including details on the methodologies) and the invoicing procedure.

The next steps will be to finalise the proposals for the ECB's supervisory fee methodology, and to issue a draft ECB Regulation on supervisory fees for public consultation (currently expected for the first half of 2014).

7.4 IT INFRASTRUCTURES

The creation of new business processes and operations for the SSM is supported by four IT work streams:

- **Shared IT services:** new workstations have been set up in the temporary site for the SSM staff, to be followed by a total of 1,100 new workstations by the end of autumn 2014. NCAs will connect to SSM applications through CoreNet, the current network infrastructure used by the NCBs (with the exception of the NCAs of Germany and Latvia, where a different solution may be required). Options for exchanging signed and encrypted messages with non-ESCB NCAs are being reviewed.
- **Collaboration, workflow and information management:** a public helpline for SSM enquiries is being set up (see Section 7.6) and an IT workflow project (e-Contact) has been initiated.
- **Enterprise resource planning:** the business requirements and potential solutions for the SSM budget, organisational structure and reporting-related changes have been identified with business area representatives and are under review. As regards cost calculation, invoicing and payment collection and reconciliation (see Section 7.3), the ECB has identified SAP's "Public Sector Collection and Disbursement" and "Tax and Revenue Management" modules as possible solutions. The development of a prototype is in progress and will be assessed in due course by business area representatives.
- **Data collection, data quality management and analytics:** the Supervisory Banking Data System (SUBA) project has been initiated. The business and technical analysis has been concluded. A prototyping was started in December to facilitate the collection and assessment of supervisory files at an early stage (i.e. during the first quarter of 2014) following the new data standards (ITS and XBRL). The business requirements for mapping and representing the significant banks within the RIAD system have been analysed and addressed. In addition, workshops with ESCB business users have been held to gather and assess business requirements for the RAS. To facilitate decision-making and communication on SSM issues, the Eurosystem/ESCB Information Technology Committee (ITC) has also started to meet in an SSM composition.

7.5 INFORMATION MANAGEMENT

Creating synergies, albeit in full respect of the functional separation between the ECB's monetary policy mandate and its new supervisory function, the ECB has decided to reuse and adapt its existing Information⁹ Management policies, practices and tools (i.e. the DARWIN document and records management system) for the SSM, as they have proven to meet

⁹ Any information, irrespective of its medium or format, related to the policies, tasks, activities or decisions of the ECB (including the tasks and activities performed in accordance with the provisions of the Statute of the ESCB and of the ECB), that is originated or held by the ECB.

successfully similar requirements in other environments (e.g. ECB, ESRB or ESCB committees).

Over the past few months, the ECB has deployed secure DARWIN access to NCAs and has prepared workspaces to support the work related to the preparatory phase, the SSM decision-making bodies, the comprehensive assessment and the ESCB committees meeting in an SSM composition. Each workspace comprises a secure portal which provides easy access to information and advanced retrieval and collaboration functions.

The ECB is also designing future Information Management solutions to support the supervisory processes. The aim is to provide workspaces where supervisors from the ECB and all NCAs can exchange information related to prudential supervision and inspections of credit institutions easily and in compliance with the highest standards of information security. This project includes connecting the JSTs via a user interface that provides a unique entry point to the SSM informational environment, as well as providing an analytical and a reporting toolkit to the JSTs for the complete risk assessment of supervised institutions and the related capital and liquidity quantifications.

7.6 COMMUNICATION

A dedicated project team has been established in the ECB's DG Communications & Language Services for the coordination of SSM external communication matters. The SSM will take advantage of existing synergies within the DG and will have dedicated spokespersons for supervision, and staff to coordinate translation, protocol and outreach, English translation and editing, internal communication, public queries, multimedia and media monitoring. Key communication policies are being developed with the involvement of the Eurosystem/ESCB Communications Committee (ECCO), for which a new SSM format has been established comprising, among others, senior communication experts from the competent authorities.

