Contents

Foreword by Mario Draghi, President of the ECB 3
Introductory interview with Andrea Enria, Chair of the Supervisory Board 4
1  Implementing the SSM model of supervision 8
   1.1  Credit institutions: main risks and general performance 8
   Box 1  The 2018 stress tests 10
   1.2  Work on non-performing loans (NPLs) 14
   1.3  Further development of the SREP methodology 21
   Overview of the seven ICAAP and ILAAP principles 23
   1.4  Thematic reviews 25
   1.5  Ongoing supervision 29
   1.6  On-site supervision 33
   1.7  Targeted review of internal models (TRIM) 37
   1.8  Indirect supervision of less significant institutions 39
   1.9  Macroprudential tasks 42
2  Contribution to the EU crisis management and resolution framework 44
   2.1  Crisis cases in 2018 44
   Box 2  The ECB’s role in fighting money laundering 47
   2.2  The ECB’s crisis management framework 48
   2.3  Interaction with the Single Resolution Board 50
   2.4  Work on recovery planning 51
   2.5  Crisis cases involving less significant institutions 52
3  Authorisations, enforcement and sanctioning procedures 54
   3.1  Authorisations 54
   3.2  Reporting of breaches, enforcement and sanctioning procedures 58
4  The SSM as part of the European and global supervisory architecture 62
4.1 European and international cooperation

**Box 3** Preparing for Brexit

4.2 Contribution to developing the European and international regulatory framework

5 Organisational set-up of ECB banking supervision

5.1 Discharging of accountability requirements

**Box 4** SSM risk appetite

5.2 Transparency and communications

5.3 Decision-making

5.4 Improving the efficiency and effectiveness of the SSM

5.5 ECB Banking Supervision staffing

5.6 Implementing the Code of Conduct

5.7 Applying the principle of separation between monetary policy and supervisory tasks

5.8 Data reporting framework and information management

6 Reporting on budgetary consumption

6.1 Expenditure for 2018

6.2 Fees framework for 2018

6.3 Other income related to banking supervisory tasks

7 Legal instruments adopted by the ECB

7.1 ECB regulations

7.2 ECB legal instruments other than regulations

8 The European banking sector in figures
Foreword by Mario Draghi, President of the ECB

Five years on, the benefits of European banking supervision are now evident. Supervisory practices have converged from 19 national models to one European one. And more harmonised rules and increased transparency have led to a more level playing field for banks in the euro area.

Supervisors now have a more comprehensive view of the banking system. Banks across the euro area are now being compared with a large number of their peers, leading to effective benchmarking in terms of business models and risk profiles. At the same time, cross-border linkages and spillovers can also be monitored more easily, which has strengthened not only our understanding of bank-level risk, but also of systemic risk originating in the banking sector.

These benefits have been instrumental in making the European banking sector more resilient. Banks have increased their CET1 ratios from 11.3% at the end of 2014 to 14.1% in 2018. Progress has been made in reducing legacy assets, with non-performing loans (NPLs) falling by around €300 billion over the same period. And funding and liquidity are also more stable than they used to be.

Banks continue to face some key challenges. Profitability remained low in 2018, which affects the capacity of banks to lend to the economy. Between 2016 and 2018, better-performing banks in the euro area offset lower interest margins by expanding credit, while worse-performing banks deleveraged instead.

Reducing overcapacity and high costs improves profitability. To the same end, it is necessary to further reduce the remaining stock of NPLs as well as the hidden losses and uncertainty associated with the valuation of certain complex financial assets – including, but not limited to, level 3 assets. Looking forward, banks, supervisors and regulators need to continue to work together to address these issues, while ensuring that banks adhere to high risk-management standards.

It is equally important to establish a consistent regulatory and institutional framework for robust cross-border integration. A more integrated banking sector would encourage cross-border consolidation and deepen private risk-sharing within the euro area, creating a more stable macroeconomic environment. Regulators and supervisors should push further towards a more unified prudential framework that impedes the ring-fencing of regulatory capital and liquidity.

These efforts go hand in hand with the necessary process of completing the banking union. European banking supervision should be supported by a strong resolution framework and effective deposit insurance scheme to ensure that the integrity of the single banking market remains unchallenged.
Introductory interview with Andrea Enria, Chair of the Supervisory Board

You took up the position of Chair of the ECB’s Supervisory Board in January 2019. How will you approach this important task?

First of all, Danièle Nouy, Sabine Lautenschläger and all our colleagues – both here at the ECB and in the national competent authorities (NCAs) – have done a great job of establishing a well-functioning organisation. So I do not have to re-invent the wheel. High standards of supervision will have to be maintained, following the rigorous and demanding approach defined in the set-up phase.

Establishing a single supervisory mechanism has been a major step forward, but we have to acknowledge that we still do not have a truly integrated European banking market. Progress in this area will require the removal of legislative barriers, which is not our task, of course. Still, I think we have to do all we can to achieve progress towards the banking union as a single jurisdiction – a single jurisdiction with regard to banking regulation and supervision, that is. This would lay the foundation for a true domestic market for European banks.

The one thing we must remember is who we are working for: European citizens, depositors, investors, borrowers and the economy at large. Our work must benefit them, and we are accountable to them. This is something I take very seriously, and I see good reasons for being as transparent as possible. People must be able to understand what we do and how it benefits them. Banks must be able to understand and anticipate our policies and actions. And the same is true for investors. We now live in a “bail-in world”; if a bank gets into trouble, its investors will have to take losses. For that reason, they need to better understand the risks they take.

Right at the start of your term, you had to deal with a bank in trouble. How was your first experience with the new European framework for crisis management?

What struck me most was the commitment of our staff. Everyone worked very hard, throughout the Christmas and New Year period. And everyone knew what was at stake and how much the woes of a bank can affect people’s lives. That’s what counts in a crisis. All the processes ran smoothly, and all the authorities involved worked together well.

That said, there is some room for improvement. When we supervisors deal with a crisis, we have to work within the boundaries set by existing regulation. And regulation still differs from country to country. The Bank Recovery and Resolution Directive (BRRD), for instance, has not been uniformly transposed into national law. Likewise, each country has its own insolvency laws. This means that the tools we can use in a crisis are not the same in all countries. And we cannot always be certain that a smooth exit from the market can be ensured in all cases. This is a problem,
not least in the case of cross-border banks. The lack of arrangements for liquidity in resolution is another issue that has recently been highlighted. So, we still have some work to do in order to prepare for future crises.

**Looking ahead, the next big change on the horizon is the United Kingdom’s withdrawal from the European Union. What is your view on this?**

To me, Brexit is a very sad event – not least because I studied in the United Kingdom and then lived in London for 12 years. And speaking from that experience, I can also say that the European Union is not always accurately portrayed in the United Kingdom. Many people seem to overestimate the costs – and underestimate the benefits – of a united Europe.

As for the banking sector, Brexit will bring a lot of change. Quite a number of banks will relocate to the euro area, and this will transform the banking landscape. This raises plenty of questions – how to regulate and supervise third-country branches or investment firms is just one of them. Banks, regulators and supervisors have had to make many preparations for Brexit, and we will have a great deal to do post-Brexit. Nevertheless, I am confident that we will rise to the challenge, also thanks to our effective cooperation with the supervisory authorities in the United Kingdom.

**What other challenges do banks face?**

Well, there is certainly no lack of challenges for banks. They need to further clean up their balance sheets, they need to rethink their business models, they need to improve their governance, and they need to ensure their resolvability. And these are just the challenges of the past and the present.

Looking ahead, banks should also keep a close eye on what’s happening in the markets. Liquidity has been abundant and cheap for quite some time now. Together with low profits, this has induced banks to take on greater risks. But they should be careful; high asset valuations and compressed risk premia should not be taken for granted. At some point, things may change, and such a change can come very suddenly. Risk and term premia could suddenly increase and hurt banks in many ways, potentially affecting their profits, liquidity and capital. Funding and market risks are likely to become more material going forward. We supervisors take these risks very seriously, and so should banks.

**You just mentioned governance as something banks need to work on. How important is this?**

Banks now hold more and better capital, more liquidity, and have reverted to more stable sources of funding. However, all this is of little value if a bank suffers from poor governance, short-sighted leadership and a problematic culture. There are two things that bankers must keep in mind. Short-term profits should not be the driving force of bank operations; keeping banks in business long term is what counts. Sustainability is key. Besides being unacceptable from a societal perspective, short-term profits generated by causing long-term detriment to customers, shareholders and taxpayers are not in the interest of the banks themselves. The recent string of scandals and money laundering cases are a case in point.
It has become conventional wisdom that these are difficult times for banks. What can we learn from those banks that are still thriving?

In the euro area, there are indeed a number of banks that are performing better than their peers. What do these banks have in common? At first glance, not much: they are all very different from one another. It seems that there is no “golden” strategy for becoming profitable. But having a strategy is of the essence. The one thing that unites these successful banks is that they excel at what we call strategic steering. They are able to formulate a strategy and to pull it off. It’s not just what they do, it’s how they do it. This is the lesson they offer.

We also have to acknowledge that there is still a structural problem in European banking markets: many banks have been bailed out, but not so many have actually left the market. As a result, Europe still seems to be overbanked, which is reflected in profitability. In other industries, consolidation has been key in eliminating the excess capacity accumulated in the run-up to the crisis.

On the subject of changes in market structure – what is your take on digitalisation? Challenge, opportunity or both?

Technological change is always a complex process that is hard to predict. But I do see opportunities. Digitalisation can help banks to become more efficient and unlock new sources of revenue; it facilitates leaner and faster processes and enables banks to offer customers a better service and new products. If banks manage to seize these opportunities, they will benefit. But if they don’t act, others will – be they small and agile fintech start-ups or well-established tech giants. That’s the challenge for banks.

Surely it is not the task of regulators and supervisors to protect incumbent banks from more efficient competitors. That said, we still have to deal with new risks – cyber risk being the most obvious example. We have to keep a close eye on such new risks and assess whether they require us to adapt the rules. At the same time, digitalisation can help regulators and supervisors become more efficient and reduce compliance costs, especially for smaller and simpler firms. In other words, there are opportunities for us as well.

Adapting the rules has been the leading theme ever since the crisis. What is your view on regulatory reform – has it gone too far, as some claim, or not far enough?

The reform was needed. The crisis had revealed a lot of gaps in the regulatory framework, and we had to close them. I believe the package developed at the G20 level is a balanced one: it has significantly enhanced the safety and soundness of banks, with requirements calibrated and phased in to avoid unwarranted effects on lending and real growth. Some jurisdictions went beyond the requirements set by international standards in some areas and are now reconsidering these choices. In general, I think we should resist pressure to alleviate requirements in good times. As I said before, banks must resist short-term thinking – the same should apply to
regulators. We need to think about the long-term stability of the system and avoid pro-cyclical approaches to rule-making.

That said, it is true, of course, that the revised rulebook is fairly complex. So we do have to monitor its effects, and adjust it if necessary. But the priority now must be to finalise the implementation of the reforms consistently around the world.

**In Europe, the banking package is about to be finalised and will shape the regulatory landscape for years to come. Are you happy with the outcome?**

The banking package is a very important piece of legislation, not least because it implements the Basel standards into European law. While the overall assessment is positive, there are some areas in which the proposed legislation deviates from international standards. This is the case for some technical details of the leverage ratio, the net stable funding ratio and the new rules for banks’ trading books. So the global playing field will not be as level as it could have been.

Turning to the European Union, my view is that the banking package could have been more ambitious in pursuing the objective of a truly integrated banking sector, at least within the banking union. If we aspire to a single jurisdiction for banking, we must overcome the instinct to ring-fence. Banking groups must be able to freely allocate their regulatory capital and their liquidity within the euro area. Unfortunately, the banking package maintains a narrow national scope with respect to waivers from capital and liquidity requirements within banking groups. I hope the legislators will reconsider their approach in the near future as further steps are taken towards completing the banking union.

**What else needs to be done in order to move closer to a truly European banking sector?**

It is clear that in the absence of a genuinely European safety net, national authorities will remain reluctant to allow the integrated management of capital and liquidity within cross-border groups operating in the banking union. Some progress has been made in establishing a backstop for the Single Resolution Fund, but the political debate on the establishment of the third pillar of the banking union, the European deposit insurance scheme, remains fraught with difficulties. I believe the polarisation between the “risk reduction camp”, which argues that risks should go down before common guarantees are set up, and the “risk-sharing camp”, which argues that the time is now ripe for integrated deposit insurance, is misleading. The two objectives are interlinked. Hence, the European Union should do what it is good at and come up with a clear roadmap. This roadmap should acknowledge how closely connected the remaining elements of reform are. This would allow us to make progress on all those elements in lockstep.
Implementing the SSM model of supervision

Credit institutions: main risks and general performance

Main risks in the banking sector

ECB Banking Supervision, in close cooperation with national supervisors, conducted its annual risk identification and assessment exercise, and updated the SSM Risk Map, which depicts the main risks faced by euro area banks over a two to three-year horizon, accordingly. During the period under review, a broad-based expansion in euro area economic activity supported banks’ profitability and their balance sheets. This helped to improve the resilience of the euro area banking sector and mitigate some of the related risks, in particular those related to legacy non-performing loans (NPLs) and the low interest rate environment. Nevertheless, the current aggregate level of NPLs in the euro area remains far too high by international standards.

Geopolitical uncertainties and the risk of repricing in financial markets, on the other hand, have escalated since 2017. Moreover, ever-increasing digitalisation is exacerbating the risks related to banks’ (often legacy) IT systems and cyber security (see Chart 1).

Chart 1
SSM Risk Map for 2019

In 2018, a broad-based expansion in euro area economic activity supported banks’ profitability and balance sheets.

The reporting period saw an escalation of geopolitical uncertainties regarding, among other things, the political situation in some euro area countries, rising trade protectionism and adverse developments in certain emerging market economies, all of which could have negative repercussions on financial markets and the economic...
outlook for the euro area. With regard to Brexit, it remains uncertain whether a withdrawal agreement will be in place on the date of the United Kingdom’s withdrawal from the European Union and, therefore, whether a transition period will apply, meaning that banks and supervisors need to be prepared for all possible scenarios.

Despite a significant improvement in asset quality in recent years, high levels of NPLs remain a concern for a significant number of euro area banks. Owing to the ongoing implementation of NPL reduction strategies, those banks have already made significant progress in reducing their volumes of legacy NPLs, with the NPL ratio of significant institutions (SIs) falling from 8% in 2014 to 4.2% in the third quarter of 2018. Nevertheless, the current aggregate level of NPLs remains high, and further efforts are needed to ensure that the issue of NPLs in the euro area is adequately addressed.

In addition, banks’ continued search for yield could increase the potential for a future build-up of NPLs. Euro area banks reported an easing of credit standards throughout 2018, although this development slowed down in the last quarter of 2018. Moreover, they seem to be turning to more risky sectors and accepting lower levels of protection. Leveraged loan issuance in the euro area reached new heights in 2017, with “covenant-lite” loans making up a record high proportion of the volumes issued.

Cybercrime and IT disruptions are a growing challenge for banks amid the trend towards digitalisation. They are under mounting pressure to invest in and modernise their core IT infrastructures to boost efficiency, enhance the quality of customers’ experience and compete with fintech/big tech companies. Moreover, they are faced with an increasing number of cyberthreats.

The global search for yield, ample liquidity and compressed risk premia have heightened the risk of a sudden repricing in financial markets, which is also being exacerbated by the high level of geopolitical uncertainty. On average, the sustainability of public sector debt has improved in the euro area, supported by the positive cyclical momentum. However, stock imbalances are still elevated in several countries, leaving them vulnerable to a potential repricing of sovereign risk.

The positive economic developments during the reporting period supported banks’ profitability levels, although they remain subdued. The long period of low interest rates, while supporting the economy, has put pressure on banks’ interest margins. On aggregate, SIs forecast a pick-up in net interest income in 2019 and 2020. However, many expect their profits to remain low in terms of return on equity in the coming years.

The results of the 2018 EU-wide stress test, coordinated by the European Banking Authority (EBA), show that the 33 largest banks directly supervised by the ECB have further enhanced their resilience over the past two years. Owing to their efforts in dealing with legacy assets and consistently building up capital, they entered

1 For further details, see the euro area bank lending survey.
the stress test with an average capital base that was much stronger, with Common Equity Tier 1 (CET1) standing at 13.7%, up from 12.2% prior to the 2016 stress test.

For the 33 largest banks under the direct supervision of the ECB, the **adverse scenario led to an aggregate CET1 depletion of 3.8 percentage points** on a fully loaded basis\(^2\), which is 0.5 percentage point higher than in the 2016 stress test. This includes a 0.3 percentage point impact from the first-time application of IFRS 9, which came into force on 1 January 2018. It also reflects the use of a more severe macroeconomic scenario and more risk-sensitive methodology than in 2016. All of these factors offset the positive effects of the improvement in asset quality following the successful reduction of NPLs.

Despite the higher capital depletion, the aggregate **post-stress capital ratio was higher than in the 2016 adverse scenario, standing at 9.9% compared with 8.8%**. This confirms that the resilience of the participating banks to macroeconomic shocks has improved. However, the exercise also exposed vulnerabilities in some individual banks, which supervisors will follow up on in 2019.

In addition to the 33 banks in the EBA sample, the ECB conducted its own stress test on another 54 banks which it directly supervises and which were not included in the EBA sample. The results of the stress test show that these 54 banks have also become better capitalised, increasing their ability to absorb financial shocks. Thanks to the continuous build-up of capital in recent years, they entered the stress test with a higher average CET1 ratio of 16.9%, up from 14.7% in 2016. They exited the test with a higher average final CET1 ratio of 11.8%, compared with 8.5% in 2016.\(^3\)

**Box 1**

**The 2018 stress tests**

**Overall set-up of the 2018 stress test and involvement of the ECB**

As in previous years, the ECB was involved in both the preparation and execution of the 2018 EU-wide stress test, which was coordinated by the EBA. As part of the preparatory work, the ECB took part in designing the stress test methodology as well as the baseline and adverse scenarios. The adverse scenario was developed together with the European Systemic Risk Board (ESRB) and the EBA, and in close cooperation with the NCAs. Benefiting from a fruitful collaboration with experts from the EBA and NCAs, the ECB also produced the official credit risk benchmarks for the stress test. Banks are expected to apply these credit risk benchmarks to portfolios where no appropriate credit risk models are available.

Following the launch of the EU-wide stress test on 31 January 2018, the ECB, together with the NCAs, carried out the quality assurance process for the banks under its direct supervision. The key objective was to ensure that banks were correctly applying the common methodology developed by the EBA. Of the 48 banks covered by the EU-wide stress test, 33 are directly supervised by ECB

---

\(^2\) CET1 capital ratios on a "fully loaded" basis are calculated using the harmonised rules without any of the transitional arrangements specified in the CRR or CRD.

\(^3\) See Presentation of SSM-wide stress test 2018 – Final results.
Banking Supervision and account for 70% of euro area banking assets. The EBA published the individual results for all 48 participant banks, along with detailed balance sheet and exposure data as at year-end 2017, on Friday, 2 November 2018.4

In addition, the ECB conducted its own stress test on 54 banks that are under its direct supervision, but were not included in the EBA sample. Earlier in 2018, it had also stress tested the four Greek banks that it directly supervises. While this stress test used the same methodology, scenarios and quality assurance approach as the EBA stress test, it was brought forward in order to complete the exercise before the end of the European Stability Mechanism’s third economic adjustment programme for Greece.

Scenarios

The adverse scenario for the 2018 stress test was based on a consistent set of macro-financial shocks that could materialise in a crisis, including a contraction of 2.4% in GDP, a 17% fall in real estate prices and a sudden 31% drop in equity prices across the euro area as a whole. It reflected the main systemic risks identified at the launch of the exercise, namely (i) abrupt and sizeable repricing of risk premia in global financial markets, (ii) an adverse feedback loop between weak bank profitability and low nominal GDP growth, (iii) concerns about the sustainability of public and private debt, and (iv) liquidity risks in the non-bank financial sector with potential spillover effects on the broader financial system.

Key drivers of the 2018 stress test results

One key driver of the capital depletion in the adverse macroeconomic scenario were credit impairments, which were largely attributable to the fact that the macroeconomic scenario was more severe than in the 2016 stress test, although NPL stocks played a less prominent role than in 2016 owing to the improved quality of assets on banks’ balance sheets. A second key driver was a funding spread shock that was partly offset by the positive effect of higher long-term interest rates. A third key driver was the impact of market price and liquidity shocks on fair value portfolios. The impact of the full revaluation of these portfolios was strongest for global systemically important banks (G-SIBs). However, these banks were largely able to compensate for the losses with high client revenues. The stress impact of the scenario on liquidity reserves and model uncertainty also affected G-SIBs more than other entities. Another key driver was significant stress on net fee and commission income.

Stress test integration into regular supervisory work

Both the qualitative results (i.e. the quality and timeliness of banks’ submissions) and the quantitative results (i.e. capital depletion and banks’ resilience to adverse market conditions) of the stress test have served as input to the annual Supervisory Review and Evaluation Process (SREP). In the context of the SREP, the stress test results have also been taken into account when determining the supervisory capital demand.

---

4 For an overview of the results, see Section 1.1 of this report and the EBA’s publication of the 2018 EU-wide stress test results.
SSM supervisory priorities

The SSM supervisory priorities, which set out focus areas for supervision in a given year, are discussed and approved by the Supervisory Board of the ECB. They build on an assessment of the key risks faced by supervised banks, taking into account the latest developments in the economic, regulatory and supervisory environment. The priorities, which are reviewed on an annual basis, are an essential tool for coordinating supervisory actions across banks in an appropriately harmonised, proportionate and efficient way, thereby contributing to a level playing field and a stronger supervisory impact (see Figure 1).

Figure 1
Supervisory priorities 2019

<table>
<thead>
<tr>
<th>Supervisory priorities 2019</th>
<th>Supervisory activities for 2019 and beyond</th>
<th>Continued from 2018</th>
<th>Likely to be continued in 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit risk</td>
<td>Follow-up on NPL(^1) guidance</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td></td>
<td>Credit underwriting criteria and exposure quality (e.g. real estate, leverage finance)</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Risk management</td>
<td>TRIM(^2) - Credit risk, market risk and counterparty credit risk models</td>
<td>✔</td>
<td>☐</td>
</tr>
<tr>
<td></td>
<td>Improvement of banks’ ICAAP and ILAAP(^3) approaches and further integration into SREP</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td></td>
<td>Assess IT and cyber risk</td>
<td>☐</td>
<td>✔</td>
</tr>
<tr>
<td></td>
<td>Liquidity stress test</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Multiple risk dimensions</td>
<td>Brexit preparations</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td></td>
<td>Trading risk and asset valuations(^5)</td>
<td>☐</td>
<td>✔</td>
</tr>
</tbody>
</table>

Source: ECB.