The key communication tool for the SSM will be the website. A new "Banking Supervision" section went live on the ECB's website on the day the European Parliament voted on the SSM Regulation. This temporary section is being gradually enlarged and enhanced with SSM-related information.

In parallel, a new dedicated SSM website is being developed, which is scheduled to go live in November 2014 when the SSM becomes fully operational. The baseline communication requirements for the SSM – in addition to aspects covered in the Interinstitutional Agreement between the European Parliament and the ECB – are currently being gathered and assessed. They will inform the content and structure of the new website.

Although there is to be a clear, functional separation between the ECB's monetary policy mandate and its new supervisory function, information on the SSM will be available through both the ECB's main website and the stand-alone SSM website.

It is expected that the ECB's new supervisory tasks will trigger a significant increase in the number of public queries to the ECB on related matters. Following the outcomes of a survey on managing public queries in the context of supervision as well as a feasibility study, the ECB plans to increase the capacity and capability of its public queries function.

8 ACCOUNTABILITY

The accountability framework is key for the transparency, legitimacy and independence of supervisory decisions, while at the same time allowing the SSM to perform its supervisory duties efficiently and effectively. The SSM Regulation sets out a substantive and robust accountability framework.

For the implementation of the SSM Regulation, the ECB is accountable to the European Parliament and the EU Council and/or, as appropriate, the Eurogroup in the presence of representatives from non-euro participating Member States. To that end, the SSM Regulation provides for various channels of accountability while reporting takes place to not only these two institutions but also the European Commission and the national parliaments. The SSM Regulation also establishes clear procedures for appointing the Chair and Vice-Chair of the Supervisory Board.

8.1 ACCOUNTABILITY TO THE EUROPEAN PARLIAMENT AND THE EU COUNCIL

On 12 September 2013 the European Parliament and the ECB signed a declaration committing both institutions to formally conclude an **Interinstitutional Agreement** on the practical aspects of the exercise of democratic accountability and oversight of the tasks conferred on the ECB within the framework of the SSM; in other words, clarifying how the relevant provisions on accountability in the SSM Regulation are to be implemented in practice. On that occasion, the Presidents of the European Parliament and the ECB also declared their intention to progress rapidly with the selection procedure for appointing the Chair of the Supervisory Board.

The SSM Regulation entered into force on 3 November 2013 and the Interinstitutional Agreement on 7 November 2013. Although not explicitly provided for in the SSM Regulation, the EU Council also concluded with the ECB a **Memorandum of Understanding** elaborating

in more detail the SSM Regulation's provisions on cooperation between both institutions related to the SSM. The Memorandum of Understanding entered into force on 12 December 2013.

A key channel of accountability is provided through regular hearings and ad hoc exchanges of views with the Chair of the Supervisory Board in the European Parliament's Committee on Economic and Monetary Affairs (ECON) and in the Eurogroup. The publication of this SSM Quarterly Report will be accompanied by a first hearing in ECON, which is planned for 4 February 2014. The Interinstitutional Agreement also sets the parameters of the SSM's cooperation in Parliamentary investigations and for confidential oral discussions with the Chair of the Supervisory Board, which are covered by appropriate confidentiality safeguards, namely that all participants are to sign confidentiality agreements. ECON will receive a record of the Supervisory Board's meetings, as well as non-confidential information after the end of a process of winding up a credit institution. ECB legal acts related to the supervisory tasks that are to be subject to public consultation will be submitted in advance to Parliament.

As regards other specific accountability and reporting channels, in the transition period, quarterly reports will be presented to the European Parliament, the EU Council and the European Commission, and an annual report to the European Parliament, the EU Council, the European Commission and the Eurogroup. The Annual Report will also be forwarded to the national parliaments of participating Member States, which may raise questions and observations. A broad outline of the main content of the quarterly and annual reports has already been elaborated in the Interinstitutional Agreement and Memorandum of Understanding.