1 Non-performing loans
2 Targeted Review of Internal Models
3 Internal Capital and Liquidity Adequacy Assessment Processes
4 In 2018 the EU-wide stress test was performed.
5 Planned activities include an OSI campaign on valuation risk and a horizontal analysis consisting of a data collection exercise to equip the JSTs with more granular information on complex assets assessed at fair value, such as those classified as level 2 and level 3.

General performance of significant banks in 2018

The profitability of euro area banks remained more or less stable in 2018, after improving in 2017. The annualised return on equity for SIs changed only slightly, averaging at 6.9%, compared with 7.0% in 2017 and 5.4% in 2016. However, this overall stable level of profitability masks considerable differences across banks. Moreover, many publicly listed banks are still trading with price-to-book ratios below one, indicating that further improvements are needed to meet investors’ expectations.
In 2018 two main factors affected banks’ aggregate earnings. Having increased in 2017, pre-impairment operating profits fell considerably, by 7.1%, over the first nine months of 2018. This decline was largely offset by a sharp decrease in impairments (-31.8% compared with 2017).

The drop in pre-impairment operating profits was driven mainly by lower net trading income (-50%)\(^5\), compared with the first three quarters of 2017. By contrast, net fee and commission income continued to improve and stood 1.4% above the value recorded in the first three quarters of 2017, while over the same time period, net interest income remained broadly stable (-0.1%).

**Chart 2**

Stable return on equity (annualised figures) in 2018: lower pre-impairment operating profits offset by a decline in impairments

(All items are displayed as percentages of equity)

<table>
<thead>
<tr>
<th>Year</th>
<th>Pre-impairment operating profits</th>
<th>Impairments</th>
<th>Other</th>
<th>Return on equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>11.82%</td>
<td>-5.19%</td>
<td>-1.23%</td>
<td>11.22%</td>
</tr>
<tr>
<td>2017</td>
<td>11.95%</td>
<td>-4.42%</td>
<td>-0.90%</td>
<td>11.22%</td>
</tr>
<tr>
<td>2018</td>
<td>-3.04%</td>
<td>-1.29%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: ECB Supervisory Banking Statistics.
Note: Data for all years are shown as second quarter cumulated figures, in annualised terms.

The stable evolution of net interest income masks two underlying trends, as growing loan volumes were offset by lower interest margins. Loan volumes increased by 2.8% between the third quarter of 2017 and the third quarter of 2018, with the financial institutions segment (loans to credit institutions: +3.7%; loans to other financial corporations: +12.1%) and the non-financial corporations segment (+3.3%) displaying the most dynamic growth. Over the first three quarters of 2018, net interest income improved for roughly half of SIs and declined for the remaining half.

Operating expenses increased by 2.0% in the first three quarters of 2018 with respect to the same period in 2017, despite the restructuring measures recently taken by several euro area banks.

---

\(^5\) This variation reverses a strong increase in trading income in the previous year.
1.2 Work on non-performing loans (NPLs)

1.2.1 The situation across Europe

The volume of NPLs on SIs’ balance sheets stood at €628 billion in the third quarter of 2018, down from €1 trillion in early 2015. Between the third quarter of 2017 and the third quarter of 2018, it decreased by €131 billion, and the gross NPL ratio dropped by 1 percentage point, to 4.2%. The decline in NPLs has accelerated over the past two years and has been particularly rapid in countries with high NPL ratios.

Nevertheless, the aggregate level of NPLs in the European banking sector remains elevated by international standards, and the clean-up of balance sheets will take more time.

Work on NPLs was one of ECB Banking Supervision’s most important supervisory priorities in 2018 and will continue to be an area of focus in 2019, building on the achievements thus far by engaging with affected institutions to define bank-specific supervisory expectations within a harmonised framework. The aim is to ensure continued progress in reducing legacy risks and to achieve consistent coverage of both the stock of NPLs and new NPLs over the medium term.

With regard to NPL statistics, the ECB publishes its Supervisory Banking Statistics on a quarterly basis, including data on asset quality for SIs. Table 1 shows the decrease in NPL levels between 2017 and 2018.

Table 1
NPLs and advances – amounts and ratios by reference period

<table>
<thead>
<tr>
<th>Item</th>
<th>Q3 2017</th>
<th>Q4 2017</th>
<th>Q1 2018</th>
<th>Q2 2018</th>
<th>Q3 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans and advances</td>
<td>14,730.0</td>
<td>14,650.0</td>
<td>14,884.5</td>
<td>14,934.6</td>
<td>15,058.1</td>
</tr>
<tr>
<td>NPLs and advances</td>
<td>759.1</td>
<td>721.7</td>
<td>699.5</td>
<td>656.7</td>
<td>627.7</td>
</tr>
<tr>
<td>NPL ratio (%)</td>
<td>5.2</td>
<td>4.9</td>
<td>4.7</td>
<td>4.4</td>
<td>4.2</td>
</tr>
<tr>
<td>NPL coverage ratio (%)</td>
<td>45.9</td>
<td>45.9</td>
<td>48.3</td>
<td>47.7</td>
<td>47.4</td>
</tr>
</tbody>
</table>

Source: ECB.

Note: The table covers SIs at the highest level of consolidation for which common reporting on capital adequacy (COREP) and financial reporting (FINREP) are available. Specifically, there were 114 SIs in the third quarter of 2017, 111 in the fourth quarter of 2017 and 109 in the first, second and third quarters of 2018. The number of entities per reference period reflects changes resulting from amendments to the list of SIs following assessments by ECB Banking Supervision, which generally occur on an annual basis, and mergers and acquisitions.

1) Loans and advances in the asset quality tables are displayed at gross carrying amount. In line with FINREP: i) held for trading exposures are excluded, and ii) cash balances at central banks and other demand deposits are included. In accordance with the EBA’s definition, NPLs are loans and advances other than held for trading that satisfy either or both of the following criteria: (a) material loans which are more than 90 days past due; (b) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due. The coverage ratio is the ratio between accumulated impairments on loans and advances and the stock of NPLs.

Across the euro area, NPL ratios continue to differ significantly from country to country, as shown in Table 2. Greek, Cypriot and Portuguese SIs have the highest NPL ratios (with country-weighted averages standing at 43.4%, 20.7% and 14.5% respectively in the third quarter of 2018). Looking at the trend, the NPL ratio decreased significantly year-on-year for SIs in Cyprus (-13.3 percentage points), Slovenia (-5.3 percentage points), Ireland (-3.7 percentage points), Portugal (-3.6 percentage points), Greece (-3.2 percentage points) and Italy (-2.5 percentage points). In the third quarter of 2018, the stock of NPLs was largest in the case of Italian SIs (€153 billion), followed by French SIs (€130 billion), Spanish SIs (€95 billion) and Greek SIs (€90 billion).

Table 2
NPLs and advances – amounts and ratios by country (reference period: third quarter of 2018)

<table>
<thead>
<tr>
<th>Country</th>
<th>Loans and advances (EUR billions)</th>
<th>NPLs and advances (EUR billions)</th>
<th>NPL ratio (percentages)</th>
<th>Year-on-year change in NPL stock (EUR billions)</th>
<th>Year-on-year change in NPL ratio (percentage points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>493.2</td>
<td>10.4</td>
<td>2.1</td>
<td>-3.1</td>
<td>-0.8</td>
</tr>
<tr>
<td>Germany</td>
<td>2,811.9</td>
<td>44.3</td>
<td>1.6</td>
<td>-10.9</td>
<td>-0.4</td>
</tr>
<tr>
<td>Estonia</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
</tr>
<tr>
<td>Ireland</td>
<td>243.4</td>
<td>20.6</td>
<td>8.5</td>
<td>-9.2</td>
<td>-3.7</td>
</tr>
<tr>
<td>Greece</td>
<td>207.7</td>
<td>90.0</td>
<td>43.4</td>
<td>-16.3</td>
<td>-3.2</td>
</tr>
<tr>
<td>Spain</td>
<td>2,349.8</td>
<td>95.4</td>
<td>4.1</td>
<td>-16.5</td>
<td>-0.7</td>
</tr>
<tr>
<td>France</td>
<td>4,532.8</td>
<td>130.2</td>
<td>2.9</td>
<td>-7.6</td>
<td>-0.3</td>
</tr>
<tr>
<td>Italy</td>
<td>1,639.8</td>
<td>153.4</td>
<td>9.4</td>
<td>-42.6</td>
<td>-2.5</td>
</tr>
<tr>
<td>Cyprus</td>
<td>35.9</td>
<td>7.4</td>
<td>20.7</td>
<td>-10.3</td>
<td>-13.3</td>
</tr>
<tr>
<td>Latvia</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
</tr>
<tr>
<td>Lithuania</td>
<td>29.8</td>
<td>1.0</td>
<td>3.2</td>
<td>0.4</td>
<td>0.1</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>96.0</td>
<td>1.0</td>
<td>1.0</td>
<td>-0.1</td>
<td>-0.4</td>
</tr>
<tr>
<td>Malta</td>
<td>14.4</td>
<td>0.5</td>
<td>3.5</td>
<td>-0.0</td>
<td>-0.2</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1,896.2</td>
<td>36.6</td>
<td>1.9</td>
<td>-3.5</td>
<td>-0.3</td>
</tr>
<tr>
<td>Austria</td>
<td>391.2</td>
<td>12.3</td>
<td>3.1</td>
<td>-4.3</td>
<td>-1.0</td>
</tr>
<tr>
<td>Portugal</td>
<td>149.2</td>
<td>21.7</td>
<td>14.5</td>
<td>-5.5</td>
<td>-3.6</td>
</tr>
<tr>
<td>Slovenia</td>
<td>15.2</td>
<td>1.3</td>
<td>8.3</td>
<td>-0.8</td>
<td>-5.3</td>
</tr>
<tr>
<td>Slovakia</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Finland</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
<td>C</td>
</tr>
<tr>
<td>Total</td>
<td>15,058.1</td>
<td>627.7</td>
<td>4.2</td>
<td>-131.4</td>
<td>-1.0</td>
</tr>
</tbody>
</table>

Source: ECB.
Notes: SIs at the highest level of consolidation for which common reporting (COREP) and financial reporting (FINREP) are available. C denotes that the value is not included for confidentiality reasons.
1) Loans and advances in the asset quality tables are displayed at gross carrying amount. In line with FINREP: i) held for trading exposures are excluded, and ii) cash balances at central banks and other demand deposits are included.
2) The increase in the NPL ratio in LT was driven by a change in the approach to consolidation regarding one SI.
3) There are no SIs at the highest level of consolidation in Slovakia.
1.2.2 The role of ECB Banking Supervision in the comprehensive strategy to resolve NPL issues in the EU

Addressing the risks related to high stocks of NPLs is important for the economy as a whole, as NPLs weigh on banks’ profitability and absorb valuable resources, restricting their ability to grant new loans. Problems in the banking sector can quickly spread to other parts of the economy to the detriment of the outlook for jobs and growth. The ECB thus recommends that banks do more to tackle their stocks of NPLs, in line with its mandate to help ensure the safety and soundness of the European banking system.

ECB Banking Supervision has developed a supervisory framework for NPLs. This includes three strategic elements, which either directly address legacy NPLs or aim to prevent the build-up of new NPLs in the future:

- **NPL guidance** to all SIs, outlining qualitative supervisory expectations with regard to managing and reducing NPLs;

- A framework to address NPL stocks as part of the supervisory dialogue, comprising: (i) an assessment of the banks’ own NPL reduction strategies, and (ii) bank-specific supervisory expectations with a view to ensuring adequate provisioning of legacy NPLs;

- **Addendum to the NPL guidance**, outlining quantitative supervisory expectations to foster timely provisioning practices for new NPLs.

The framework was developed by a dedicated task force, which comprised representatives from NCAs and the ECB. The EBA was also represented in the group as an observer. A high-level group on NPLs – chaired by Sharon Donnery (Deputy Governor of the Central Bank of Ireland) – steered the task force’s work. Between 2015 and 2018 the high-level group met 16 times to discuss proposals for developing and implementing a supervisory framework for NPLs. The Chair reported back to the Supervisory Board 14 times and to the Governing Council five times.

Having delivered on its mandate, the task force was disbanded in late 2018 and the application of the NPL supervisory framework successfully handed over to ECB Banking Supervision line functions.

However, solving the challenge of NPLs goes far beyond supervisory action. National authorities and European institutions need to join forces to resolve the issue. This was also one of the main findings of the ECB’s NPL stocktake on national practices, the latest version of which was published in June 2017. Furthermore, it was recognised by the Economic and Financial Affairs Council in July 2017, when finance ministers agreed on an Action plan to tackle non-performing loans in Europe. The plan sets out the need for action in three areas: banking supervision, reforms of insolvency and debt recovery frameworks, and the development of secondary markets. In November 2018 the Commission published the Third Progress Report on the action plan, which stated that substantial progress had been made with its implementation. ECB Banking Supervision has been actively contributing to numerous NPL initiatives in the three aforementioned areas, including those outlined...
in the action plan, in close collaboration with the stakeholders in charge of the initiatives.

In this context, ECB Banking Supervision closely coordinated with the relevant European institutions, such as the European Commission, on the need to ensure the complementary nature of (i) the proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures, and (ii) the Addendum to the ECB guidance to banks on NPLs.

Furthermore, ECB Banking Supervision supported the EBA in issuing general guidelines on the management of non-performing and forborne exposures, and guidelines on the disclosure of non-performing and forborne exposures. These guidelines are to be applied by all credit institutions across the EU. With regard to less significant institutions (LSIs), they are to apply the guidelines in a proportionate manner, as set out in the guidelines. In addition, the ECB, in close cooperation with the EBA and the Single Resolution Board (SRB), assisted the European Commission services in the preparation of a technical blueprint for setting up national asset management companies, which was published in March 2018.

Finally, ECB Banking Supervision continued to work alongside the EBA to enhance underwriting standards for new loans. It also participated in the ESRB working group that produced the report on macroprudential approaches to non-performing loans, which focuses on the role macroprudential policy can play in preventing system-wide increases in NPLs.

1.2.3 Key elements of ECB Banking Supervision’s supervisory approach to NPLs

Banks’ NPL reduction strategies – progress and assessment

In March 2017 the ECB published its guidance to banks on NPLs. As a follow-up to this guidance, SIs with higher levels of NPLs and foreclosed assets were asked to submit their NPL and foreclosed asset reduction strategies to ECB Banking Supervision. In this regard, the NPL guidance forms the basis for the ongoing supervisory dialogue with individual banks. It is the banks themselves that are responsible for implementing adequate NPL strategies and managing their NPL portfolios using a range of strategic options, such as NPL workout, servicing, portfolio sales, etc.

Such NPL strategies should contain targets for reducing NPLs at the portfolio level over a three-year horizon. These targets are set by the banks themselves and submitted to the JSTs. Chapter 2 of the NPL guidance outlines best practices for formulating NPL reduction strategies and provides a list of tools for their implementation, including forbearance, active portfolio reductions, change of exposure type and legal options. It also highlights that banks should ensure that their
NPL strategies include “not just a single strategic option but rather combinations of strategies/options to best achieve their objectives over the short, medium and long term”. The ideal combination of such tools depends on the characteristics of each bank’s portfolio and on the market and legal environment in which it is operating. It is important to note that each bank’s management should use its own discretion when choosing the combination of tools on the basis of a thorough assessment. The ECB has not expressed any preference for certain NPL reduction tools over others.

The role of the Joint Supervisory Teams (JSTs) is to review, challenge and monitor the banks’ progress against their NPL reduction targets. This role is fully embedded in their normal supervisory work and is an integral part of the SREP. The JSTs’ assessment of the strategies focuses on three overarching elements: (i) level of ambition, (ii) the credibility of the strategy, and (iii) governance aspects. The assessments are based on very granular examinations of the banks’ portfolios of gross non-performing exposures and foreclosed assets, which can be bundled under the term “non-performing assets”).

Banks with higher levels of NPLs are required to report specific NPL data to the JSTs on a quarterly basis, detailing the underlying drivers of their NPL reduction. The JSTs use these quarterly reports to monitor the banks’ progress and measure it against the reduction targets in their strategies, on both an overall and portfolio level basis. In addition, they monitor the banks’ progress against targets both gross and net of provisions to ensure that the analysis follows a holistic approach. As part of their regular interaction with the JSTs, banks are expected to prepare and submit an implementation report twice a year.

The objective of the implementation report is to ascertain how the banks are performing against their NPL strategies, from both a quantitative and qualitative perspective. Quantitative progress can be measured on the basis of the quarterly NPL data and broken down to identify specific drivers of the reduction in NPLs, such as cash repayments, sales, write-offs, etc. Accordingly, a bank should focus not only on analysing its overall reductions but also on pinpointing drivers at the portfolio level and the reasons behind the associated over or underperformance. The rationale is that a bank’s track record and future capabilities in reducing NPLs are strongly linked.

To document these quantitative aspects, it is recommended that banks carry out a targeted analysis and review of specific problematic asset classes or portfolios, including their impact on capital at the portfolio level. They should also ensure that their NPL strategies are constantly updated, taking into account all such inputs and analyses to ensure that they are credible, fit for purpose and actionable.

The qualitative aspects of a bank’s progress are also very important. Its NPL strategy should therefore also include a well-defined operational plan as a basis for the qualitative milestones, actions and objectives of the strategy. When reviewing its qualitative progress, it should proactively identify any potential roadblocks to the strategy’s successful implementation. In this regard, the various drivers of reductions in NPLs require different things. The curing of loans, for instance, requires a sound operational framework, adequate resources and a comprehensive forbearance
framework, while the sale of portfolios requires good quality data, a sophisticated IT infrastructure, experienced management and suitable financial advisors. On a bank-by-bank basis, the JSTs review the qualitative aspects of the banks’ strategies and provide them with feedback on any deficiencies identified.

The NPL guidance focuses heavily on the importance of dedicated NPL workout units, clear policies and procedures, and a well-defined suite of forbearance products. It also emphasises the need for management bodies to be heavily involved and engaged with regard to the issue of NPLs. Banks therefore need to review their internal governance structures and operational arrangements in terms of the management of NPLs – management bodies should, for example, take full ownership of the problem.

A greater focus on curing, workout and restructuring may help to foster more prudent credit risk practices, which could, over time, help banks to apply more risk-appropriate standards and governance to their lending activities.

Over the past few years, banks have generally made good progress with their NPL strategies, as evidenced by the significant decline in NPL stocks across many European countries and banks. This notwithstanding, NPL stocks remain at a high level. For this reason, the JSTs are continuing to engage with the banks and challenge them when necessary to ensure that they make further progress. If individual banks do not meet their own targets, they are expected to implement sufficient and appropriate remediation action in a timely manner.

Banks are using a variety of drivers to reduce NPL stocks, across both institutions and countries. These include forbearance and associated cash repayments, portfolio sales, write-offs and foreclosures. Certain countries favour some drivers over others because of individual circumstances. However, there also appears to be a variety of approaches, even within individual countries, depending on the banks’ individual circumstances.

The NPL strategy process is now an integral part of the high-NPL banks’ processes and ECB Banking Supervision’s supervisory processes. Accordingly, work on this supervisory priority will be continued in 2019.

Bank-specific supervisory expectations for the provisioning of NPL stocks

On 11 July 2018 the ECB announced further steps in its supervisory approach to the stock of NPLs (i.e. exposures classified as non-performing according to the EBA’s definition of 31 March 2018). The approach creates a consistent framework for addressing the issue, as part of the supervisory dialogue, through bank-specific supervisory expectations aimed at achieving adequate provisioning of legacy NPLs, thereby contributing to the resilience of the euro area banking system as a whole.

Under this approach, ECB Banking Supervision has further engaged with each bank to define its supervisory expectations. This assessment was guided by individual
banks’ current NPL ratios, their main financial features, their NPL reduction strategy (if available) and a benchmarking of comparable peers in order to ensure consistent treatment. It also took into account the most recent data and their capacity to absorb additional provisions.

All SIs under the direct supervision of the ECB have been assessed with the aim of setting bank-specific expectations to ensure continued progress in reducing legacy risks in individual banks and to achieve the same coverage of the stock and flow of NPLs over the medium term.

Finalisation of the addendum to the NPL guidance

In early 2018 the ECB finalised its addendum to the ECB Guidance to banks on non-performing loans. This was preceded by a public consultation, which ran from 4 October to 8 December 2017. On 15 March 2018 the ECB published the addendum together with detailed comments from the consultation and a feedback statement setting out the ECB’s response to those comments.

The addendum supplements the qualitative NPL guidance, published on 20 March 2017, and specifies the ECB’s supervisory expectations for prudent levels of provisions for new NPLs. It is non-binding and serves as a basis for the supervisory dialogue between SIs and ECB Banking Supervision. It addresses loans classified as NPLs after 1 April 2018, in line with the EBA’s definition.

The background to the addendum is that, in line with the Capital Requirements Directive (CRD IV), supervisors have to assess and address institution-specific risks which are not already covered, or which are insufficiently covered, by the mandatory prudential requirements in the Capital Requirements Regulation (CRR) (often referred to as “the Pillar 1 rules”). In particular, the existing prudential framework requires supervisors to assess and decide whether banks’ provisions are adequate and timely from a prudential perspective. The addendum lays out what ECB Banking Supervision expects in this regard and thus clarifies the starting point for the supervisory dialogue. As with other supervisory expectations, the addendum is complementary to any binding legislation; this includes the proposal for a Regulation amending the CRR as regards minimum loss coverage for non-performing exposures. The ECB therefore cooperated closely on the addendum with the relevant European institutions, such as the European Commission.
The supervisory expectations outlined in the addendum take into account the extent to which NPLs are secured. For fully unsecured exposures and unsecured parts of partially secured exposures, it is expected that 100% coverage is achieved within two years of the NPL classification. For fully secured exposures and secured parts of partially secured exposures, it is expected that 100% coverage is achieved within seven years of the NPL classification, following a gradual path. The expectations for secured exposures adhere to the prudential principle that credit risk protection must be enforceable in a timely manner.

The practical implementation of the addendum is to form part of the supervisory dialogue, in which the JSTs discuss with each bank divergences from the prudential provisioning expectations set out in the addendum. Thereafter, and taking into account the bank’s specific circumstances, ECB Banking Supervision will decide, on a case-by-case basis, whether supervisory measures are appropriate and if so, which. The results of this dialogue will be incorporated, for the first time, in the 2021 SREP. Banks should use the time to prepare themselves and also to review their credit underwriting policies and criteria to reduce the emergence of new NPLs, in particular during the current benign economic conditions.

### 1.3 Further development of the SREP methodology

#### 1.3.1 ICAAP/ILAAP to play a greater role in supervisory assessment

Financial shocks to the banking sector are often amplified or even caused by the inadequate amount and quality of the capital and liquidity held by banks. Two core processes, the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP), are essential to strengthening institutions’ resilience. The requirements for their ICAAPs and ILAAPs are stipulated in the CRD IV.
Both the ICAAP and ILAAP aim to encourage institutions to measure and manage their capital and liquidity risks in a structured way, using institution-specific approaches. They are not simply about producing a report for the benefit of supervisors: they are comprehensive and valuable bank-internal processes for identifying, assessing and effectively managing and covering capital and liquidity risk at all times. Banks are responsible for implementing the ICAAP and ILAAP in a proportionate manner, i.e. they need to be commensurate with, among other things, the institution’s business model, size, complexity and riskiness, as well as with market expectations.

As stated in the SSM supervisory priorities, the ICAAP and ILAAP are key instruments for institutions in managing their capital and liquidity adequacy. For that reason, they warrant particular attention from supervisors. As part of the SREP, the quality and the results of ICAAPs and ILAAPs are taken into account when establishing capital, liquidity and qualitative measures. Good ICAAPs and ILAAPs reduce uncertainty for both institutions and supervisors regarding the actual risks an institution is exposed to. In addition, they reassure supervisors to a greater extent of the institution’s ability to ensure its capital and liquidity adequacy, and thus remain viable.

In the future, the ICAAP and ILAAP are to play an even bigger role in the SREP, incentivising banks to keep improving their internal processes. Among other things, both the qualitative and quantitative aspects of the ICAAP will play an enhanced role in the determination of Pillar 2 own funds requirements on a risk-by-risk basis.

1.3.2 Finalisation of the guides for banks on their capital and liquidity management

In its recent SREP assessments, ECB Banking Supervision came to the conclusion that there were serious shortcomings in more than half of SIs’ ICAAPs and more than one-third of their ILAAPs, as reflected in overall verdicts of either “inadequate” or “weak”. Such ICAAPs and ILAAPs do not provide a solid basis for either the prudent management of capital and liquidity or the determination of additional own funds requirements. Thus, there is a need for institutions to (further) improve their ICAAPs and ILAAPs.

In November 2018 ECB Banking Supervision published guides regarding institutions’ ICAAPs and ILAAPs. These guides will play an important role in facilitating the necessary improvements. They are a major milestone in the ECB’s attempt to improve banks’ approaches to capital and liquidity management, which began with the publication of its supervisory expectations regarding ICAAPs and ILAAPs in January 2016. As a follow-up, it then launched a multi-year plan for ICAAPs and ILAAPs in early 2017, the aim being to set out more detailed expectations and communicate to institutions early on what direction they would be expected to take. The 2016 expectations were used as a basis for the guides and underwent three rounds of enhancements, taking into consideration around 800 comments that were
collected by means of two public consultations. Nevertheless, the general direction of the expectations remained unchanged throughout that process.

Overview of the seven ICAAP and ILAAP principles

The seven ICAAP and ILAAP principles refer to:

- **Governance:** management bodies are expected to take full responsibility for ICAAPs and ILAAPs.

- **Integration:** ICAAPs and ILAAPs should form integral parts of the overall management framework, including business decision-making. Both processes should be consistent within themselves, between each other and with other strategic processes.

- **Quantitative framework:** it is expected that capital and liquidity adequacy are ensured from two different perspectives in terms of the institution’s continued viability – a “normative” perspective, which reflects external requirements and constraints, and an “economic” perspective, which should reflect the undisguised economic situation.

- **Risk identification:** all material risks are expected to be identified and managed.

- **Internal capital/liquidity definitions:** from the economic perspective, the capital and liquidity buffers are expected to be of a high quality and clearly defined so that economic losses can be absorbed when they occur.

- **Risk quantification methodologies:** risks are expected to be assessed and quantified in a conservative manner, using own risk quantification methodologies that have been thoroughly validated.

- **Stress testing:** the ECB expects banks to implement sound and comprehensive stress-testing frameworks which ensure that they can survive by themselves during plausible, yet very severe and prolonged periods of adverse circumstances.

The expectations in the guides are now far more comprehensive, and the ECB started to apply them in January 2019. However, the guides are not intended to provide complete guidance on all aspects relevant to sound ICAAPs and ILAAPs. Instead, they follow a principles-based approach with a focus on selected key aspects from a supervisory perspective. ECB Banking Supervision thus stresses that, in the first place, ICAAPs and ILAAPs are internal processes that should be tailored to each institution. The implementation of an ICAAP and ILAAP appropriate for its particular circumstances therefore remains the responsibility of each individual institution. The guides help banks do this by setting out the ICAAP and ILAAP expectations in the form of seven principles and by providing a number of charts and examples as illustrations.

As a key part of the SREP, but also in other activities such as on-site inspections (OSIs), supervisors will assess on a case-by-case basis whether institutions are meeting their responsibilities and managing their capital and liquidity in a way that is
commensurate with their individual business activities, risk profile and other relevant circumstances. It is expected that the conclusions drawn from these assessments will have an ever greater influence on the SREP and its follow-up in terms of supervisory measures. If banks have good and sound ICAAPs/ILAAPs, this will be positively acknowledged in the SREP.

As sound, effective, comprehensive and forward-looking ICAAPs and ILAAPs are key instruments for ensuring their resilience, banks are encouraged to use the guides to close any gaps and remedy deficiencies in their capital and liquidity management as soon as possible. As the overall philosophy and direction of the ECB’s supervisory expectations have not changed since they were first published in January 2016, SIs are expected to do their utmost to take these expectations into account as soon as possible. The development of the guides was a multi-year process, and the ECB was very transparent about the gradual enhancement of its expectations. The short period between the publication of the guides in November 2018 and the start of their application in January 2019 does not justify inaction.

1.3.3 Steps taken to address IT risk

IT risk, including cyber risk, has been a focus area of ECB Banking Supervision from the outset and became one of the supervisory priorities for 2019.

As part of the ongoing operational risk supervision, the JSTs supervise IT risk. In 2018 they were provided with additional training on all relevant IT risk areas in order to advance their awareness and skills for ongoing supervisory activities, as well as for the annual SREP. On the basis of the EBA’s Guidelines on ICT Risk Assessment under the SREP, ECB Banking Supervision implemented a common and standardised IT risk assessment methodology. Using a comprehensive self-assessment questionnaire for banks, and the JSTs’ IT risk assessment results, an elaborate set of horizontal analyses was performed. This produced a wealth of findings that informed the JSTs’ supervisory activities, as well as thematic feedback on the overall state of IT risk management in SIs. In general, the analyses confirmed ECB Banking Supervision’s previous focus areas, namely IT security, third-party dependencies and third-party management, and IT operations.

OSIs focusing on IT risk continued in 2018, supplementing the ongoing supervision by the JSTs. Based on ECB Banking Supervision’s OSI methodology, the inspections investigated specific IT risk objectives at the request of the JSTs, in order to elaborate on and substantiate the IT risk assessments made by the JSTs and get a better idea of how SIs manage IT risks. In 2019 some IT risk OSIs will follow a campaign approach, where the same topic is inspected in several SIs on a comparable scale. This facilitates a more efficient preparation and execution of inspections, as well as a comparison of results.

As in previous years, all SIs from the 19 euro area countries were required to report significant cyber incidents as soon as they had been detected. This enables ECB Banking Supervision to identify and monitor trends in cyber incidents affecting SIs. It
also allows it to react quickly in the event that a major incident affects one or more SIs.

In order to ensure a coordinated approach to IT and cyber risk, and to facilitate the sharing of knowledge and best practices, ECB Banking Supervision continued to liaise with all relevant stakeholders (NCAs, internal ECB stakeholders, payment systems and market infrastructure experts, other supervisors within and outside the EU, European Securities and Markets Authority (ESMA), etc.) through bilateral meetings and participation in international working groups.

1.4 Thematic reviews

Thematic review of business models and profitability drivers

In 2018 ECB Banking Supervision concluded its thematic review on business models and profitability drivers, and published a report on it. The thematic review was launched in 2016 with the aim of performing an in-depth, bank-by-bank analysis of SIs’ ability to mitigate weaknesses in their business models, monitoring the consequences of weak profitability and enriching horizontal analysis by integrating JSTs’ insights in a consistent manner across banks. The first two years of the review were dedicated to developing tools, collecting data and, for the JSTs, performing in-depth analyses.

At the beginning of 2018 the JSTs informed the SIs of the findings and main conclusions of the thematic review. As part of a dedicated supervisory dialogue, they discussed any shortcomings identified and challenged the SIs’ business plans. Follow-up letters summarised the findings and formalised the results of the supervisory dialogue. The findings fed into the business model assessment for the 2018 SREP cycle. In September 2018 ECB Banking Supervision published the overall messages from the thematic review on its website.

The review showed that even though the economic situation of banks in the euro area has generally improved, profitability and business models remain under pressure. Looking beyond the aggregate trends, the profitability situation differs widely across SIs, with some convergence to the mean projected by banks, as the worst performers expect significant improvements in their profitability (see Chart 3). Banks that outperformed their peers in previous years are geographically spread out, are of different sizes and have differing business models.
The analysis confirmed that banks’ strategic steering capabilities⁷ have a major influence on their profitability. JSTs also observed that many banks try to boost profitability by turning to activities that can entail more risk (most notably related to credit risk⁸ or operational risk⁹). As there can be valid business reasons to turn to such activities, the individual recommendations do not necessarily challenge a given strategy, but rather focus on ensuring that strategic steering and risk management are improved by monitoring and containing the risk. JSTs have been involved in the identification and assessment of these issues and are following up on them as part of their regular monitoring of banks, using their full supervisory toolkit.

Thematic review of IFRS 9

The new accounting standard for financial instruments (IFRS 9) entered into force in January 2018. It addresses the lessons learned from the financial crisis, namely, that provisions based on incurred loss models often resulted in loss recognition that could be described as “too little, too late”. IFRS 9 addresses this weakness by introducing an expected credit loss model that incorporates forward-looking information over a loan’s remaining lifetime. This, by its very nature, requires considerable effort to implement, with potential risks arising from the as-yet-unknown effectiveness of expected credit loss models in practice.

Notes:

⁷ Strategic steering refers to the management’s ability to set a course towards the bank’s long-term objectives, comprising aspects such as efficient processes and good governance.

⁸ More specifically, loosening credit standards, offering new products or entering new segments, increasing concentrations and aggressive loan pricing.

⁹ For example, from digitalisation, conduct-related vulnerabilities and the impact of cost optimisation on the capabilities of control functions or other relevant sources of risk arising from the bank’s strategic decisions.
The ECB therefore decided in 2016 to launch a thematic review on IFRS 9 as part of its supervisory priorities. The aim was to assess institutions’ preparedness and foster high quality and consistent implementation of the new standard. Institutions were divided into two batches, based on the progress they had made in implementing IFRS 9. The results of the thematic review for the first batch were published in a report on the ECB’s banking supervision website in 2017. The results for the second batch were published in an article in the Supervision Newsletter in 2018.

Overall, the thematic review helped increase awareness of the challenges banks are facing in implementing IFRS 9. At the same time, it highlighted that there is still room for improvement.

It was recommended that institutions put in place remedial actions to rectify the shortcomings identified by the thematic review in 2017 and 2018. ECB Banking Supervision is currently closely monitoring their progress in implementing those actions. Among other things, the thematic review revealed a significant divergence in banks’ provisioning practices, which were subject to a follow-up by JSTs throughout 2018 and which will continue to be scrutinised in 2019. Another area of supervisory focus in 2018 was the impact of the first-time application of IFRS 9, including the change in the classification of exposures, the allocation of provisions and the migration of exposures between stages. In this regard, the ECB is looking into the banks’ accounting with a focus on regulatory capital and reporting.

In conducting its follow-up activities on the implementation of IFRS 9, ECB Banking Supervision is cooperating with the ESRB, EBA and ESMA on accounting-related topics in order to ensure a high-quality, consistent implementation of IFRS 9 and a high level of transparency for investors across the EU.10

In addition, it is closely monitoring how banks are using the transitional arrangements for IFRS 9. These transitional arrangements were incorporated into the prudential framework by the EU co-legislators to mitigate the impact on banks’ CET1 capital of the transition to IFRS 9 impairment requirements. As the phasing-in rules could have an impact on some banks’ capital ratios, the ECB is monitoring the correct application of the phasing-in rules.

Thematic review of BCBS 239

The Basel Committee on Banking Supervision (BCBS) principles on risk data aggregation and risk reporting were published in January 2013. Against this background, a thematic review on banks’ risk data aggregation and risk reporting was conducted between 2016 and 2018, covering a sample of 25 SIs. The outcome was published in the form of a dedicated report on the ECB’s website in May 2018. The report revealed that the SIs covered had implemented the BCBS 239 principles in an unsatisfactory manner. The results of the review were communicated to the banks and requests for remedial action were set out in follow-up letters. In this

10 For further details, see Financial stability implications of IFRS 9, ESRB, 2017.
context, the banks were also requested to submit clear, accurate and detailed action plans. The centralised working group, supported by the JSTs, has assessed these action plans in order to ensure horizontal consistency and is now closely monitoring the banks’ progress in implementing them.

The methodology used in the thematic review will enrich the supervisory assessment methodology on risk data aggregation and risk reporting. Currently, a dedicated drafting team is incorporating this methodology into the SREP methodology, which will be used for all SIs in the future.

The review was guided by the principles for effective risk data aggregation and risk reporting issued by the BCBS. As the ECB monitors how institutions’ risk data aggregation and risk reporting capabilities are improving, it regularly informs and updates the BCBS’s Risk Data Network on relevant insights.

**Thematic review of outsourcing**

In recent years, technological developments have affected the way banking services are offered worldwide. Outsourcing, for instance, may help banks to be more efficient, but it may also pose challenges for them in terms of their risk management and the ways in which they control outsourced activities. Banks are also showing increasing interest in outsourcing to cloud service providers. While cloud services can offer some advantages (e.g. economies of scale and cost-effectiveness), they also present challenges in terms of data protection and data location.

Against this backdrop, ECB Banking Supervision has been keeping a close eye on outsourcing, which was identified as one of the SSM supervisory priorities for 2017. To this end, a thematic review involving a targeted sample of SIs was launched and concluded in 2017, with follow-up actions continuing in 2018 as part of ordinary ongoing supervision. The thematic review took stock of banks’ outsourcing practices, revealing significant differences in terms of their governance and management. ECB Banking Supervision also identified best practices in order to promote further improvements. Based on the thematic review, it has contributed to the EBA’s work in relation to (i) the EBA Recommendations on outsourcing to cloud service providers, and (ii) the new EBA Guidelines on outsourcing, which will replace the CEBS Guidelines and the aforementioned recommendations, when they enter into force later in 2019.

In these documents, the EBA addresses a number of relevant issues which arose during ECB Banking Supervision’s thematic review. Overall, the EBA Recommendations deal with specific features of material cloud outsourcing, such as security and location of data and systems. Other relevant aspects, such as ensuring access and audit rights in written outsourcing agreements, confidentiality matters, exit strategies and sub-outsourcing or “chain” outsourcing, are covered in the revised

---

11 These recommendations came into force in July 2018.
Guidelines. A duty to maintain a register of information for all outsourcing activities and to make it available to supervisors, on request, has also been introduced.

Under the revised EBA framework, ECB Banking Supervision aims to ensure that banks take full advantage of innovative advancements while maintaining a secure environment, with risks duly monitored and mitigated. To this end, it has embedded the EBA Recommendations in its supervisory standards, duly taking them into account in the context of ongoing supervision. ECB Banking Supervision is also committed to implementing the Guidelines and will monitor the actions taken by banks to adapt their outsourcing arrangements. Furthermore, it is paying attention to the outsourcing-related challenges arising from Brexit and banks’ relocation plans, in order to ensure that outsourcing arrangements do not hinder effective supervision.

1.5 Ongoing supervision

ECB Banking Supervision strives to supervise SIs in a risk-based and proportionate manner, while, at the same time, being tough and consistent. To that end, each year a set of core ongoing supervisory activities is defined. These activities draw on the existing regulatory requirements, the SSM Supervisory Manual and the SSM supervisory priorities. They are included in the ongoing supervisory examination programme (SEP) for each of the SIs.

In addition to these centrally defined core activities, JSTs can adapt supervisory activities to banks’ specificities, where appropriate. This allows them to address rapidly changing risks at individual institutions or at the level of the entire system.

In 2018 ongoing SEP activities comprised: (i) risk-related activities (i.e. SREP and stress testing); (ii) other activities related to organisational, administrative or legal requirements (e.g. the annual assessment of significance); and (iii) additional activities that are planned by JSTs to further adapt the ongoing SEP to the specificities of the supervised group or entity (e.g. analyses of specific topics such as selected credit portfolios and asset classes).

Being proportionate

The SEP follows the principle of proportionality, i.e. the intensity of supervision is tailored to the size, systemic importance and complexity of each institution. It is these factors that determine the overall number of ongoing activities performed for any particular institution (see Chart 4).
Taking a risk-based approach

The SEP also follows a risk-based approach, focusing on the most relevant risk categories for each SI. Banks with high levels of NPLs serve as an example. For these banks, dedicated tasks, such as assessing NPL reduction strategies against the ECB’s expectations, were carried out in 2018. As a result, the percentage of tasks related to credit risk for high-NPL banks was higher than for the average bank. The same applies to institutions with high exposures to market and trading activities. These banks were the subject of more intense supervision for market risk-related issues (see Chart 25).
Highlights of ongoing supervision in 2018

In the context of the ongoing 2018 SEP, activities related to the SREP assessment, the conduct of the EU-wide stress test and the follow-up to the IRRBB (interest rate risk in the banking book) sensitivity analysis were particularly significant for JSTs.

The SREP is one of the JSTs' key tasks. JSTs were involved in the SREP exercise throughout 2018, with some peaks in activity in relation to key milestones, such as the preliminary assessment of capital, liquidity and qualitative measures and the production of draft decisions. To be able to include the results of the EU-wide stress test, the deadline for drafting the final decision letters was extended to January 2019.

Another activity that required considerable JST involvement was the supervisory stress-testing exercise. This exercise comprised the EU-wide stress test (on 33 SIs included in the EBA sample) and the ECB’s own stress test (on 54 SIs which were not part of the EBA sample). ¹²

One additional key activity performed by the JSTs in 2018 was the follow-up to the IRRBB sensitivity analysis conducted in 2017. Those banks in respect of which the exercise revealed potential vulnerabilities were subject to a follow-up by the JSTs in the first quarter of 2018. The remedial actions taken in response to the individual findings were monitored throughout the year as part of the ongoing supervisory dialogue with the banks.

Deep dives

As a part of ongoing supervision, JSTs have the discretion to address institution-specific risks. They do so, for instance, by setting the scope of the deep dives, i.e. analyses of idiosyncratic issues, which are part of the SEPs. In 2018 the JSTs focused mostly on governance, credit risk, and business models and profitability. This focus broadly reflected the 2018 supervisory priorities (see Chart 6).

¹² For further details, see Box 1, “The 2018 stress tests”.

The 2018 SEPs were successfully executed, with a 95% implementation rate.

Status of SEP activities

The 2018 SEPs were successfully executed. At the end of the year, 95% of all activities had been implemented. Of these, 82% had been completed, while 13% were still being executed as planned (e.g. the assessment of recovery plans, which began in 2018 and was planned to be completed in 2019). Another 3% of activities will be completed with some delay, and 2% of activities were cancelled, mainly owing to changes in bank structures or licence withdrawals (see Chart 7). The key activities were performed according to plan, though, covering the main risks for the banking system. Overall, the low proportion of delays and cancellations confirms the suitability and stability of the ongoing SEPs, as well as the JSTs’ ability to carry out activities according to plan.

Chart 7
Completion rate in 2018

Source: ECB.
Supervisory findings

One of the main outcomes of regular supervisory activities are the “supervisory findings”, in other words, shortcomings which need to be remedied by the banks. JSTs are responsible for monitoring how banks follow up on these findings. The annual number of registered findings has stabilised after increasing in the first few years of the SSM. In 2018 the majority of findings originated from internal model investigations (partly owing to the TRIM project, which increased supervisory involvement), OSIs and thematic reviews (e.g. of business models and profitability, see Chart 8).

Chart 8
Supervisory findings

On-site supervision

The 2018 on-site SEP represented the fourth annual cycle of on-site inspections since the SSM was established. A total of 156 OSIs at SIIs were launched in 2018, the same number as in 2017 (see Chart 9). By 31 December 2018 most inspections had either been completed (i.e. the final inspection report had been communicated to the inspected entities) or were in the reporting or investigation phase.
Owing to a better prioritisation of missions, the stability of the on-site SEP improved in 2018. Overall, 95% of all missions were launched as planned, compared with 84% in 2017. However, the on-site SEP remained flexible enough to deal with urgent situations and unexpected events by means of regular updates to the programme throughout the year.

**Chart 9**

2018 and 2017 OSIs: breakdown by risk type

OSIs are planned and staffed in close cooperation with the NCAs, which provide most of the heads of mission and team members. In 2018 88% of inspections were led by the NCAs, with a focus mainly on those banking groups that are headquartered in the respective NCA’s country. The remaining 12% of inspections were led by the ECB’s Centralised On-Site Inspections Division (COI).

In 2018 ECB Banking Supervision reached its objective of increasing the total number of cross-border and mixed-team missions. This objective is part of a multi-year effort to gradually increase the proportion of such missions out of all missions. Inspection teams are considered to be “cross-border” when the head of mission and at least one team member do not come from the relevant home/host NCA. An inspection team is considered to be “mixed” when the head of mission comes from the relevant home/host NCA, while at least two team members do not come from the relevant home/host NCA. Altogether, 44 of the 156 OSIs launched in 2018 (28%) were conducted by mixed/cross-border teams, representing a significant increase compared with 2017 (see Table 3).