In line with the prominent role given in the SSM Regulation to the Chair of the Supervisory Board for discharging accountability, the Chair will present the Annual Report to ECON and to the Eurogroup in the presence of representatives from non-euro area participating Member States. The first Annual Report is expected to be published by the end of 2014. In line with the Interinstitutional Agreement, it will be published on the ECB's website. MEPs and EU Council members will be able to address oral and written questions to the Chair of the Supervisory Board. Written questions and their answers will be published on the websites of the European Parliament and the ECB. The general public will also have the opportunity to provide comments and raise questions on this and other SSM-related matters that will be summarised in a set of FAQs (see also Section 7.6).

Some of the relevant provisions of the SSM Regulation have already been implemented by the time of submission of this first SSM Quarterly Report. This concerns most notably the open selection procedure for the appointment of the Chair of the Supervisory Board. On account of the very good cooperation between the European Parliament, the EU Council and the ECB, the steps envisaged in the SSM Regulation, and elaborated in the Interinstitutional Agreement and

Memorandum of Understanding, were followed with a sense of urgency, and led to the appointment of the Chair, Ms Danièle Nouy, by the EU Council on 16 December 2013. Following the proposal of the Governing Council on 22 January 2014 to appoint Ms Sabine Lautenschläger as Vice-Chair of the Supervisory Board, Ms Lautenschläger is scheduled to appear before the European Parliament's Committee on Economic and Monetary Affairs (ECON) on 3 February 2014 for a public confirmation hearing and a vote on the nominated candidate for the Vice-Chair. The steps of the open selection procedure leading up to proposal of the Governing Council for the Chair included the provision to the European Parliament and the EU Council of the draft vacancy notice, and the provision of a short-list of candidates for the position. ECON also held a public confirmation hearing and a vote on the nominated candidate for the Chair.

In the absence of the Chair of the Supervisory Board, MEPs sent questions to the ECB's President regarding the preparations for the SSM, which were answered and posted on the websites of the European Parliament and the ECB. Moreover, the Chair of the Supervisory Board has answered further questions since her appointment on 16 December 2013. In line with the Interinstitutional Agreement, Parliament also received on 4 February 2014 and in advance of the public consultation to be launched on 7 February, the draft Framework Regulation, which is one of the key elements of the preparatory work of the SSM.

9 NEXT STEPS AND FUTURE CHALLENGES

One of the main challenges which the ECB has had to address has been the unprecedented nature and scope of the new tasks. Furthermore, the timeframe for establishing the SSM is very short, in fact much shorter than the timeframe available when the ECB and the single monetary policy were set up.

Another difficulty has been the changes to the time schedule. The date on which the ECB is to assume its new supervisory tasks has shifted gradually from March to November 2014, which has meant constant adjustments to all timelines (e.g. impact on decision-making processes, supervisory calendar, logistical preparations, recruitment and formation of JSTs).

Before the next Quarterly Report, scheduled for May 2014, the ECB will have to address, in particular, the following three challenges:

- In connection with the recruitment of the bulk of SSM-related staff and the establishment of the JSTs, responsible for the day-to-day supervision of the

approximately 130 significant banks, the ECB has to create the conditions for a fruitful interaction between the staff located at the “centre” and the staff of the NCAs. Good management is crucial for the SSM, due to the involvement of highly skilled people working towards the same goal, but who may be employed by different authorities and located in different cities.

- It will be crucial for the Supervisory Board to function in the most effective way from the very start. The period until the assumption of tasks by the ECB requires the adoption of several fundamental decisions, not only those that will determine the overall functioning of the SSM, but also the further development and calibration of supervisory and risk assessment methodologies applicable across the SSM, necessary to allow the ECB to already take capital and liquidity decisions in 2014. This is also relevant for the comprehensive assessment, more details on which have been announced recently.
- Following up on this first Quarterly Report, the ECB will seek to meet the legitimate expectations in terms of accountability and transparency triggered by the Interinstitutional Agreement and the Memorandum of Understanding. The ECB is fully committed to exercising its responsibilities in line with these agreements.