**Table 3**

Staffing of OSIs: cross-border and mixed-team missions

<table>
<thead>
<tr>
<th></th>
<th>Number of OSIs in 2017</th>
<th>Number of OSIs in 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cross-border (in brackets, COI-led)</td>
<td>22 (16)</td>
<td>40 (19)</td>
</tr>
<tr>
<td>Mixed-team</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>29</td>
<td>44</td>
</tr>
</tbody>
</table>

Source: ECB.
In 2018 around one-third of the SSM’s 1,150 on-site inspectors benefited from the OSI training programme developed by COI. More than 25 training sessions on ten different topics were offered, covering all major SREP risk types, as well as the processes involved in on-site missions. This programme is based on close collaboration between the ECB and the NCAs: each training course has been developed and delivered by on-site inspectors, and 75% of the courses held in 2018 were hosted by NCAs.

1.6.1 Key findings from OSIs

The following analysis provides an overview of the most critical findings from 154 on-site reports which were finalised in 2018, referring to both the 2017 and 2018 SEP.13

Credit risk

More than half of the credit risk inspections focused mainly on asset quality and were conducted by reviewing credit files. The remaining inspections focused mainly on the qualitative aspects of the banks’ processes for managing credit risk. In 2018 three coordinated credit risk inspection campaigns were launched across a number of banks, focusing on (i) residential real estate, (ii) commercial real estate, and (iii) high-NPL banks. In more detail, the most critical findings were:

- **Weak credit-granting processes**: insufficient debtor risk assessment, inadequate authorisation levels, and inappropriate underwriting criteria and exception approval processes.

- **Inappropriate classification and monitoring of debtors**: shortcomings in the definition and/or identification of defaulted or non-performing exposures and weak processes for monitoring high-risk borrowers.

- **Miscalculation of provisions**: overvaluation of collateral and cure rates, inappropriate cash-flow estimates, and shortcomings in collateral haircuts and collective provisioning parameters.

- **Regulatory ratios**: miscalculation of risk-weighted assets (RWA) and breaches of large exposure regulations.

Governance risk

Findings on internal governance and risk management were made in OSIs focusing exclusively on this topic, but also in OSIs dedicated to other risk areas. Critical findings were identified in the following areas:

---

13 The reference date for the analysis is 15 October 2018.
• **Corporate structure and organisation**: deficiencies in internal control frameworks, insufficient human resources and lack of coordination within the group.

• **Roles and responsibilities of the management body**: deficiencies in delegation of powers and weaknesses in the implementation of the institution’s strategy and governance arrangements.

• **Internal control functions, including compliance, risk management and internal audit**: critical findings on the status, resources and scope of activity of all internal control functions.

**Operational risk**

The majority of critical findings were related to the **measurement of operational risk** (deficiencies in operational risk data collection, inadequate action plans for dealing with operational incidents) and the **scope of risk management and risk identification** (incomplete coverage and definition of significant operational risks, inconsistent use of metrics across a group’s legal entities).

**IT risk**

The majority of high-importance findings were related to **IT operations management** (inadequate incident management processes, a lack of comprehensive and accurate asset inventories); **access rights management** (ineffective recertification processes, insufficient segregation of duties); **data quality management** (weak operational processes for validating manual inputs); and **IT security management** (delayed and improper detection and mitigation measures).

**Capital risk**

Findings on **regulatory capital (Pillar 1)** were related to deficiencies in the assignment of the correct risk weights to exposures, leading to an underestimation of RWA (mainly with regard to credit risk as a result of incorrect allocation of exposure classes and a failure to identify speculative immovable property financing).

The most severe issues identified in **ICAAP missions** were related to underdeveloped stress-testing frameworks (failure to address all material risks and conduct reverse stress tests), the quantification of weaknesses (mainly in credit risk modelling) and material deficiencies in the integration of the ICAAP into the management framework.
Interest rate risk in the banking book

High severity findings on IRRBB were mostly related to the measurement and management of risk, in particular insufficient grounding for the modelling of non-maturing deposits and the absence of regular validation of IRRBB models.

Liquidity risk

The majority of findings on liquidity risk concerned risk measurement and stress testing. The most common issues concerned inadequate risk modelling, weaknesses in the estimation of the run-off profile of financial products, errors in the calculation of the liquidity coverage ratio (LCR) and use of stress-testing scenarios which were not commensurate with the institution’s complexity.

Business models and profitability

The most critical findings were related to actual profitability analysis (insufficient analysis of key profitability drivers and business lines, deficiencies in the pricing tools in terms of including all costs and risks) and financial projections analysis (overly optimistic financial forecasts and scenarios, and insufficient analysis and integration of the new regulatory, accounting and competitive landscape in the forward-looking business strategy).

Market risk

The most critical findings covered risk measurement issues, from both an accounting and prudential perspective, especially with regard to fair value estimation. They concerned inadequacy of the asset-levelling framework, resulting in incorrect classification, insufficient fair value reserves and inadequate additional valuation adjustments.

1.7 Targeted review of internal models (TRIM)

TRIM is a multi-year project conducted in close cooperation with the NCAs. It started in 2017 following analytical work performed in 2016 and aims to reduce unwarranted variability in institutions’ RWA and to assess the adequacy and appropriateness of internal models. In general, it contributes to ensuring a level playing field, as it fosters consistent supervisory practices that focus on the correct and consistent implementation of regulatory requirements for internal models. It thus complements the measures set out under Basel III.

TRIM is the largest project that ECB Banking Supervision has launched so far. It constitutes a landmark initiative with regard to its quest for harmonisation in the field
of internal model supervision. In 2018, midway through the execution phase, TRIM had already yielded significant results on the path towards meeting its objectives.

First and foremost, TRIM has defined and established harmonised practices for supervising internal models used by SIs. This is a key prerequisite for ensuring a level playing field within the SSM. TRIM has forged a common understanding among NCAs of European regulations on internal models, as reflected in the ECB guide to internal models and in the common methodological framework to be applied to TRIM on-site investigations. This will benefit the SSM’s supervision of internal models well beyond the limited timeline of the project.

In this spirit, the ECB guide to internal models will be maintained as a living document to be amended and updated over time. In 2018 an important milestone was reached with the publication of a revised version, following two public consultations. The revised version also incorporates feedback from institutions within the scope of the TRIM exercise, experience gained during the TRIM on-site investigations and ongoing regulatory developments.

With a view to harmonising supervisory practices, a second important achievement of the TRIM project is the transparency it provides on typical shortcomings observed in SIs’ internal models. Since the on-site phase of TRIM has already been concluded for 60% of the approximate 200 investigations to be conducted over the period 2017-19, it was possible to conduct horizontal analyses and peer comparisons in a systematic manner, which provided an overview of the most material or common deficiencies identified across the inspected institutions. This ensured the consistency of the supervisory assessments across investigations.

In fact, the supervisory decisions resulting from TRIM on-site investigations are a third key achievement of the TRIM project, as they help to enforce improvements to models and remedy the shortcomings identified. This is ensured through a systematic and consistent use of supervisory measures to compensate for potential underestimations of risk. With this dedicated follow-up, TRIM contributes to reducing unwarranted variability of RWA in banks’ internal models.

To achieve these results, TRIM requires a substantial deployment of supervisory resources. To avoid disrupting institutions’ normal model maintenance, material model changes and initial model approvals have also continued to be assessed on-site, in addition to TRIM investigations and sometimes alongside them. In the course of 2018, on top of the 59 on-site investigations launched as part of TRIM, 85 investigations on internal models were launched at SIs (of which 55 were performed

---

14 The revised version of the General topics chapter of the ECB guide to internal models was published on 15 November 2018, following a public consultation conducted between March and May 2018. The remaining chapters (covering credit, market and counterparty credit risk) are currently being updated, following a public consultation conducted between September and November 2018, and are due to be published in the first half of 2019.

15 An interim update of this overview has been shared with the institutions to provide them with a broader framework in which to view the first TRIM-related decisions that they received.
on-site)\textsuperscript{16}. Altogether, a total of 121 supervisory decisions on internal model investigations\textsuperscript{17} were issued in 2018.

The work conducted as part of the TRIM project, as well as the regular supervisory review of material model changes or requests for initial model approvals, will continue in 2019. In particular, the on-site phase of TRIM should be concluded in the second half of 2019, with a view to completing the TRIM project in the first few months of 2020.

1.8 Indirect supervision of less significant institutions

The SSM Regulation\textsuperscript{18} gives the ECB the mandate to ensure the effective and consistent functioning of the SSM and thus entrusts it with an oversight function with regard to less significant institutions (LSIs), while the NCAs retain the primary responsibility for supervising these institutions. The overarching objective of this oversight function is to ensure that high supervisory standards are applied consistently across the entire euro area. To that end, ECB Banking Supervision is cooperating closely with the NCAs on developing an operational framework for the oversight of LSI supervision.

Joint supervisory standards (JSS) and policies

Over the years, the ECB and the NCAs have worked together on defining JSS for LSI supervision. These remain a key tool for promoting supervisory practices that ensure consistent and high-quality supervision of LSIs.

Throughout the year existing JSS were fine-tuned\textsuperscript{19}, while new ones were finalised. In addition, initiatives were undertaken to exchange best practices and promote the consistent implementation of standards in focus areas. In particular, several workshops with NCAs were held, with a view to identifying NCAs’ best practices in supervising LSIs’ internal governance, their experience with applying the new EBA Guidelines on communication between competent authorities supervising credit institutions and the statutory auditor(s) and the audit firm(s) carrying out the statutory audit of credit institutions\textsuperscript{20} and their experience with crisis management. With regard to crisis management, three new JSS were finalised.\textsuperscript{21}

\textsuperscript{16} Excluding cancellations of on-site investigations.
\textsuperscript{17} Excluding follow-up decisions on ancillary provisions.
\textsuperscript{19} Specific amendments related to reporting deadlines for NCAs were incorporated into the JSS on supervisory planning.
\textsuperscript{20} These guidelines have been applicable since 31 March 2017.
\textsuperscript{21} For more details, see Section 2.5.
After a public consultation in autumn 2017, the final version of the Guide to assessments of fintech credit institution licence applications was published in March 2018. Where relevant, it is now being applied in the assessment of new licensing cases. Work on the implications of financial technologies for banking supervision has advanced further.

In order to ensure an effective implementation of the JSS on car financing institutions (CFIs), initiatives for sharing information and promoting peer comparisons were undertaken in closer cooperation between CFI supervisors from both the ECB and NCAs. Moreover, the dialogue with the industry continued by means of workshops. In 2018 it focused on recovery planning, digitalisation and other structural trends, which affect the automotive industry and are likely to impact CFIs over time.

The thematic review on IFRS 9 continued in 2018 in close collaboration with the NCAs, with a view to ensuring that banks across the euro area implement IFRS 9 consistently. Among other things, several initiatives were launched to support supervisors in assessing LSIs’ level of preparation for IFRS 9.

Following the completion of the IMF’s euro area Financial Sector Assessment Program (FSAP)\(^22\), which focused on SIs, ECB Banking Supervision actively contributed to the assessment of LSI supervision for the national FSAPs of some euro area countries\(^23\). This contribution focused on the ECB’s oversight function with regard to LSI supervision, explaining the ECB’s role and its cooperation with the NCAs.

**SREP methodology for LSIs**

2018 marked the first year in which the NCAs applied a common, harmonised methodology for conducting the SREP for LSIs. In January 2018 the Supervisory Board approved the first version of the SREP methodology for LSIs, which had been developed jointly by NCA and ECB staff since 2015. The implementation is following a staggered timeline, allowing for a smooth transition from national methodologies to the common one over a period of three years: NCAs agreed to apply the common SREP methodology at least to the high-priority LSIs in 2018 and to roll it out to all LSIs by 2020.

The methodology is based on the SREP guidelines developed by the EBA and builds on the ECB’s approach to SIs and on existing national methodologies. The SREP methodology is flexible and proportionate. In this way, it gives NCAs the possibility to adjust the intensity and frequency of supervisory activities according to the banks’ riskiness and their potential impact on the financial system. This proportionate approach comprises varying frequencies and levels of granularity when assessing a bank’s risk levels and risk controls, or when reviewing how a bank assesses its internal capital and liquidity needs under both normal and stressed conditions. The

\(^{22}\) For more details, see Section 4.1.5.

\(^{23}\) FSAPs were launched for Malta, France and Italy.
NCAs are allowed flexibility in order to take into account national specificities (e.g. accounting standards, regulations) and to carry out the SREP decision-making process. The SREP methodology for LSIs is updated on a regular basis. Therefore, it will continue to evolve in the future.

In order to increase market transparency and convey supervisory expectations to the banks, the ECB has published a summary of the LSI SREP methodology on its banking supervision website. The summary focuses on the general aspects of the methodology and on those aspects that are particularly relevant for LSIs, such as proportionality. The ECB also held meetings with European banking associations to exchange views on the LSI SREP methodology.

Cooperation on individual LSIs

Effective cooperation between the ECB and the NCAs is essential to ensure consistent and high-quality supervision of LSIs. Throughout 2018 cooperation between the ECB and the NCAs was enhanced in three main areas: (i) senior and technical collaboration, (ii) LSI oversight, and (iii) sectoral and thematic analyses.

Senior and technical collaboration: There is a programme for regular exchanges (including meetings and calls) between senior representatives from the ECB and the NCAs. Cooperation has also been fostered at the technical level on individual LSI and supervisory practices. In this area, the ECB’s Country Desks\(^\text{24}\) have played a key role in promoting information-sharing and best supervisory practices across NCAs.

LSI oversight: In line with the approach taken in previous years and with the principle of proportionality, LSIs have been monitored on the basis of a prioritisation framework\(^\text{25}\). Cooperation between the ECB and NCAs has focused on the regular monitoring of high-priority LSIs and on LSIs with specific supervisory issues, in particular institutions that have deteriorated financially. In cases where authorisation decisions (e.g. licensing or approval of the acquisition of qualifying holdings) contained ancillary provisions\(^\text{26}\) which required a supervisory follow-up, the ECB and the relevant NCA also cooperated to ensure the implementation of such provisions. In addition, 2018 was the first year in which the notification guidance\(^\text{27}\) was fully implemented. The ECB’s views on the notifications were issued within the overall context of ongoing cooperation between the ECB and NCAs, in particular regarding

---

\(\text{24}\) Country Desks are the ECB’s organisational units responsible for regular and ongoing cooperation with NCAs.

\(\text{25}\) This framework, jointly developed and regularly updated by the ECB and the NCAs, classifies LSIs into high, medium and low priority, based on their intrinsic riskiness and their potential impact on the relevant domestic financial system. The level and intensity of supervisory and oversight activities are then aligned with the priority level assigned to the institution.

\(\text{26}\) Ancillary provisions can be attached to ECB authorisation decisions in order to address specific supervisory concerns identified as part of the assessment. Such provisions can be of a binding or non-binding nature and addressed either to the institution, one of its authorised qualifying shareholders or the NCA in charge of its direct supervision in the case of an LSI.

\(\text{27}\) The guidance for NCAs on notification requirements regarding LSIs specifies the requirements and procedural aspects for regular and ad-hoc notifications from NCAs to the ECB in relation to LSIs.
the exchange of information on individual LSIs and on the supervisory approach taken by the relevant NCAs.

**Sectoral and thematic analyses:** High-quality LSI supervision oversight has also been enhanced through the implementation of sectoral and thematic analyses. Given how important cooperative sectors are in some countries, the ECB and the relevant NCAs have jointly reviewed these sectors in two countries over the past two years. A Cooperation Group (composed of participants from both the ECB and the relevant NCAs) was established to monitor the reform of the cooperative sector in one country, with the aim of promoting a consistent implementation. With regard to institutional protection schemes (IPS), the annual monitoring of “hybrid” IPS\(^{28}\) in relevant countries was performed for the third time. Support was provided to NCAs in countries where banks were applying (or considering applying) for the recognition of an IPS. In addition, in order to compare approaches across different NCAs in relation to SREP requirements, and to achieve consistency of supervisory outcomes, a benchmarking analysis of Pillar 2 requirements on high-priority LSIs was performed in 2018. Finally, in relation to financial market infrastructures (FMIs), the ECB and relevant NCAs launched the yearly sectoral analysis of FMIs with a banking licence.

### 1.9 Macroprudential tasks

With regard to macroprudential policy in the euro area, the ECB continued to engage actively with the national authorities in 2018, in accordance with the tasks conferred on it under Article 5 of the SSM Regulation. Within this defined frame of macroprudential policy, the ECB may apply: (i) higher requirements for relevant capital buffers than those applied by the national authorities, and (ii) more stringent measures aimed at addressing systemic or macroprudential risks. The Macroprudential Forum serves as a platform for Governing Council and Supervisory Board members to bring together microprudential and macroprudential perspectives from across the SSM.\(^{29}\) This ensures that microprudential and macroprudential actions complement each other effectively.

In 2018 the ECB received over 100 macroprudential policy notifications from national authorities. Most notifications concerned quarterly decisions on setting countercyclical capital buffers (CCyB) and decisions on the identification and capital treatment of global systemically important institutions (G-SIs) and/or other systemically important institutions (O-SIs). It also received notifications on other measures, for example those introduced under Article 458 of the CRR, the systemic risk buffers and those regarding the reciprocation of macroprudential measures taken in other Member States.

---

28 Covering both SIs and LSIs.
29 For further details, see [ECB Annual Report on supervisory activities 2015](#).
Following the BCBS methodology, the ECB and national authorities identified eight G-SIIs\(^{30}\) that are required to hold additional capital buffers ranging from 1.0% to 2.0% in 2020. The ECB also received notifications on the capital buffer rates for 107 O-SIIs. These rates were in line with the floor methodology for setting the O-SII capital buffers which the ECB has followed since 2016.\(^{31}\) This methodology is currently under revision.

The ECB was also involved in the work conducted by the ESRB, which is responsible for the macroprudential oversight of the financial system in the EU. JSTs use information from the ESRB, along with other macroprudential analyses produced by the ECB, to ensure that all relevant risks are considered. Likewise, the ESRB and other macroprudential authorities use input provided by the JSTs to make sure that information on individual institutions feeds into system-wide risk analysis and to identify possible mitigation measures.

\(^{30}\) The identified G-SIIs are BNP Paribas (FR), Groupe Crédit Agricole (FR), Deutsche Bank (DE), ING Bank (NL), Banco Santander (ES), Société Générale (FR), UniCredit Group (IT) and Groupe BPCE (FR).

\(^{31}\) For further details, see ECB Macroprudential Bulletin, Issue 3, June 2017.
2 Contribution to the EU crisis management and resolution framework

2.1 Crisis cases in 2018

2.1.1 ABLV Bank determined failing or likely to fail

Under the EU crisis management framework, the ECB can determine that a bank is failing or likely to fail (FOLT) after consulting the SRB. On 23 February 2018 ECB Banking Supervision determined that the Latvian SI ABLV Bank AS was FOLT in accordance with Article 18(4)(c) of the Single Resolution Mechanism Regulation (SRMR) as it was likely to be, in the near future, unable to pay its debts or other liabilities as they fell due. The ECB also determined that ABLV Bank’s Luxembourg subsidiary, ABLV Bank, S.A., was FOLT.

Lead-up to the FOLT determination

On 13 February 2018 the US Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) proposed a measure naming ABLV Bank an “institution of primary money laundering concern” under Section 311 of the USA PATRIOT Act. The ensuing abrupt withdrawal of deposits and loss of access to US dollar funding meant that the bank was no longer able to make payments in US dollars. On 19 February 2018 the Latvian Financial and Capital Market Commission (FCMC) imposed a moratorium on ABLV Bank AS, following an instruction by ECB Banking Supervision. The moratorium imposed a prohibition of all payments by ABLV Bank AS on its financial liabilities. A moratorium was deemed necessary in order to give the bank time to address its liquidity situation. On the same day, a suspension of payments on ABLV Bank, S.A., was imposed in Luxembourg.

ABLV Bank AS and its subsidiary ABLV Bank, S.A. did not have sufficient funds available to withstand the outflows of deposits that would have been likely to occur if the moratorium had been lifted. The Supervisory Board therefore decided to start the FOLT process and initiated a formal consultation with the SRB on 22 February 2018. Subsequently, the Supervisory Board and the ECB’s Governing Council adopted the FOLT assessments for ABLV Bank AS and ABLV Bank, S.A.. On 23 February the FOLT assessments were sent to both the SRB and the European Commission, in accordance with Article 18 of the SRMR. ECB Banking Supervision

---

32 The SRB can also make this determination, but only after informing the ECB about its intention and only if the ECB does not make such an assessment itself within three calendar days of having been informed by the SRB.

33 Under Article 113(1) point 4 of the Latvian Credit Institution Law.
also notified all the relevant authorities of its decisions in line with Article 81 of the BRRD and CRD IV.

Cooperation and information exchange with the SRB

ECB Banking Supervision informed the SRB as soon as it became aware of the draft FinCEN measure. The deteriorating liquidity situation of the banks was discussed in detail with SRB representatives at crisis management meetings held by the ECB. The SRB was also invited to participate as an observer in the relevant meetings of the ECB’s Supervisory Board. In addition, an ECB representative participated in all the SRB executive sessions related to the case, including the meeting at which the SRB decided not to take resolution action.

Actions following the FOLTF assessment

On 24 February 2018 the SRB decided not to take resolution action in the cases of ABLV Bank AS and ABLV Bank, S.A.. It concluded that, while the conditions for resolution listed in Article 18(1)(a) and (b) of the SRMR had been met, the condition in Article 18(1)(c) relating to public interest had not. In parallel, the FCMC and the Luxembourg Commission de Surveillance du Secteur Financier (CSSF), in their role as designated authorities under Directive 2014/49/EU, determined that covered deposits of ABLV Bank AS and ABLV Bank, S.A. respectively had become unavailable. ABLV Bank AS subsequently applied for voluntary self-liquidation under the Latvian Credit Institution Law. ECB Banking Supervision withdrew the licence of ABLV Bank AS in July 2018 upon a proposal by the FCMC, which continues to supervise the self-liquidation process. In the case of ABLV Bank, S.A., the competent court in Luxembourg decided that the conditions for starting national insolvency proceedings had not been met. It consequently placed the bank under a suspension of payments regime under national law and appointed two external administrators to control the management of the bank’s assets.

Key lessons learned

The ABLV case highlighted a potential misalignment between the EU crisis management framework and national insolvency laws. Under the BRRD/SRMR, not only actual illiquidity, but also likely illiquidity in the near future, is sufficient reason for determining that a bank is FOLT. By contrast, insolvency laws typically require actual illiquidity to occur before insolvency proceedings can commence on liquidity grounds. For this reason, ECB Banking Supervision has encouraged and supported an amendment to the EU legal framework in order to ensure that national liquidation

---


35 Under Article 2(1) (8a) of the Directive, deposits are unavailable if the relevant administrative authorities have determined that, in their view, the credit institution concerned appears to be unable for the time being, for reasons which are directly related to its financial circumstances, to repay the deposit and the institution has no current prospect of being able to do so.

procedures are automatically triggered when a bank is declared FOLTFT and the SRB decides that the public interest criterion for starting a resolution action has not been met.

Regarding anti-money laundering (AML) issues, it is important to note that enforcing national AML legislation is a competence of the relevant national authorities. Nevertheless, within the limits of its competence and in the light of the information available, the SSM takes money laundering issues into consideration. It does so, for instance, through the SREP assessment, as serious breaches of requirements on AML and on combating the financing of terrorism (CFT) can ultimately pose a risk for a bank’s viability. In this regard, the exchange of information between the relevant authorities plays a key role (see Box 2).

### 2.1.2 Communication on FOLTFT cases

Communication is an essential component in managing a crisis. Showing that the responsible authorities are addressing a crisis can assuage market reactions and therefore reduce contagion risks. When a bank is failing or likely to fail, it is crucial not only to find a solution to the crisis, but also to effectively communicate this solution to the public.

Coordination among the various stakeholders is essential in order to send a clear and comprehensive message to the public.

In the case of ABLV Bank, the ECB, the SRB and the FCMC collaborated closely on their communication activities. Initially, on Sunday, 18 February 2018 ECB Banking Supervision announced that a moratorium had been imposed.\(^{37}\) Six days later, on Saturday, 24 February, following the ECB’s decision that ABLV Bank AS and ABLV Bank, S.A. were FOLTFT, the SRB announced its decision that resolution was not in the public interest.\(^{38}\) This was closely followed by coordinated announcements by ECB Banking Supervision\(^{39}\) and the FCMC concerning the ECB’s FOLTFT determination. The FCMC and the CSSF also published notices on their respective decisions determining the unavailability of deposits.\(^{40}\)

Following the FOLTFT determination, the ECB received questions from a Member of the European Parliament and from the President of the German Bundestag on issues related to the ABLV Bank case. The ECB answered these questions in line with:

---

\(^{37}\) "ECB instructs national supervisor to impose moratorium on ABLV Bank", ECB press release, 19 February 2018.


\(^{39}\) "ECB determined ABLV Bank was failing or likely to fail", ECB press release, 24 February 2018.

with the relevant confidentiality rules and published the answers on its banking supervision website. 41

Publication of non-confidential FOLT assessments

The FOLT assessments are subject to the professional secrecy obligations and confidentiality rules that apply to all the decisions taken by the ECB in its role as supervisor.

For the purpose of transparency and accountability, and given the general public interest, the ECB has published non-confidential versions of the two FOLT assessments for ABLV Bank AS and ABLV Bank, S.A. on its banking supervision website, in line with its approach in previous cases. In order to comply with professional secrecy obligations, confidential information was not disclosed. ECB Banking Supervision published these assessments shortly after the SRB had published the non-confidential versions of its resolution decisions. The publication of non-confidential FOLT assessments is an exception to the general communications policy of the ECB, which, in line with legal requirements, does not provide for the publication of individual supervisory decisions or assessments that are protected by professional secrecy rules.

Box 2
The ECB’s role in fighting money laundering

When creating the SSM framework, EU legislators chose to keep the responsibility for combating money laundering and countering terrorism financing at the national level. National anti-money laundering authorities are also responsible for investigating any breaches of AML regulations by credit institutions.

However, it is important for the ECB to consider the outcomes of AML/CFT supervision when performing its supervisory tasks under Article 127(6) of the Treaty on the Functioning of the European Union and the SSM Regulation 42. In particular, risks of money laundering or terrorism financing are relevant for the ECB’s prudential supervision with a view to assessing acquisitions of qualifying holdings in supervised entities (including the process of granting authorisations to credit institutions), for fit and proper assessments of existing or prospective managers of supervised entities and for day-to-day supervision. Serious AML/CFT breaches are signs of weak governance and weak internal controls. They can harm a credit institution’s reputation and can also lead to the imposition of significant administrative or criminal sanctions on supervised entities or their staff. Thus, they pose a risk for the viability of supervised entities. In recent months, several initiatives have been taken at the European level to elaborate proposals on strengthening the cooperation


between AML authorities and prudential supervisors and on more effectively integrating AML considerations into prudential supervision.

The fifth AML Directive\(^{43}\), specifically Article 57a(2), introduced two important new elements with regard to the ECB’s role in AML. First, by amending Article 56 of the CRD IV, it allowed for the ECB to exchange confidential information with national AML supervisors. Second, it obliged the ECB to conclude, with the support of the European Supervisory Authorities (ESAs), an agreement on practical ways of facilitating a smoother exchange of information with all competent AML authorities supervising credit and financial institutions. The ECB worked towards such an agreement with the help of the ESAs’ Joint AML Committee under the coordination of the EBA. This agreement was signed by the ECB on 10 January 2019.

The enhanced exchange of information between the ECB and EU AML supervisors is expected to favourably influence the conduct of both AML and prudential supervision at the EU level. As a banking supervisor, the ECB is not responsible for direct AML supervision, but will benefit from the sharing of relevant information by national AML authorities.

With due regard to the allocation of AML responsibilities within the current legal framework, ECB Banking Supervision is creating an AML coordination function, which is intended to fulfil three main roles. First, it will act as a single point of entry for the direct exchange of AML information between the ECB as a prudential supervisor and national AML authorities. Second, it will set up and chair an AML network among the JSTs of banks whose business model is prone to money laundering risks. The aim of this network will be to more strongly integrate AML considerations into prudential supervision. Third, it will act as a centre of expertise on SSM-relevant AML/CFT issues. On this basis, the new AML coordination function will help to develop ECB positions on AML policy. The new function will cooperate with the ECB AML/CFT Task Force, which brings together all the relevant ECB business areas.

2.2 The ECB’s crisis management framework

The ECB established a crisis management framework, the SSM Emergency Action Plan, to initiate timely and effective responses to a crisis, through an adequate flow of information and sound decision-making. It covers three stages of escalation depending on the specific situation of the relevant credit institution, namely: (i) enhanced monitoring of an institution, (ii) preparation for early intervention, and (iii) preparation for a potential FOLTIF assessment. The framework enables the ECB to take tailored actions to address an institution’s deteriorating financial condition, following a three-stage escalation process (see below).

Over the course of 2018, the ECB crisis management framework was further improved, following up on recommendations made by the European Court of

Auditors (ECA). The escalation procedures within the framework were refined with an extended set of qualitative and quantitative indicators to define the transition from one stage to the other. The indicators are in line with EBA guidelines for early intervention and FOTLF, and thus relate to capital and liquidity, as well as to significant events. For quantitative indicators, clear thresholds have been defined for determining a potential deterioration in a credit institution’s financial condition. These indicators are monitored centrally by the ECB’s Crisis Management Division. Institution-specific indicators and thresholds, such as those defined in each bank’s recovery plan, are considered in the framework. Irrespective of the indicators, escalation can also be based on expert judgement by the JSTs and the ECB’s Crisis Management Division.

The three-stage escalation process

At each of the three stages of the escalation process, specific actions are undertaken to ensure an appropriate reaction to the situation. In particular, the liquidity situation of institutions is carefully monitored, e.g. by frequently assessing the counterbalancing capacity and liquidity flows. To ensure that institutions are prepared for potential crises, the ECB conducted a liquidity “dry run” in September 2018 (as in previous years), i.e. a data submission exercise using a specific liquidity monitoring template. Within ECB Banking Supervision, the Crisis Management Division produces regular reports for senior management, Supervisory Board members and the SRB on the institutions covered by the crisis management framework.

The first stage (enhanced monitoring) is initiated if the financial situation of a credit institution deteriorates. The JST responds by determining the appropriate supervisory action and steps up its monitoring of the institution (e.g. by conducting further in-depth analyses, mandating on-site inspections and/or intensifying liquidity monitoring). At the same time, cooperation and information exchange between the JST and the Crisis Management Division, as well as between the ECB, NCA and SRB, is stepped up. The liquidity monitoring template is used to gather a minimum set of liquidity information where appropriate.

If the financial situation continues to deteriorate, the need to produce an early intervention assessment (as per Article 27 of the BRRD) has to be considered (second stage). The JST and the Crisis Management Division work closely together in order to assess the situation and propose measures in accordance with the applicable national transpositions of Articles 27, 28 or 29 of the BRRD. If the relevant institution has a presence in non-euro area Member States or in third countries, supervisory colleges ensure that relevant supervisors can interact. The Crisis Management Division will also inform the ECB monetary policy function in compliance with the principle of separation and in accordance with the Executive Board decision on information exchange between the monetary policy and supervision functions of the ECB.
If the financial situation deteriorates further (third stage), an institution-specific crisis management team is set up to ensure full alignment of supervisors, resolution authorities and central bank functions in a crisis situation. This team comprises senior managers from the ECB, Supervisory Board members of relevant NCAs, the Chair of the SRB and other ad hoc members. It serves as a central coordination body for the necessary supervisory actions, contingency planning and monitoring of the progress, effectiveness and efficiency of crisis management. This may include preparing for FOLTFT assessments as part of ongoing contingency planning. Any FOLTFT determination is notified to the SRB and, without undue delay, to the relevant competent host and resolution authorities, to competent ministries, central banks and deposit guarantee scheme(s), in accordance with the legal framework.

In the event of a systemic crisis, a high-level monitoring group can be established for monitoring and identifying potential liquidity and solvency-related difficulties that may arise simultaneously for both SIs and LSIs.

At all stages of the Emergency Action Plan as a crisis management framework, the ECB cooperates with the SRB, subject to the applicable laws and interinstitutional arrangements, such as the Memorandum of Understanding (MoU) between the ECB and the SRB. The Crisis Management Division in cooperation with the JST, for instance, informs the SRB of the material deterioration in the financial condition of the respective supervised entity/group, and exchanges views and knowledge with the SRB. Additionally, the SRB has direct access to the relevant bank-specific data in the ECB’s IT systems.

If a credit institution is declared FOLTFT, ECB Banking Supervision’s crisis management team coordinates the exchange of information between the SSM and the SRB/national resolution authorities (NRAs), and the preparation of any necessary follow-up actions, e.g. the authorisation of a bridge bank and the withdrawal of the residual institution’s licence. The main decision-makers in the event of resolution (following the FOLTFT determination) are the resolution authorities, i.e. the SRB and the NRAs. The ECB then acts in an advisory capacity.

2.3 Interaction with the Single Resolution Board

In 2018, as in previous years, ECB Banking Supervision and the SRB continued to cooperate closely on all levels. An ECB representative participated in the meetings of the SRB’s Executive and Plenary Sessions throughout 2018. Furthermore, the ECB’s Supervisory Board invited the Chair of the SRB to attend relevant meetings held in 2018 with a view to fostering collaboration and exchanges on topics of mutual interest. ECB Banking Supervision and the SRB also worked closely together in policy areas relevant to supervision and resolution.

Excellent and enhanced cooperation took place at a technical level within the respective committees and across the relevant horizontal functions at ECB Banking Supervision and the SRB. JSTs and Internal Resolution Teams (IRTs) responsible for individual credit institutions deepened their cooperation on various topics relating to
recovery and resolution planning. In line with the MoU, JSTs and IRTs also improved their exchange of relevant bank-specific data. In addition, they conducted joint workshops and meetings with SIs, where relevant.

In line with the legal framework, ECB Banking Supervision consulted the SRB on the recovery plans submitted by SIs for which the ECB is the consolidating supervisor. ECB Banking Supervision subsequently took the SRB’s feedback into account when assessing the recovery plans and preparing its own feedback to banks.

Also in 2018, ECB Banking Supervision was consulted on the SRB’s resolution plans, including minimum requirements of own funds and eligible liabilities (MREL) and resolvability assessments for SIs. ECB Banking Supervision assessed the resolution plans and provided feedback to the SRB from a supervisory perspective. ECB Banking Supervision focused mainly on how the resolution plans (including the MREL and resolvability assessments) might impact on SIs from a going-concern perspective, on the one hand, and on its own supervisory approach on the other hand.

As in previous years, the SRB also consulted ECB Banking Supervision on the calculation of the ex ante contributions to the Single Resolution Fund. ECB Banking Supervision reviewed the calculation to assess any potential impact on SIs from a going-concern perspective.

In 2018 ECB Banking Supervision and the SRB finalised the review of their bilateral MoU, which was first concluded in 2015 and sets out how the SRB and ECB Banking Supervision should cooperate and exchange information in accordance with the SRM Regulation. The ECB and the SRB began their review of the functioning and effectiveness of the cooperation and information exchange under the MoU in 2017. They looked back at the experience gained in the first two years of the MoU’s implementation and addressed the practical challenges encountered. With a view to facilitating enhanced cooperation, they focused mainly on the exchange of information. The SRB and ECB Banking Supervision published the MoU, including the Annex on information exchange, on their respective websites to ensure transparency towards the industry and the public.44

2.4 Work on recovery planning

Banks prepare recovery plans in order to ensure that they are resilient in periods of severe financial stress. When assessing recovery plans, the ECB’s main focus is to ensure that they are operational and can be implemented by institutions in an effective and timely manner. Robust recovery plans are a key element in ensuring the effectiveness of the European crisis management framework.

In 2018 recovery planning work focused on providing a system-wide view, with the aim of helping euro area banks to improve their own recovery plans. Having

---

44 Memorandum of Understanding between the Single Resolution Board and the European Central Bank in respect of cooperation and information exchange.
assessed three cycles of recovery plans, from 2015 to 2017, the ECB shared with the banking industry on 3 July 2018 a report on recovery plans, identifying best practices in five key areas: (i) recovery options, (ii) overall recovery capacity, (iii) recovery indicators, (iv) playbooks (implementation guides for recovery plans) and (v) dry runs (simulation exercises).

While most banks have made progress in recovery planning, there is still room for improvement. This is particularly true in relation to identifying feasible and credible recovery options, and developing an indicator framework covering banks’ most relevant risks and vulnerabilities.

An adequate estimation of overall recovery capacity (ORC) is crucial for supervisors. It enables them to assess whether a bank can recover from a crisis situation by implementing recovery options set out in its recovery plan. It is also useful for resolution authorities as an input to resolution planning and the definition of MREL targets. However, experience from the previous assessment cycles has shown that banks tend to overestimate their ORC. The ECB’s report shows banks how they may present their ORC (e.g. by taking into account mutual exclusivity or interdependencies between options, applicability under different types of stress and operational constraints in the simultaneous deployment of multiple options). Over the next cycles, the ECB will focus on obtaining credible ORC estimates from banks and on encouraging those banks with limited recovery options to build up their recovery capacity.

Another central issue is whether banks can implement their recovery plans in a timely and effective manner in situations of severe stress. The ECB has identified two best practices to help banks achieve this goal: playbooks and dry runs. Playbooks serve as concise implementation guides and enable banks to quickly implement their recovery plans during crises. Dry runs are “live” simulation exercises that help banks to test key parts of their recovery plans, train staff to react in crises and identify areas for improvement.

2.5 Crisis cases involving less significant institutions

Managing the crisis of an LSI requires the relevant NCA and the ECB to intensively exchange information and to coordinate closely – the NCA in its capacity as direct supervisor of the LSI and the ECB in its oversight function and in its capacity as competent authority for decisions on common procedures. The need for intensified cooperation arises when an LSI is close to the point of non-viability. The ECB and the NCA then have to jointly consider liquidation or resolution of the bank and liaise on the withdrawal of the authorisation, the assessment of acquisitions or increases in qualifying holdings and the granting of new authorisations (e.g. for a bridge institution).

Such cooperation in the area of crisis management aims to support the NCAs and the ECB in their respective tasks and ensure that the required information is available when urgent decisions need to be taken rapidly. The information
exchanged, the actions taken and the cooperation between the ECB and the NCAs are proportionate to the risks posed by an LSI, also taking into account private sector solutions already identified by the NCA. Throughout 2018 the cooperation between the NCAs and the ECB in several LSI crisis cases was characterised by a regular, fruitful exchange which enabled decisions to be taken quickly.

In 2018 three Joint Supervisory Standards (JSSs) were finalised and are now operational:

1. JSS on NCAs’ supervisory practices for LSI crisis management and cooperation with resolution authorities: ensures that LSI crisis management practices are applied consistently at the national level.

2. JSS on NCAs’ supervisory procedures for LSIs breaching minimum capital requirements: promotes a joint understanding of the administrative practices used in addressing the financial deterioration of LSIs.

3. JSS on LSIs’ FOLTf determination: promotes a joint understanding of FOLTf determinations for LSIs, focusing on applying proportionality in the expert judgement, to ensure that the intended measure is appropriate and necessary to achieve the objectives pursued by the supervisor.

All three above-mentioned JSSs, together with the JSS on the LSI crisis management cooperation framework in force since 2017, will foster common supervisory approaches within European banking supervision.
3 Authorisations, enforcement and sanctioning procedures

3.1 Authorisations

3.1.1 Developments in the number of significant institutions

The annual assessment, in line with the SSM Framework Regulation, of whether a bank or banking group fulfils any of the significance criteria45, was conducted in November 2018. It was supplemented by ad hoc significance assessments that were carried out following changes in group structures and other developments in banking groups. In all, 119 institutions46 were classified as significant as of 14 December 2018, the same overall number of SIs as in the previous annual assessment of significance as of 5 December 2017. The changes in the composition of SIs between these dates are set out in detail below.

In 2018 two new institutions were included in the list of SIs owing to Brexit. Barclays Bank Ireland PLC and Bank of America Merrill Lynch International DAC were newly classified as significant and have been directly supervised by the ECB since 1 January 2019. This resulted from a request by the Central Bank of Ireland in view of the anticipated expansion of both banking groups’ activities in the euro area.

As the result of the annual significance assessment, Permanent tsb Group Holdings plc was reclassified to less significant after not meeting any of the significance criteria for three consecutive calendar years. The Central Bank of Ireland started to supervise the bank on 1 January 2019.

Changes in the list of ECB supervised banks during the year result from group reorganisations, mergers and acquisitions, new authorisations and licence withdrawals.

In 2018 five banks were removed from the list of ECB supervised banks:

- Banco Mare Nostrum, S.A. merged into Bankia, S.A.;
- Nordea Bank AB (publ), Suomen sivuliike, a Finnish branch of Nordea, ceased to exist as a separate entity after its parent Nordea Bank AB (publ) merged into Nordea Bank Abp;
- Danske Bank Plc, a Finnish subsidiary of Danske Bank A/S, transferred its business to its parent and ceased to exist;

---

45 These criteria are set out in Article 6(4) of the SSM Regulation.
46 The list of significant and less significant institutions published in December 2018 reflects (i) the significance decisions notified to the supervised institutions before 14 December 2018 and (ii) other changes and developments in group structures effective before 1 November 2018.
VTB Bank (Austria) AG ceased to exist after its business was transferred to VTB Bank (Europe) S.E. in Germany which is supervised as a less significant institution;

the licence of Cyprus Cooperative Bank Ltd was withdrawn by the ECB.

Another four banks were newly included under the direct supervision of the ECB:

the creation of Luminor group added Luminor Bank AS in Estonia and Luminor Bank AS in Latvia to the list of SIs;

Banque Internationale à Luxembourg S.A. moved under the ECB’s direct supervision after its split from Precision Capital S.A.;

Nordea Bank Abp in Finland was classified as significant as it was granted a new licence in Finland after relocating its headquarters there from Sweden.

The branch of HSBC Bank Plc in the Netherlands remains classified as less significant. Although it met the significance criterion of size, particular circumstances related to HSBC group’s reorganisation prevented its classification as an SI.

The list of supervised entities is updated throughout the year. The most recent version of the list can be found on the ECB’s banking supervision website.

### Table 4
Significant and less significant banking groups or stand-alone banks in the SSM following the 2018 annual assessment

<table>
<thead>
<tr>
<th></th>
<th>Total assets (EUR billions)</th>
<th>Number of entities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>at consolidated level</td>
<td>at individual level</td>
</tr>
<tr>
<td>Significant institutions</td>
<td>21,399.7</td>
<td>119</td>
</tr>
<tr>
<td>Less significant institutions</td>
<td>4,919.7</td>
<td>2,719</td>
</tr>
<tr>
<td>Total</td>
<td>26,319.4</td>
<td>2,838</td>
</tr>
</tbody>
</table>

Source: ECB.

Notes: Total assets of entities included in the list of supervised entities as published in December 2018 (with reference date for the group structures of 1 November 2018 and for significance decisions of 14 December 2018); reference date of total assets is 31 December 2017 (or the latest available).

### Comprehensive assessment 2018

In 2018 the ECB published an updated version of the asset quality review methodology applied in its comprehensive assessments. The update was carried out in order to reflect changes to accounting rules (introduction of IFRS 9) and to better capture the risk profiles of banks with business models focusing on investment services (particularly relevant for banks relocating to SSM countries as a consequence of Brexit).

47 Article 70 of the SSM Framework Regulation.
Furthermore, a comprehensive assessment of the Nordea Group was initiated in the second half of 2018 following the bank’s decision to relocate its headquarters and parent company from Sweden to Finland, resulting in its inclusion in the scope of European banking supervision. The exercise is expected to be concluded in the second quarter of 2019.

### 3.1.2 Authorisation procedures

#### Number of procedures

In 2018 NCAs notified a total of 2,696 authorisation procedures to ECB Banking Supervision. These notifications comprised 43 licence applications, 26 licence withdrawals, 82 lapsing of authorisation\(^{48}\), 100 acquisitions of qualifying holdings, 419 passporting procedures and 2,026 fit and proper procedures (individual assessments for management and supervisory board members, key function holders and third-country branch managers\(^{49}\)).

<table>
<thead>
<tr>
<th>Table 5</th>
<th>Authorisation procedures notified to the ECB</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Common procedures (SIs and LSIs)</td>
</tr>
<tr>
<td></td>
<td>Licensing</td>
</tr>
<tr>
<td>2015</td>
<td>37</td>
</tr>
<tr>
<td>2016</td>
<td>24</td>
</tr>
<tr>
<td>2017</td>
<td>24</td>
</tr>
<tr>
<td>2018</td>
<td>43</td>
</tr>
</tbody>
</table>

Source: ECB.

In 2018 2,013 authorisation procedures were completed. This number corresponds to 1,168 decisions,\(^{50}\) 526 of which were approved by the Supervisory Board and the Governing Council and 642 by senior management within the framework for delegation\(^{51}\). These 1,168 authorisation decisions account for approximately 61% of all ECB individual supervisory decisions.

---

\(^{48}\) Lapsing of an authorisation means that, where national law so provides, the authorisation ceases to exist without requiring a formal decision to that effect; it is a legal effect that takes place as soon as a specific, well-defined trigger occurs, e.g. the express renouncement of a licence by the entity or the fact that the institution itself ceases to exist, for instance owing to a merger with another company.

\(^{49}\) A very limited number (15) of requests for additional directorships is also included.

\(^{50}\) Some decisions cover more than one authorisation procedure (e.g. fit and proper assessments of several board members of the same SI or acquisitions of qualifying holdings in different subsidiaries resulting from a single transaction). Some authorisation procedures do not require a formal ECB decision, mostly comprising passporting and lapsing procedures.

\(^{51}\) These procedures refer to the assessment of management and supervisory board members, which are subject to the delegation framework approved in the Decision (EU) 2017/935 of the European Central Bank of 16 November 2016 on delegation of the power to adopt fit and proper decisions and the assessment of fit and proper requirements (ECB/2016/42).
Compared with 2017, trends in authorisation procedures diverged: the number of licensing and lapsing procedures increased, while the number of qualifying holdings, withdrawals of licence and passporting procedures decreased. The number of fit and proper procedures has decreased by 10% since 2017.

Developments in common procedures

The majority of licensing procedures (approximately 81%) related to the establishment of new LSIs. As in 2017, the two main drivers of new bank applications were the increasing use of digital innovations to provide services to EU clients (fintech business models), and the planned withdrawal of the United Kingdom from the EU, which led to an increase in requests for banking licences in the euro area. In 2019 these trends are expected to continue: the fintech sector will grow and there will be more Brexit-related restructurings. The remaining 19% of licensing procedures concerned SIs, mainly pertaining to the extension of licences for investment services. One SI procedure concerned the establishment of a new subsidiary in order to move the headquarters of a global systemically important bank to the euro area.

Regarding licensing policies, the ECB published a Guide to assessments of licence applications and a Guide to assessments of fintech credit institution licence applications in March 2018, following public consultations. These guides seek to support common supervisory practices and increase the transparency of policies. Following a separate public consultation in October 2018 on Part 2 of the Guide to assessments of licence applications, a consolidated edition of the two parts was published in January 2019.

Withdrawal procedures usually arise from banks voluntarily terminating their business activity or entering into mergers or other types of restructuring. This pertains, in particular, to licence relinquishments by SIs, which account for around 50% of all withdrawal procedures. However, in a limited number of cases, the withdrawal of an authorisation was driven by an institution’s failure to meet prudential requirements, as determined jointly by the relevant NCA and the ECB, or a failure to comply with national rules on money-laundering prevention.

Two-thirds of qualifying holding procedures concerned LSIs and one-third concerned SIs. In 2018 only limited cross-border banking sector consolidation activities among SIs were observed. Several procedures were related to acquisitions of majority stakes in SIs by private equity investors. The assessment of such transactions requires great scrutiny, given the complex structures of the transactions, the short-term investment horizons and the occasional use of leveraged funding. However, in terms of numbers, the majority of qualifying holding procedures notified to the ECB in 2018 related to internal reorganisations of the shareholding structure of supervised institutions. Such reorganisations mainly seek to simplify the group structure and/or reduce costs, but can also be driven by regulatory arbitrage.

Brexit required significant supervisory effort in 2018 in assessing banks wishing to shift activities from their UK-based entities to the euro area. With a view to
preventing the set-up of empty shells, the ECB engaged continuously with these banks, resulting in important adjustments to their plans. These adjustments concerned, among other things, internal governance, staffing and organisation, business origination, booking and hedging strategy and intragroup arrangements.

Developments in fit and proper assessments

In 2018 the ECB handled fewer fit and proper procedures than in 2017. This may be explained by (i) greater stability of bank boards (less new mandates overall in 2018) and (ii) the lasting impact of changes in French law which ceased to require fit and proper assessments for the reappointment of supervisory board members.

Around two-thirds of fit and proper procedures concerned supervisory board members. The remaining third concerned management board members, key function holders and third-country branch managers. In around one-third of the fit and proper procedures closed in 2018, a more detailed assessment had to be conducted. In many of these cases, the ECB imposed conditions, obligations or recommendations on the SIs to address specific concerns, for example regarding the experience and time commitment of certain board members. Most of these cases concerned supervisory board members.

In May 2018 an update was published to the Guide to fit and proper assessments, aligning it with the EBA and ESMA’s joint Guidelines on the assessment of the suitability of members of the management body and key function holders.

In 2018 the ECB intensified its dialogue with the banks that submit the highest number of fit and proper applications and released an explanatory video on the ECB’s fit and proper assessments. The aim was to further enhance transparency and communication around fit and proper assessments and support banks in submitting complete and accurate applications.

The role of fit and proper assessments in improving banks’ governance was also highlighted in the second banking supervision conference “Governance expectations for banks in a changing financial environment”, held on 22 March 2018.

3.2 Reporting of breaches, enforcement and sanctioning procedures

Enforcement and sanctioning

Under the SSM Regulation and the SSM Framework Regulation, the allocation of enforcement and sanctioning powers between the ECB and the NCAs depends on (i) the nature of the alleged breach, (ii) the person responsible, and (iii) the measure to be adopted (see ECB Annual Report on supervisory activities 2014).
In 2018 the ECB continued to enhance its enforcement and sanctioning processes in order to support a more efficient and consistent approach. At the same time, it used its sanctioning powers more often.

Altogether, the ECB initiated 27 sanctioning proceedings in 2018. Taking into account the 24 proceedings that were ongoing at the end of 2017, the ECB handled 51 sanctioning proceedings in 2018 (see Table 6), an increase of 13% relative to the 45 proceedings handled in 2017. The 51 proceedings in 2018 led to 16 ECB decisions, an increase of 60% on the previous year.

Table 6
ECB enforcement and sanctioning activity in 2018

<table>
<thead>
<tr>
<th>Enforcement and sanctioning proceedings</th>
<th>ECB decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ongoing proceedings at year-end 2017</td>
<td>24 n.a.</td>
</tr>
<tr>
<td>of which finalised with ECB decisions imposing penalties</td>
<td>3 3</td>
</tr>
<tr>
<td>of which finalised with ECB requests addressed to NCAs to open proceedings</td>
<td>26 10</td>
</tr>
<tr>
<td>of which proceedings closed</td>
<td>11 3</td>
</tr>
<tr>
<td>of which ongoing proceedings at year-end 2018</td>
<td>11 n.a.</td>
</tr>
</tbody>
</table>

Source: ECB.
1) Several ECB decisions addressed more than one proceeding.

Of the 51 sanctioning proceedings handled in 2018, 22 were related to suspected breaches of directly applicable EU law (ECB decisions and regulations included) committed by 13 significant institutions. These breaches, in respect of which the ECB is directly competent to impose administrative penalties, occurred in the areas of own funds, capital requirements, reporting, public disclosure and large exposures. In 2018 the ECB adopted three sanction decisions, leading to penalties in an overall amount of €4.8 million. The penalties were imposed on three supervised entities for breaching own funds rules. Eight of the 22 proceedings related to breaches of directly applicable EU law were closed in the course of 2018, owing mainly to the non-materiality of the suspected breaches or the absence of a legal basis for imposing sanctions in the specific cases at hand. Three of these eight proceedings were closed with an ECB decision; it was decided not to pursue the other five any further before the hearing phase. Another 11 proceedings were still ongoing at the end of the year.

The remaining 29 out of the 51 sanctioning proceedings handled in 2018, in respect of which the ECB had no direct sanctioning powers and could only request the NCAs to open proceedings, were related to (i) suspected breaches of national law transposing CRD IV provisions by significant institutions or natural persons, and (ii) suspected breaches of directly applicable EU law by natural persons. These proceedings were mostly related to suspected breaches of governance requirements. In 2018 the ECB addressed ten requests to NCAs to open sanctioning proceedings within the remit of their national competences. Three of the 29 proceedings were closed in 2018. Following the ECB’s requests, and having...
assessed the cases in accordance with their national law, in 2018 the NCAs imposed penalties in an overall amount of €1.33 million.

A complete breakdown by area of infringement of the suspected breaches subject to the enforcement and sanctioning proceedings handled in 2018 by the ECB is displayed in Chart 10.

**Chart 10**

Suspected breaches subject to the enforcement and sanctioning proceedings mostly relate to governance requirements

![Bar chart showing the distribution of suspected breaches by category.](image)

Source: ECB.

If the ECB has reason to suspect that a criminal offence may have been committed, it requests the relevant NCA to refer the matter to the appropriate authorities for investigation and possible criminal prosecution, in accordance with national law. In 2018 one such request was submitted to the relevant NCA.

**Experience with reporting on breaches under Article 23 of the SSM Regulation**

The ECB has a duty to ensure that effective mechanisms are put in place to enable any person to report breaches of relevant EU law (a process commonly referred to as “whistle-blowing”). Accordingly, the ECB set up a breach reporting mechanism (BRM) incorporating a pre-structured web platform, which can be accessed through the ECB’s banking supervision website.

The information received through the BRM is appropriately considered (e.g. by assessing the impact on the bank’s risk profile) and followed-up on (e.g. by requesting information, conducting on-site inspections or adopting supervisory measures).

In 2018 the ECB received 124 breach reports, an increase of 39% on the previous year. Of these reports, 93 referred to alleged breaches of relevant EU law, 75 of which were considered to be within the ECB’s supervisory remit and 18 within that of the NCAs. The remainder referred mainly to national issues not related to prudential...
requirements (e.g. consumer protection) and therefore fell outside the scope of the BRM.

Among the most common alleged breaches reported were governance issues (80%) and inadequate calculation of own funds and capital requirements (8%). The complete breakdown is shown in Chart 11. Governance-related issues referred mainly to risk management and internal controls, fit and proper requirements and organisational structure\(^{52}\).

### Chart 11
Alleged breaches reported in the breach reporting mechanism mainly concern governance issues

![Chart showing governance issues](source: ECB)

The main investigatory actions taken in 2018 in relation to the breach reports received were:

- internal assessment based on existing documentation (45% of the cases);
- request for an internal investigation/audit or documents/explanations to the supervised entity (40% of the cases);
- on-site inspection (15% of the cases).

Finally, in 2018 the ECB optimised the assessment and treatment of incoming breach reports, ensuring due response in an efficient and timely manner despite the higher number of cases.

---

52 “Risk management and internal controls” comprises the mechanisms or processes that an entity needs to have in place for the adequate identification, management and reporting of the risks it is or might be exposed to. “Organisational structure” refers to the extent to which an institution has well-defined, transparent and consistent lines of responsibility.
The SSM as part of the European and global supervisory architecture

European and international cooperation

Euro area banks have a presence in more than 100 non-EU countries, and the SSM cooperates extensively with supervisory authorities inside and outside the EU. The ECB is committed to facilitating this cooperation by contributing to supervisory colleges and by developing cooperation tools such as MoUs and case-by-case agreements. MoUs have so far been negotiated with counterparties such as supervisory authorities of non-euro area EU Member States, third-country supervisory authorities and national market authorities.

4.1.1 Cooperation with other supervisory authorities

Cooperation with supervisory authorities within the European Economic Area

The ECB frequently cooperates with the NCAs of non-euro area EU countries, in compliance with the provisions of the CRD IV on cooperation and the exchange of information between competent authorities in the EU.

So far, ECB Banking Supervision has also entered into three MoUs with national market authorities from euro area countries. These MoUs are based on a template jointly prepared by the ECB and ESMA.

Cooperation with supervisory authorities from third countries

The ECB strives to engage in fruitful cooperation with third-country supervisory authorities and facilitate ongoing cross-border supervision. Where feasible, ECB Banking Supervision joined the existing MoUs that had been agreed between euro area NCAs and third-country supervisory authorities before the SSM was established. In some cases, ECB Banking Supervision needed to develop tailored cooperation solutions. In 2015 the ECB began to conclude its own MoUs with third-country supervisory authorities so that it would not have to rely on existing MoUs between euro area NCAs and third-country supervisory authorities.

In order to ensure consistency at the EU level, ECB Banking Supervision closely cooperates with the EBA Network on Equivalence, which conducts equivalence assessments of the confidentiality regimes of third-country supervisory authorities. MoUs for supervisory cooperation may only be concluded if the required equivalence of professional secrecy is met.
Post-Brexit cooperation with supervisory authorities in the United Kingdom

The United Kingdom is an important global financial centre, with its banks operating both in the euro area and at home. In view of the UK’s planned withdrawal from the EU, the ECB is working closely with the UK authorities to design a cooperation framework that will allow for continued and smooth supervisory cooperation and information exchange (for further information on preparations for Brexit, see Box 3).

Box 3
Preparing for Brexit

In 2018 ECB Banking Supervision’s work on Brexit focused on two things: (i) on assessing the plans of international banks seeking to relocate activities from the United Kingdom to the euro area; (ii) on scrutinising the preparedness of banks that have their headquarters in the euro area and operate in the United Kingdom. Throughout the year, the ECB clearly communicated to banks that they should prepare for all possible contingencies, including a no-deal scenario that might lead to a hard Brexit with no transition period. Banks seeking to relocate to the euro area were asked to submit applications for all necessary authorisations from the ECB in due time, and at the very latest by the end of the second quarter of 2018.

Consequently, the number of authorisation procedures assessed by the ECB and the NCAs increased significantly throughout 2018. The ECB and NCAs also assessed the plans of banks wishing to expand the activities of their pre-existing euro area entities due to Brexit. In all cases, special attention was given to the presence of adequate risk management and related capabilities in order to avoid the setting-up of “empty shells” in the euro area. Supervisors put particular emphasis on banks’ internal organisation and governance, their local risk management capacities and the proposed booking models.53

By the end of 2018, most banks relocating to the euro area had advanced reasonably well in their preparations – driven by supervisory expectations developed jointly with national authorities. Overall, the key prudential issues identified by the ECB relate to booking and business models. Supervisors will continue their dialogue with banks in 2019 to address any remaining issues and monitor the implementation of the relocation plans.

With regard to banks that are headquartered in the euro area and have operations in the United Kingdom, the ECB, as their direct supervisor, has requested them to prepare in a timely fashion and to present relevant plans that would meet the ECB’s supervisory expectations. Special emphasis was placed on diligent contingency planning for all potential outcomes of the negotiations, and on adequate preparations and plans for operations of branches located in the United Kingdom.

The ECB also continued to communicate on its supervisory expectations through updates to the FAQs on the ECB’s banking supervision website and in bilateral discussions with the supervised entities. In addition, workshops were organised with the industry to discuss issues related to banks’ booking models and their risk management. The ECB also published several key messages and

53 Booking models are employed by banks to centralise risks incurred in multiple locations at certain trading and risk management hubs to enable cost-effective risk management.
Brexit statements in the SSM Supervision Newsletter and intends to publish further articles on Brexit-related issues in the course of 2019.

**Looking ahead**

As the United Kingdom’s withdrawal from the EU is approaching, 2019 will be a crucial year for the ECB’s work on Brexit. The ECB will continue to monitor banks’ implementation of their plans and preparations, as well as their adherence to the SSM’s supervisory expectations. ECB Banking Supervision has also begun taking over the direct supervision of institutions that became significant owing to the Brexit-induced relocation of activities. Further significant institutions will be taken on board in the course of 2019. In general, Brexit-related supervisory work in 2019 will be highly dependent on how the political negotiations develop, and on whether a withdrawal agreement including a transition period will ultimately be ratified. The ECB will closely follow the political developments and assess whether its supervisory expectations need to be modified.

### 4.1.2 Colleges of supervisors

Colleges of supervisors are permanent yet flexible coordination structures that bring together the competent authorities involved in supervising cross-border banking groups. Colleges play an important role for euro area banks with a presence in non-euro area countries.

At the end of 2018, the ECB acted as consolidating supervisor in 29 EU supervisory colleges, which were accordingly chaired by the respective JSTs. This is one college less than in 2017 because two banks are now undergoing reorganisation, while a new college was set up for Nordea after it had relocated its headquarters to a euro area Member State.

Also reflecting Nordea’s relocation to the euro area, the number of cross-border institutions domiciled in non-euro area EU Member States and operating through euro area SIs fell from seven in 2017 to six. The ECB participates in the colleges for these banks as an active member, represented by the JST which supervises the relevant subsidiary or branch. The ECB thus contributes to the consolidated supervision of these institutions.

Four SIs have material cross-border activities outside the EU. The ECB has set up and operates colleges of supervisors for these banks, with a view to facilitating coordination and the exchange of information among relevant supervisors.

Finally, six banks headquartered outside the EU have significant subsidiaries in the euro area. The ECB participates in the relevant colleges as a host authority. In that role, it contributes in a constructive manner to the objectives of the college and of the consolidating supervisor, in accordance with international standards and agreements.

In 2019 the landscape for colleges is expected to change significantly owing to the United Kingdom’s withdrawal from the EU. On the one hand, the UK subsidiaries and
branches of euro area institutions will become third-country entities. The relevant UK competent authorities will consequently become third-country observers in the ECB-led colleges. On the other hand, UK banks will become third-country institutions and the existing colleges under European legislation are expected to become non-EU colleges. Finally, several institutions located in the United Kingdom are planning to move operations to the euro area. A significant number of new colleges may need to be set up and operated by the ECB as consolidating supervisor. Likewise, the ECB might become host supervisor in the third-country led colleges.

4.1.3 State of play on close cooperation

EU Member States whose currency is not the euro may participate in the SSM under a regime of close cooperation. The main conditions for this are set out in Article 7 of the SSMR and the procedural aspects are specified in Decision ECB/2014/5.

In July 2018 Bulgaria submitted a formal request to establish close cooperation between the ECB and Българска народна банка (Bulgarian National Bank), thus becoming the first non-euro area Member State to take formal steps to participate in the banking union.

The ECB will decide on whether to establish close cooperation when it has concluded its assessment of Bulgaria’s request. To this end, the ECB will conduct a comprehensive assessment of six Bulgarian credit institutions, as well as an assessment of the relevant national legislation, also taking into account its practical implementation. In parallel, the ECB is working closely with Българска народна банка (Bulgarian National Bank), as the national competent authority, to support its smooth integration into the SSM.

4.1.4 The EBA review panel

ECB Banking Supervision continued to actively contribute to the EBA Review Panel. This panel periodically organises and conducts peer reviews of the activities of European banking supervisors in order to promote consistency in supervisory outcomes. The reviews focus on the degree of convergence in applying European legislation and on best practices developed by the relevant authorities.

In 2018 the EBA Review Panel performed a peer review of the Regulatory Technical Standards on passport notifications under Articles 35, 36 and 39 of the CRD IV. The objective was to assess the granularity and timeliness of the relevant information provided by banks to home and host authorities. The review also assessed whether home authorities were satisfied with the information received and whether host authorities received essential information enabling them to prepare for supervision.

In the euro area, the ECB is ultimately responsible for passporting tasks related to SIs inside and outside the SSM. The ECB monitors these passporting procedures, relevant parts of which are carried out with the assistance of NCAs (such as
collecting notifications from SIs and carrying out initial assessments of their completeness).

The peer review concluded that the ECB has fully comprehensive processes. Nevertheless, the review helped to identify areas for improving or simplifying the processes – topics the ECB and the NCAs are already working on.

### 4.1.5 IMF Financial Sector Assessment Programs

The IMF’s Financial Sector Assessment Programs (FSAPs) are comprehensive, in-depth assessments of a jurisdiction’s financial sector. They encompass (i) the identification of key vulnerabilities and the assessment of the resilience of the financial sector; (ii) the assessment of a country’s financial stability policy framework, as well as its supervisory framework and practices; and (iii) the evaluation of financial safety nets and the financial system’s capacity to manage and resolve a financial crisis.

In January 2017 the President of the EU’s Economic and Financial Committee asked the IMF to carry out the first EU/euro area FSAP, with a view to acknowledging the new banking supervision and resolution architecture in the euro area. This FSAP was launched in June 2017, and its conclusions were made public in July 2018. It focused, among other things, on banking supervision and crisis management of SIs. To this end, the IMF carried out (i) a detailed assessment of the relevant Basel Core Principles for Effective Banking Supervision⁵⁴, resulting in compliance grades; and (ii) an analysis of the arrangements for euro area bank resolution and crisis management, which was informed by the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions. In addition, the IMF assessed the solvency of the banking sector in the context of the FSAP financial stability assessment. The findings of this FSAP informed the 2018 IMF Article IV consultations with euro area countries.

The ECB welcomed the outcome of the IMF euro area FSAP. Some of the relevant recommendations require the ECB to act in order to adapt its internal structures and/or processes. Most notably, with regard to banking supervision, it is recommended that the ECB: (a) continue its current efforts to streamline internal procedures and decision-making processes, as they have resulted in more effective resource use and more timely responses to emerging supervisory issues; (b) ensure that staffing arrangements with NCAs provide JSTs and on-site inspections with the necessary staff; and (c) improve some aspects of its supervisory approach, such as its supervisory expectations, where transparency should be increased, and the supervision of liquidity risk. Many other recommendations require the EU co-legislators to act in order to change EU law. Examples include the recommendation that further harmonisation of European regulatory requirements be promoted in order to avoid fragmentation along national lines, and the recommendation that the ECB

---

⁵⁴ One of the 29 Basel Core Principles for Effective Banking Supervision, Principle 29 – Abuse of financial services, was not covered in this exercise, as the ECB is not the competent authority for anti-money laundering issues. The 28 relevant Principles collectively cover 216 essential criteria and 17 additional criteria.
be granted supervisory powers over all significant forms of credit intermediation in the euro area. This relates to the supervision of third-country branches and, most notably, relevant cross-border investment firms. Another pertinent recommendation is that European legislation be further aligned with Basel standards. ECB Banking Supervision has prepared an action plan to address the recommendations that fall within the ECB’s supervisory remit. This plan has been endorsed by the Supervisory Board.

In future national FSAPs, the IMF will continue to take a holistic view of the banking system under review, while avoiding duplication with euro area FSAPs. By analogy with the handling of monetary policy in national IMF Article IV reports, national FSAPs should not include assessments of the effectiveness of ECB/SSM banking supervisory work. This general approach enables the IMF to align the scope of both national and euro area FSAPs with the EU’s new banking supervision and resolution architecture. It will help ensure that IMF surveillance and advice continue to be effective and relevant for all the authorities concerned. In 2018 the IMF concluded the national FSAP for Belgium55 and launched FSAPs for France, Italy and Malta. A national FSAP for Austria is scheduled for 2019.

4.2 Contribution to developing the European and international regulatory framework

4.2.1 Contribution to the Basel process

In 2018 the Basel Committee on Banking Supervision (BCBS) focused on finalising ongoing policy initiatives, evaluating the impact of post-crisis reforms and promoting strong supervision. The ECB, which is actively involved in the work of the BCBS, contributed by taking part in policy discussions, providing expertise in various BCBS groups (e.g. on regulatory arbitrage), cooperating with BCBS members within the EU and around the globe, and contributing to relevant impact analyses. The ECB was mainly involved in work on the Basel III reform package.

In 2018 the BCBS continued to work on ensuring full, timely and consistent implementation of Basel III and, more generally, on promoting strong banking supervision. It will continue this work in the years to come.

The BCBS also initiated a comprehensive work programme for evaluating the reforms put in place since the crisis. This programme will evaluate the effectiveness of individual standards, the interaction between standards, their coherence and the risk of regulatory arbitrage, as well as the broader macroeconomic impact of the post-crisis reforms. The ECB will continue to contribute actively to the BCBS agenda.

55 The national FSAP on Belgium was concluded before the euro area FSAP. It contained recommendations which are also relevant for the SSM, particularly in the context of financial conglomerate supervision, the oversight of internal models, loan classification and provisioning, as well as the need for a careful transition to the banking union.
4.2.2 The European legislative agenda

In 2018 the ECB continued to contribute to EU legislative reforms. On the review of EU banking legislation (CRR/CRD IV, BRRD and SRMR), the ECB welcomed the outcome of the political negotiations between the Council of the European Union and the European Parliament in December 2018, which paved the way for the final adoption of the legislation ahead of the European elections in May 2019. This legislation is an important milestone in strengthening the resilience of the banking sector through the implementation of international standards and in further reducing risks. This should allow for further progress towards completing the banking union, including a European deposit insurance scheme. In this context, the ECB continued to contribute to the work of the ad hoc working party on the strengthening of the banking union.

In 2018 the ECB also contributed to other legislative files, notably the European Commission’s proposals on the regulation of investment firms, covered bonds, non-performing exposures and on the reinforcement of the EBA’s mandate in preventing the use of the financial system for the purpose of money laundering and terrorism financing. At the request of the European Parliament and the Council of the European Union, the ECB issued opinions outlining its advice to the co-legislators.56

4.2.3 Contribution to the work of the EBA

Throughout 2018 ECB Banking Supervision worked closely with the EBA towards their shared objectives of increasing financial stability and promoting consistent supervision across the European banking sector.

ECB Banking Supervision actively contributed to the EBA’s work at all levels. In 2018 ECB Banking Supervision staff was represented in a total of 50 EBA committees and work streams, four of which in the role of chair or co-chair. In the EBA Board of Supervisors, ECB Banking Supervision participated as a non-voting member.

---

The EBA and ECB Banking Supervision’s collaborative work covered a range of issues. The ECB contributed, for instance, to the EBA’s reply to the European Commission’s call for advice on the implementation of the Basel III finalisation package. Other ECB contributions include the EBA Opinion on the United Kingdom’s withdrawal from the EU\(^57\) (see Box 3) and the EBA technical standards and guidelines for internal models and model validation.\(^58\)

Another aspect central to supervision is the review of the robustness of bank governance arrangements and the suitability of board members. The revised ECB Guide to fit and proper assessments, published in May 2018, follows the terminology used in CRD IV, the joint ESMA and EBA guidelines on suitability and the EBA guidelines on internal governance. This mirrors work on updating the guidelines on outsourcing arrangements, which were the subject of an EBA public consultation in 2018 (see Section 1.4).

ECB Banking Supervision also contributed to the progress of the European NPL action plan (see Section 1.2). In October 2018, the EBA finalised its guidance on the management of non-performing and forborne exposures, which is aligned with ECB Banking Supervision’s own NPL guidance. For collecting and mapping supervisory data across the European banking sector, the EBA and ECB Banking Supervision are currently developing the European centralised infrastructure for supervisory data (EUCLID). In 2018 the EBA/ECB Task force on the implementation of EUCLID oversaw joint efforts and held technical workshops to ensure the alignment of data models, categorisation of entities and reporting obligations.

The EBA follows a comply-or-explain procedure to foster regulatory harmonisation in the EU.\(^59\) Under this procedure, the ECB, as the competent authority for the direct supervision of SIs, must inform the EBA whether it complies or intends to comply with newly issued guidelines and recommendations. In 2018 the ECB made notifications to the EBA with respect to seven guidelines, one joint committee guideline, and three recommendations as documented on the ECB’s banking supervision website.\(^60\) So far, ECB Banking Supervision has always informed the EBA that it complies or intends to comply with the relevant EBA Guidelines.

### 4.2.4 Contribution to the work of the FSB

In 2018 ECB Banking Supervision actively contributed to the work of the Financial Stability Board (FSB), in particular in the areas of supervisory and regulatory cooperation, implementation of standards and resolution. ECB Banking Supervision also participated in the meetings of the FSB’s regional consultative group for Europe.

---

\(^{57}\) Opinion of the European Banking Authority on preparations for the withdrawal of the United Kingdom from the European Union, EBA, 25 June 2018.

\(^{58}\) See Model validation, EBA website.


\(^{60}\) ECB compliance with EBA guidelines and recommendations, ECB’s banking supervision website.
The FSB currently focuses on monitoring the implementation of the global financial sector reforms and evaluating their effects. ECB Banking Supervision will actively participate in the relevant FSB initiatives, which are aimed at determining the impact of the agreed reforms on specific forms of lending, also with a view to highlighting how a stable and well-functioning banking sector benefits sustainable economic growth. In addition, ECB Banking Supervision will contribute to the work on a number of major policy topics, such as the too-big-to-fail problem, resolution, crisis management and risks resulting from the use of new technologies in financial services.
5 Organisational set-up of ECB banking supervision

5.1 Discharging of accountability requirements

This Annual Report constitutes one of the main accountability channels for ECB Banking Supervision vis-à-vis the European Parliament and the EU Council, as stipulated in the SSM Regulation. The Regulation provides that the ECB’s supervisory tasks should be subject to appropriate transparency and accountability requirements. The ECB attaches great importance to maintaining and fully applying the accountability framework that is set out in further detail in the Interinstitutional Agreement between the European Parliament and the ECB and the Memorandum of Understanding between the EU Council and the ECB.

With regard to interactions with the European Parliament in 2018, the Chair of the Supervisory Board spoke before the Parliament’s Committee on Economic and Monetary Affairs (i) to present the 2017 ECB Annual Report on supervisory activities (26 March), (ii) at two ordinary public hearings (19 June and 20 November) and (iii) in four ad-hoc exchanges of views (26 March, 19 June, 9 September and 20 November). Among the key issues discussed were non-performing loans, the role of the ECB in anti-money laundering and the 2018 EBA stress test. In the course of 2018 the ECB also published 35 replies to written questions from MEPs on banking supervision matters. The letters addressed questions on a range of topics, including non-performing loans, less significant institutions and the fitness and propriety of bank managers.

In addition, the ECB transmitted the records of proceedings of its Supervisory Board meetings to the European Parliament, as required under the Interinstitutional Agreement.

With regard to the EU Council, the Chair of the Supervisory Board attended three Eurogroup meetings, the first of which took place on 19 February. On 27 April the Chair presented the 2017 ECB Annual Report on supervisory activities. On 5 November the Chair participated in an exchange of views on the execution of the ECB’s supervisory tasks.

In 2018 ECB Banking Supervision continued to fulfil its reporting requirements towards national parliaments, as set out in the SSM Regulation. It published six replies to written questions from members of national parliaments.

In 2018 the ECB also contributed to the ECA’s audits of the ESRB and of the EBA regarding the EU stress-testing exercises. In its role as evidence provider, the ECB helped to facilitate the ECA’s investigations into these issues and to describe how the relevant collaborative processes work.
At the same time, the ECB also worked on implementing the recommendations from the two ECA reports on ECB Banking Supervision, which were published in January 2018 and November 2016 and focused on crisis management as well as on the functioning of the SSM more generally.

The ECB highly values the audits conducted by the ECA. It is committed to cooperating closely with the ECA and providing it with all the information needed to facilitate its work. In the light of the Treaty provisions concerning the scope of the ECA’s mandate to audit the ECB, in 2017 the Commission suggested that the ECB and the ECA conclude an interinstitutional agreement to “specify the modalities of information exchange”. Discussions between the ECB and the ECA on this matter are under way.

**Box 4**

**SSM risk appetite**

In March 2018, ECB Banking Supervision published its Supervisory Manual, which spells out the functioning and key processes of how the ECB approaches banking supervision in the euro area. As a follow-up, the ECB published a statement on SSM risk appetite. This statement is meant to allow external stakeholders to better understand the ECB’s objective and its general approach. ECB Banking Supervision contributes to the stability of the financial system by promoting a resilient and well-functioning banking sector which can fulfil its service-providing function to the economy. To this end, the ECB exercises forward-looking, risk-based supervision. However, ECB Banking Supervision’s objective is not to prevent bank failures in themselves. A zero-failure policy is neither feasible nor desirable.

**5.2 Transparency and communications**

To help meet its commitment to transparency, ECB Banking Supervision continued to explain its activities via a range of communications channels. In 2018 the Chair and Vice-Chair gave 32 speeches and the two ECB Representatives on the Supervisory Board gave 11 speeches; together, they gave 20 media interviews. ECB Banking Supervision published 31 press releases and four letters to the directly supervised banks. The Supervision Newsletter, a digital publication, marked its second anniversary in November with more than 5,000 subscribers. The ECB used its social media channels to draw attention to new information and ensure broad dissemination of key content.

In addition, the Chair and Vice-Chair held a press conference early in the year to outline the priorities for banking supervision. They also engaged in ECB-led events to reach out to younger audiences. In the first ECB Youth Dialogue, held at the Banco de España in Madrid, the Chair exchanged views with a group of 40 young professionals from the finance industry and in the second dialogue, the Chair and Vice-Chair jointly engaged in a discussion with over 260 students and alumni from the Frankfurt School of Finance and Management. In 2018 the ECB also responded...
to more than 1,600 public enquiries focusing on banking supervision and hosted 31 tailored lectures to some 1,000 participants on topics relating specifically to the ECB’s supervisory responsibilities.

5.3 Decision-making

5.3.1 Supervisory Board and Steering Committee

In 2018 the Supervisory Board met 20 times. Of these meetings, 14 were held in Frankfurt am Main and five were held via teleconference. One meeting took place in Madrid, upon the invitation of the Banco de España. The Supervisory Board took the majority of its decisions by written procedure. Of the 119 banking groups directly supervised by the ECB in 2018, 35 asked to receive formal ECB decisions in an EU official language other than English.

---

61 Under Article 6.7 of the Supervisory Board’s Rules of Procedure, decisions may also take place by written procedure, unless at least three members of the Supervisory Board who have a voting right object. In such cases, the item is put on the agenda of the subsequent Supervisory Board meeting. A written procedure normally requires at least five working days for consideration by the Supervisory Board.
**Figure 3**

Decisions by the Supervisory Board in 2018

The Supervisory Board discussed and decided on issues in

<table>
<thead>
<tr>
<th>20 meetings</th>
<th>1,608 written procedures&lt;sup&gt;1&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1,924 supervisory decisions were taken&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

The most common decisions were on

| 1,006 fit and proper assessments<sup>2,3</sup> | 160 internal models<sup>2</sup> | 153 own funds<sup>2</sup> |

The ECB directly supervised

| 119 significant banking groups | 35 of which communicate in a language other than English |

Notes:

1) This number includes written procedures on both individual supervisory decisions and on other issues such as common methodologies and consultations of the Supervisory Board. One written procedure may contain several supervisory decisions.

2) This is the number of individual supervisory decisions addressed to supervised entities or their potential acquirers and instructions to national competent authorities on significant institutions or less significant institutions. One decision may contain several supervisory approvals. With the application of the delegation framework, not all of the supervisory decisions included in this number were approved by the Supervisory Board and adopted by the Governing Council. In addition, the Supervisory Board took other decisions on a number of horizontal issues (e.g. common methodologies) and institutional issues.

3) The 1,006 decisions on fit and proper assessments cover 2,026 individual procedures (see Section 3.1.2).

In addition to the bank-specific final draft decisions submitted to the Governing Council for non-objection, the Supervisory Board decided on several horizontal issues, most notably the application of common methodologies and frameworks in specific areas of supervision. Some of these decisions were prepared by temporary structures mandated by the Supervisory Board. These structures comprised senior managers from the ECB and the NCAs. They carried out preparatory work on topics such as the SREP methodology, the supervisory approach to supervised institutions with high levels of non-performing loans, and the simplification of processes in the SSM.
### Supervisory Board

<table>
<thead>
<tr>
<th>Role</th>
<th>Name and Institution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chair</td>
<td>Danièle Nouy (until 31 December 2018), Andrea Enria (since 1 January 2019)</td>
</tr>
<tr>
<td>Vice-Chair</td>
<td>Sabine Lautenschläger (until 11 February 2019)</td>
</tr>
<tr>
<td>ECB representatives</td>
<td>Ignazio Angeloni, Pentti Hakkarainen</td>
</tr>
<tr>
<td>Belgium</td>
<td>Tom Dechaene (Nationale Bank van België/Banque Nationale de Belgique)</td>
</tr>
<tr>
<td>Germany</td>
<td>Felix Hufeld (Bundesanstalt für Finanzdienstleistungsaufsicht), Andreas Dombret (Deutsche Bundesbank) (until 30 April 2018), Joachim Wuermeling (Deutsche Bundesbank) (since 1 May 2018)</td>
</tr>
<tr>
<td>Estonia</td>
<td>Kilvar Kessler (Finantsinspektsioon), Madis Müller (Eesti Pank)</td>
</tr>
<tr>
<td>Ireland</td>
<td>Ed Sibley (Central Bank of Ireland/Banc Ceannais na hÉireann)</td>
</tr>
<tr>
<td>Greece</td>
<td>Ilias Plaskovitis (Bank of Greece)</td>
</tr>
<tr>
<td>Spain</td>
<td>Javier Alonso (Banco de España) (until 10 September 2018), Margarita Delgado (Banco de España) (since 11 September 2018)</td>
</tr>
<tr>
<td>France</td>
<td>Denis Beau (Banque de France)</td>
</tr>
<tr>
<td>Italy</td>
<td>Fabio Panetta (Banca d’Italia)</td>
</tr>
<tr>
<td>Cyprus</td>
<td>Yiaygos Demetriou (Central Bank of Cyprus)</td>
</tr>
<tr>
<td>Latvia</td>
<td>Pēters Putniņš (Finanšu un kapitāla tirgus komisija), Zoja Razmusa (Latvijas Banka)</td>
</tr>
<tr>
<td>Lithuania</td>
<td>Vytautas Valionis (Lietuvos bankas)</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>Claude Simon (Commission de Surveillance du Secteur Financier) (until 31 December 2018), Claude Wampach (Commission de Surveillance du Secteur Financier) (since 1 January 2019), Norbert Goffinet (Banque centrale du Luxembourg) (until 31 December 2018), Eric Cadilhac (Banque centrale du Luxembourg) (since 1 January 2019)</td>
</tr>
<tr>
<td>Malta</td>
<td>Karol Gabarretta (Malta Financial Services Authority) (until 8 March 2018), Andrew Portelli (Malta Financial Services Authority) (from 9 March 2018 until 10 June 2018)</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Jan Sijsbrand (De Nederlandsche Bank) (until 30 June 2018), Frank Elderson (De Nederlandsche Bank)</td>
</tr>
</tbody>
</table>
The Steering Committee held 12 meetings in 2018. Of these, ten were held in Frankfurt am Main, one was held via teleconference, and one was held in Madrid upon the invitation of the Banco de España. In April, the usual rotation of the five NCA members, who are appointed for a one-year term, took place.

5.3.2 Simplification of decision-making

In 2018 the SSM Simplification Group (see Section 5.4) proposed and implemented several measures to optimise the functioning of the Supervisory Board, both by simplifying decision-making procedures and by improving access to information for the members. Three measures were central to these efforts: (i) reducing the number of meetings of the Supervisory Board as well as the number of written procedures and information items, allowing the members to focus on the most important supervisory issues; (ii) optimising and simplifying Supervisory Board meetings in order to make them as efficient and effective as possible; and (iii) streamlining and further improving the flow of information to the Supervisory Board.

One of the measures that had the most significant impact on decision-making was the extension of the delegation framework to additional types of routine ECB supervisory decisions. In March 2018 the delegation framework was extended to decision-making powers with regard to decisions on the reduction of own funds, the classification of CET 1 instruments and, where required by national law, to the classification of Additional Tier 1/Tier 2 instruments.

5.3.3 Administrative Board of Review

The Administrative Board of Review (ABoR)\(^2\) is an ECB body comprised of members who are individually and collectively independent from the ECB and are entrusted with the task of reviewing decisions adopted by the Governing Council on supervisory matters upon an admissible request for review. An ABoR review focuses on the “procedural and substantive conformity” of the contested decision with the SSM Regulation, while respecting the margin of discretion left to the ECB. In practical terms, an ABoR review involves checking whether due process was respected, whether the decision is appropriately reasoned and complies with applicable law, whether there is a manifest error in the assessment, whether the

---

\(^2\) The Administrative Board of Review is composed of five members: Jean-Paul Redouin (Chair), Concetta Brescia Morra (Vice-Chair), Javier Arístegui, André Camilleri and Edgar Meister, and two alternates: René Smits and Ivan Šramko.
decision is manifestly disproportionate or if the ECB misused its powers. The
outcome of the review is a non-binding opinion addressed to the Supervisory Board
proposing that it either abrogate the original decision or replace it with a new one of
identical or amended content for final approval by the Governing Council under the
non-objection procedure.

In 2018 five new requests for an administrative review of an ECB supervisory
decision were filed with the ABoR. The Board adopted four opinions, as one request
for review was withdrawn after the ECB produced a corrigendum to a supervisory
decision (see Table 7). In all cases reviewed in 2018 the ABoR conducted a hearing
as part of its investigation phase, which gave the applicant and the ECB an
additional opportunity to comment on the contested decision.

### Table 7
Number of reviews performed by the ABoR

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ABoR opinions finalised</td>
<td>4</td>
<td>4</td>
<td>6</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>ECB decisions confirmed after ABoR Opinion</td>
<td>3</td>
<td>4</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>ECB decisions amended/reasoning improved after ABoR Opinion</td>
<td>1</td>
<td>-</td>
<td>2</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Opinions finding request inadmissible</td>
<td>-</td>
<td>-</td>
<td>3</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Request withdrawn</td>
<td>1</td>
<td>-</td>
<td>1</td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: ECB.

### Topics under review and issues of relevance

The cases reviewed by the ABoR touched upon several types of supervisory
decision: compliance with supervisory requirements, withdrawal of a licence,
acquisition of qualifying holdings and administrative sanctions.

The review of ECB decisions in 2018 mainly concerned issues related to compliance
with procedural rules (e.g. accurate statement of the facts, appropriate legal basis,
sufficient grounds in the statement of reasons and the proportionality principle), and
to cooperation between the ECB and NCAs in preparing ECB decisions.

### Jurisdiction of the Court of Justice of the European Union

concerning the ECB

In 2018, 19 direct actions were served on the ECB and appeals were lodged with the
European Court of Justice against the judgment of the General Court of the
European Union (“the General Court”) in two cases related to the ECB. Two groups
of cases related to ECB Banking Supervision were decided in 2018 – on 24 April
2018 the General Court upheld ECB decisions addressed to Caisse régionale de
credit agricole mutuel Alpes Provence, (Case T-133/16), Caisse régionale de crédit
agricole mutuel Nord Midi-Pyrénées (Case T-134/16), Caisse régionale de crédit
agricole mutuel Charente-Maritime Deux-Sèvres (Case T-135/16) and Caisse
régionale de crédit agricole mutuel Brie Picardie (Case T-136/16). In those four decisions, adopted by the ECB on 7 October 2015, the ECB had approved the appointment of specific persons as chairmen of the boards of directors of each of the applicant banks but was opposed to those same specific persons simultaneously carrying out the function of “effective director” at each of those banks. On 13 July 2018 the General Court annulled ECB decisions addressed to La Banque Postale (Case T-733/16), BNP Paribas (Case T-768/16), Crédit Agricole SA (Case T-758/16), Société générale (Case T-757/16), Confédération nationale du Crédit mutuel (Case T-751/16) and BPCE (Case T-745/16). In those six decisions, the ECB had rejected the banks’ applications for permission to exclude from the calculation of their leverage ratios certain exposures to Caisse des Dépôts et Consignations (CDC) related to deposits made within the scope of the livret A, the livret de développement durable et solidaire and the livret d’épargne populaire savings accounts.

5.4 Improving the efficiency and effectiveness of the SSM

5.4.1 The ECB’s Supervisory Quality Assurance Division: review of work conducted since its establishment

In order to strengthen ECB Banking Supervision’s credibility, and to ensure the maintenance of high-quality, consistent supervision across the SSM, the ECB has established a division for Supervisory Quality Assurance (SQA). This division operates in close cooperation with a network of NCA quality assurance functions, which discusses and provides input on SQA deliverables impacting NCAs.

In order to create value, the division utilises a number of interconnected tools, in particular ex-post quality reviews. The objective is to foster quality and consistency and to ensure that ECB Banking Supervision is effective. Moreover, SQA acts as a hub for knowledge about best practices.

SQA’s modus operandi is based on open cooperation and mutual understanding with the operating units and the NCAs involved, reflecting their actual supervisory practices, risks, weaknesses and needs for feasible improvements. SQA therefore aims to deliver constructive, forward-looking and risk-based solutions, targeting SSM deliverables, methodologies, processes and tools.

After each quality review, SQA seeks to agree with the relevant business areas on proposals for improvement, also identifying the appropriate addressees and timelines for implementing the proposals. This means that the addressees of these proposals maintain ownership of the process; they are the parties who are primarily interested in following up on and implementing the proposals designed together with SQA. Since its establishment, SQA has carried out 24 reviews leading to more than 300 proposals for improvements. In addition to the reviews, SQA offers feedback to the operating units, for example through workshops, seminars and NCA visits.
In addition to carrying out quality reviews, SQA also promotes efficiency and effectiveness in the SSM. It does so through an array of complementary tools, such as the SSM Training Curriculum, which aims to maintain a high level of competence among SSM staff and contribute to the convergence of supervisory practices. Furthermore, SQA supports business areas in their interactions with internal and external auditors (e.g., Directorate Internal Audit, Internal Auditors Committee, ECA). It also supports the SSM Operational Risk Management Senior Expert Group, which is responsible for monitoring the management of operational risks. Likewise, SQA acts as a hub for simplification, supported by its network of counterparts at the ECB and in the NCAs. It supports business areas and NCAs in implementing simplification measures, as part of the efforts to instil simplicity as a core value in the SSM.

5.4.2 Conclusions of the SSM Simplification Group

Over time, structures and processes within the SSM had become increasingly complex, which generated a need for simplification. Since the SSM has entered into a more mature stage, an SSM Simplification Group (SSG) has been set up, representing the ECB and NCAs. The SSG has assessed the supervisory processes with the objective of reducing unnecessary complexity and duplication of work, thereby optimising the use of the SSM’s resources and fostering more risk-based supervision.

In order to raise awareness among supervisors, simplification will be defined as a general principle for the functioning of the SSM in the Supervisory Manual.

The SSG proposed a three-line approach to simplifying structures and processes within the SSM. First, the business areas of the ECB and the NCAs, including JSTs and horizontal functions, should play a continuous and active role in proposing lean processes. Second, there should be a horizontal, SSM-wide approach to encouraging best practices. Third, the Supervisory Board should steer simplification, set the tone and promote lean processes to support the SSM’s objectives.

More specifically, the SSG proposed new simplification measures, which also served as a catalyst for initiatives that were already ongoing. One such proposal was to limit the number of approval levels and the length of Supervisory Board proposals. Another was related to the sharing of information between the ECB and the NCAs using the SSM information management system, IMAS. The SSG also proposed several measures for simplifying supervisory reporting requirements and for processing and storing the data obtained through reporting requests.

The SSG also made proposals for optimising the functioning of the Supervisory Board, aimed at simplifying decision-making procedures and access to information for the Supervisory Board Members.

As a result of these initiatives, the number of procedures submitted to the Governing Council and the Supervisory Board has been reduced, thanks in particular to the delegation framework (see Section 5.3.2). Furthermore, the streamlining,
automation, and improved quality of the flow of information to the Supervisory Board, as well as enhanced tracking tools, helped to simplify and optimise its meetings. Finally, the frequency of Supervisory Board proceedings was reduced, thanks to a more efficient meeting schedule and an optimised distribution of written procedures and information items.

Other proposals made by the SSG include: improving team work within the JSTs; taking a holistic approach to the simplification of planning on-site and off-site supervisory activities and the internal organisation of tasks; digitalising processes and optimising the existing IT infrastructure.

**Figure 4**  
The impact of simplification

Process automation  
Risk-based supervision  
Time saving & operational cost reduction  
Intelligent use of resources  
Quality & efficiency  
Continuous monitoring  
Building bridges

Source: DG Secretariat to the Supervisory Board/Decision-Making Division.

5.5 ECB Banking Supervision staffing

**Internal reorganisation of ECB Banking Supervision**

Organisational changes in ECB Banking Supervision included a move of three divisions from the Directorate General Microprudential Supervision IV (DG/MS IV) to the Directorate Secretariat.

The Authorisation Division, the Enforcement & Sanctions Division as well as the Supervisory Quality Assurance Division were transferred to the Directorate Secretariat in February 2018. Following this transfer, the Directorate was upgraded to a Directorate General (DG/SSB). The SSM Decision-Making Division was created within the Directorate General, comprising the two sections of the former Directorate Secretariat. This transfer rebalances the size of the ECB’s banking supervision
business areas. It also improves corporate governance and fosters a clearer division of responsibilities between DG/MS IV and the new DG/SSB.

Increase in headcount

In 2018 the total number of approved full-time equivalent positions (FTEs) for the five core ECB Banking Supervision business areas was 1,099 FTEs, compared with 1,028.5 in 2017. The increase in 2018 was mainly driven by preparations for Brexit in activities such as JST staffing and comprehensive assessments. In addition, for SSM-related tasks in shared services 63 30.5 FTEs were approved, bringing the total number of FTEs to 453.

As for 2019, the Governing Council approved a headcount increase of 90 FTEs for core ECB Banking Supervision business areas, and 18 FTEs for business areas providing shared services for SSM-related tasks. Of the former, almost half are related to Brexit-related staffing needs for the coming year. The remaining increase for core ECB Banking Supervision business areas in 2019 is primarily associated with the internalisation of resources for stress-testing activities that were formerly provided using external consultancy support. With regard to future resources directly associated with Brexit, it is now expected that the additional headcount needs will be lower than initial estimates, with the on-boarding of FTEs extended to 2022.

In terms of gender diversity, the percentage of female staff remained at 40% of all permanent and fixed-term staff in core ECB Banking Supervision business areas in 2018. The proportion of female staff in managerial positions had decreased slightly from the previous year to 31%. In non-managerial positions, the proportion of female staff remained at 42%, unchanged from the previous year.

Fostering cross-border on-site missions: greater recourse to short-term assignments of NCA inspectors to the ECB

European banking supervision has undertaken a multi-year effort to increase the proportion of cross-border and mixed-team on-site missions.64 This initiative aims to promote a level playing field and harmonise the application of the methodology for conducting on-site inspections at banks. It also aims to foster team spirit among the on-site staff and to build a common on-site culture. It also provides an additional perspective on a bank’s situation as seen through the eyes of non-national NCA staff.

In order to promote cross-border and mixed-team missions, several options have been made available to NCA inspectors. Notably, they can opt to be seconded to the ECB for the duration of the cross-border or mixed-team missions, by entering into an

63 ECB business areas that support supervisory activities.
64 See the definition of cross-border and mixed-team missions in Section 1.6.
ESCB/IO\textsuperscript{65} contract with the ECB where the salary, travel and accommodation costs are covered by the ECB budget (instead of remaining under their NCA's current working regime). This option was introduced in 2018 and has been widely used: altogether, 128 ESCB/IO contracts have been put in place for NCA inspectors for cross-border and mixed team missions, fostering staff exchange in European banking supervision. Those members of inspection teams on ESCB/IO contracts work under equal employment conditions. This facilitates the emergence of an inclusive team spirit and a common on-site culture. It also improves the interchangeability of on-site resources across European banking supervision. If there’s a shortage of specific expertise in a certain area, it can be filled by experts from another supervisory authority.

**First “Supervisors Connect” and “Inspectors’ Day” organised for NCA and ECB staff**

In order to further shape a common European supervisory culture, two SSM-wide events were organised in Frankfurt in 2018.

The first event, “Supervisors Connect”, took place on 17-19 April. It was primarily geared to all JST coordinators and sub-coordinators, but also targeted senior managers in charge of LSI supervision and the most senior representatives of the SSM’s horizontal networks. The second event, “Inspectors’ Day”, was held on 29-30 October and was aimed at on-site inspectors, including those involved in model investigations and planning.

“Supervisors Connect” brought together 280 supervisors, 200 of whom came from NCAs and NCBs. For two and a half days, participants attended several panels and break-out sessions, covering topics such as digitalisation and cyber risk, profitability and Brexit. Supervisors from the NCAs actively participated in setting up the discussions: out of 38 speakers, 30 were from NCAs. In addition, participants were able to attend workshops on soft skills such as leadership, conflict management and communication. Furthermore, participants had the opportunity to network, including at an “Information Fair” where various ECB business areas presented their work. This allowed participants to mingle, learn from each other and share best practices.

“Inspectors’ Day” broadly replicated the format of “Supervisors Connect”, combining plenary sessions, break-out sessions (28 in total) on technical topics (credit file review and statistical sampling, IFRS 9, TRIM) and the sharing of experiences. The event brought together nearly 400 on-site inspectors from across the SSM.

“Supervisors Connect” and “Inspectors’ Day” are the first events of this kind and scope organised by the SSM since its inception. They will be held every two years.

\textsuperscript{65} The ESCB/IO contracts (European System of Central Banks and International Organisations) are short-term ECB employment contacts which are open exclusively to staff from the 28 national central banks of the ESCB, the national competent authorities, European public institutions and agencies and international public institutions (e.g. the IMF, the Bank for International Settlements and the European Bank for Reconstruction and Development).
and – not least for considerations of cost – will be hosted by ECB Banking Supervision in Frankfurt.

5.6 Implementing the Code of Conduct

Under Article 19(3) of the SSM Regulation, the ECB is required to have a Code of Conduct that governs ECB staff and management involved in banking supervision and that addresses any concerns regarding conflicts of interest. The relevant provisions are contained in the ECB’s Ethics Framework, which is implemented by the Compliance and Governance Office (CGO). The CGO advises all ECB staff on ethical issues.

Throughout 2018 the CGO continued in its efforts to build a strong ethics culture across the ESCB and the SSM. The Executive Board and Supervisory Board have lent their full support to these efforts. To this end, all new ECB Banking Supervision staff members have undergone a mandatory e-learning programme and increased their awareness regarding ethical dilemmas via dedicated workshops. Moreover, the CGO responded to about 1,850 requests on a wide range of topics, one third of which were submitted by ECB Banking Supervision staff. Almost half of these requests concerned private financial transactions, followed by requests on post-employment restrictions and conflict of interest issues (see Chart 12).

In the context of its regular compliance monitoring exercise the CGO identified a limited number of instances of non-compliance, 40% of which related to the staff and management of ECB Banking Supervision. None of these instances involved intentional misconduct or other serious instances of non-compliance.

Chart 12
Overview of requests from ECB Banking Supervision staff received in 2018

<table>
<thead>
<tr>
<th>Topic</th>
<th>Requests</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private financial transactions</td>
<td>280</td>
</tr>
<tr>
<td>Post-employment restrictions</td>
<td>165</td>
</tr>
<tr>
<td>Conflicts of interest</td>
<td>81</td>
</tr>
<tr>
<td>External activities</td>
<td>38</td>
</tr>
<tr>
<td>Gifts and hospitality</td>
<td>37</td>
</tr>
<tr>
<td>Other</td>
<td>19</td>
</tr>
<tr>
<td>Account declaration</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: ECB.

Of those members of staff and management involved in banking supervision who resigned from their posts in 2018, three cases triggered a cooling-off period in line with the Ethics Framework. All of these cases concerned SSM managers moving to financial corporations that they had not been previously responsible for supervising.
The ECB verified the measures taken by NCAs to comply with the ECB’s Guideline regarding the common principles of an Ethics Framework for both the ECB and NCAs and concluded that the Guideline had been fully implemented across the SSM. The Ethics and Compliance Officers Task Force facilitated this exercise and continues to support the Governing Council in further aligning the ethics standards over the medium term.

The ECB’s Ethics Committee advises members of high-level ECB bodies on ethical questions. In 2018 it issued eleven opinions related to high-level ECB officials involved in banking supervision. The majority of these cases were related to applicable cooling-off periods.

The Ethics Committee was also instrumental in elaborating a new, common and comprehensive, state-of-the-art ethics framework for all high-level ECB officials, including the members of the Supervisory Board. This new framework was endorsed by the Governing Council in December 2018 and entered into force in January 2019. It reflects the ECB’s core principles and values, while appropriately taking into account the ECB’s specificities as a central bank, banking supervisor and EU institution. It moreover responds to requests from the European Parliament and recommendations by the European Ombudsman.

5.7 Applying the principle of separation between monetary policy and supervisory tasks

In 2018 the principle of separation between monetary policy and supervisory tasks was mainly applied to the exchange of information between different policy areas.\(^{66}\)

In line with Decision ECB/2014/39 on the implementation of separation between the monetary policy and supervision functions of the ECB, this exchange of information was subject to a need-to-know requirement: each policy area had to demonstrate that the information requested was necessary to achieve its policy goals. In most cases, access to confidential information was granted directly by the ECB policy function that owned the information. This was done in line with Decision ECB/2014/39, which allows access to information pertaining to anonymised data or non-policy sensitive information, to be granted by the policy functions directly. Intervention by the Executive Board to resolve possible conflicts of interest was not necessary. Under Decision ECB/2014/39, the involvement of the Executive Board was nonetheless required in a few instances to allow for the exchange of non-anonymised information relating to individual banks (e.g. individual FINREP or

\(^{66}\) Decision ECB/2014/39 also contains provisions relating to organisational aspects.
COREP templates or other raw data) or policy-sensitive assessments. Access to the data was granted on a need-to-know basis after assessing the business case, and for a limited period of time, to ensure that the need-to-know requirement was fulfilled at all relevant points in time.

Separation at the decision-making level did not raise concerns, and no intervention by the Mediation Panel was required.

5.8 Data reporting framework and information management

5.8.1 Developments in the data reporting framework

In accordance with the SSM Framework Regulation, the ECB is responsible for organising the collection and quality-review of supervisory data reported by supervised entities. The main objective is to ensure that banking supervisors use reliable and timely data.

The data flow follows a “sequential approach”, in which the ECB closely cooperates with NCAs, which are the first recipients of prudential reports from credit institutions, and which perform the first quality checks. Once the ECB receives the data reports, it makes them available to end-users such as JSTs or horizontal functions within ECB Banking Supervision. This is done through the SSM Information Management System (IMAS). Selected data from a subset of institutions (mainly significant institutions) are also forwarded to the EBA and the SRB upon receipt. In addition to supervisory data, the ECB also collects information on the reporting entities themselves (master data), for example their country of residence and their relationship with other entities of banking groups. Since 1 December 2018 NCAs/NCBs and the ECB have been transmitting all master data and related updates directly through the Register of Institutions and Affiliates Data (RIAD).

In line with the EBA reporting framework 2.7, which applies to the submission of data as of 31 March 2018, the supervisory dataset now also covers data on sovereign exposures, detailed information on operational risk losses, and additional metrics for monitoring liquidity. It also reflects the changes stemming from IFRS 9. Data as of 31

67 FINREP (FInancial REPoring) and COREP (COmmon REPoring) form part of the EBA’s Implementing Technical Standards (ITS) and are included in Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council. FINREP is the framework for collecting financial information from banking institutions; it represents a standardised format of their annual accounts (balance sheet, profit and loss and detailed annexes). COREP is the framework for collecting, also in a standardised format, 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.

68 Article 140(4) of the SSM Framework Regulation.

69 The “sequential approach” is the framework for the transmission of supervisory data from banks to the NCAs, from the NCAs to the ECB, and from the ECB to the EBA.

70 RIAD is a shared dataset which uses a platform shared across the ESCB and SSM. It is designed to store reference data on legal entities and other (statistical) institutional units (mainly branches) and the relationships between them.
December 2018 follow the EBA reporting framework 2.8, which introduces new reporting requirements with regard to prudent valuation (COREP) and to the ITS on resolution reporting.

The ECB assesses the quality of the supervisory data which are transmitted under the EBA’s Implementing Technical Standards (ITS), ad hoc Short-Term Exercises (STE) and quarterly reporting on NPLs. A data quality escalation process has been set up within the ECB framework for data monitoring and quality assessments. The key rationale is to ensure that institutions’ supervisory reporting is compliant with data quality requirements. It is designed to ensure that the ECB’s response (including supervisory measures) to data quality issues is commensurate, fair and dissuasive. In addition, the ECB produces a dashboard which presents the assessment of the quality of the data reported by each institution, and which also allows supervisors to compare the results with peers.

In addition to dashboards, the ECB produces regular supervisory datasets, key risk indicators and reports for supervisors. Aggregated banking statistics covering significant institutions at the highest level of consolidation are published on the ECB’s banking supervision website each quarter. Following the introduction of the latest EBA reporting framework and the changing focus of market analysts and participants, the publication was extensively enhanced in 2018. It now includes new indicators such as level 1, level 2 and level 3 assets, total exposures to general governments and IRB credit risk parameters. Each year, the ECB also publishes solvency and leverage indicators at bank level, as disclosed by banks in line with their Pillar 3 requirements. In 2018 this publication was expanded to include individual information on risk-weighted assets by risk type and by computation method for ECB-supervised global and other systemically important institutions. This new level of transparency enables stakeholders to perform meaningful comparisons of prudential metrics.

### 5.8.2 Statistical data available for supervisory use

In addition to data reported to supervisors, confidential statistical information\(^71\) can also be made available for supervisory use. This information comprises, for instance, the instrument-level datasets AnaCredit\(^72\) and money market statistical reporting (MMSR)\(^73\), which complement the coverage of financial instruments that are held by ECB-supervised institutions.

AnaCredit collects harmonised loan-by-loan data on credit granted by credit institutions from all euro area countries. AnaCredit went live in the fourth quarter of

---


\(^{72}\) The legal basis is Regulation (EU) 2016/867 on the collection of granular credit and credit risk data (ECB/2016/13) and Guideline ECB/2017/38.

2018 with initial data from a number of countries; data covering all euro area countries are expected to be available by the end of the first quarter of 2019. With regard to debtors, data cover credit granted to legal persons, which include non-financial corporations, government agencies and financial institutions. With regard to instruments, data cover deposits (other than reverse repurchase agreements), overdrafts, credit card debt, revolving credit (other than overdrafts and credit card debt), credit lines (other than revolving credit), reverse repurchase agreements, trade receivables, financial leases and other loans. Besides providing information on the risk of the counterparty and on its default status, information from AnaCredit is expected to allow supervisors to also identify risks from significant borrower concentrations, monitor and assess credit risk in supervised entities, and perform detailed analyses of non-performing exposures or collateral adequacy. Although the benefits that AnaCredit offers to supervisors when assessing credit risk are well identified, there are several limitations to the current framework that might prevent supervisors from using it extensively. In particular, those shortcomings include consolidation level (information only available at the level of individual entities), counterparty and instrument coverage (e.g. no information on households or on derivatives/off-balance sheet items) and materiality thresholds (e.g. small misalignments between AnaCredit and supervisory statistics). Ways to overcome these limits will be investigated when preparing for future stages of AnaCredit.

The MMSR dataset went live on 1 July 2016. It provides transaction-by-transaction data on different segments of the money market: secured and unsecured transactions, foreign exchange swaps and euro overnight index swaps. Altogether, 50 credit institutions in the euro area (resident in ten euro area countries) report relevant data. The reporting covers transactions between the reporting agents and other financial institutions (e.g. central banks, other financial intermediaries, insurance corporations and pension funds), general governments, and non-financial corporations classified as “wholesale” according to the Basel III LCR framework. MMSR data supplements supervisory data on both secured and unsecured credit exposures. It also provides data on overnight indexed swap transactions and FX swap transactions.

5.8.3 Information management within the SSM – IMAS

The Information Management System for the SSM (IMAS) underwent important changes in 2018. These included new modules for SREP and for the tracking and monitoring of supervisory findings and measures set out in ECB decisions and operational acts. The changes also include a new database on internal models, as well as new IMAS workflows for the ongoing monitoring of models and for referrals to enforcement and sanctions, including the reporting of potential breaches.

In addition to SSM-related activities, IMAS is now also supporting the SRB and the national resolution authorities (NRAs) in their resolution activities – it is the platform used by both the SSM and the SRM for the sharing of information, as the corresponding MoU stipulates.
6 Reporting on budgetary consumption

The SSM Regulation provides that the ECB must be able to devote adequate resources to the effective exercise of its supervisory tasks. These resources are financed via a supervisory fee that is borne by the entities subject to ECB supervision.

The expenditure incurred for supervisory tasks is separately identifiable within the ECB’s budget. The budgetary authority of the ECB is vested in its Governing Council. The Governing Council adopts the ECB’s annual budget following a proposal by the Executive Board in consultation with the Chair and the Vice-Chair of the Supervisory Board for matters related to banking supervision. The Governing Council is assisted by the Budget Committee (BUCOM), which consists of members from all the NCBs of the Eurosystem and the ECB. BUCOM assists the Governing Council by providing it with evaluations of the ECB’s reports on budget planning and monitoring.

The ECB expects the growth in managed expenditure to continue in 2019, primarily for the direct supervision of significant institutions. Budgeted expenditure for regular tasks has stabilised. However, there are external factors, most notably the United Kingdom’s withdrawal from the European Union, which necessitate an increase in resources for the coming year. Information on the approved increase in ECB Banking Supervision staffing can be found in Section 5.5 of this report.

6.1 Expenditure for 2018

The expenditure incurred by the ECB for the conduct of supervisory-related tasks primarily consists of the direct expenses of the ECB Banking Supervision Directorates General. The supervisory function also relies on shared services provided by the ECB’s existing support business areas.

In April 2018 the Governing Council adopted the ECB decision on the amount to be recovered via supervisory fees in 2018. This decision set the estimate for annual expenditure for banking supervisory tasks at €502.5 million. At the end of 2018 the ECB’s expenditure for supervisory tasks stood at €517.8 million. This was just 3% more than what was estimated in April 2018, but closer to budget than in 2017. In accordance with the ECB Regulation on supervisory fees ("the Fees Regulation"),

---

74 In accordance with Article 29 of the SSM Regulation.
75 These include premises, human resources management, administrative services, budgeting and controlling, accounting, legal, communication and translation services, internal audit, statistical and information services.
76 Decision (EU) 2018/667 of the ECB of 19 April 2018 on the total amount of annual supervisory fees for 2018 (ECB/2018/12).
the resulting deficit of €15.3 million will be collected in the total amount to be levied in 2019.\textsuperscript{77}

Table 8
Cost of the ECB’s supervisory tasks by function (2018-2016)

<table>
<thead>
<tr>
<th>Function</th>
<th>Actual expenditure 2018</th>
<th>Estimated expenditure 2018</th>
<th>Actual expenditure 2017</th>
<th>Actual expenditure 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct supervision of significant banks</td>
<td>304.8</td>
<td>283.4</td>
<td>242.9</td>
<td>192.0</td>
</tr>
<tr>
<td>Indirect supervision of less significant banks</td>
<td>28.7</td>
<td>27.1</td>
<td>24.0</td>
<td>24.8</td>
</tr>
<tr>
<td>Horizontal tasks and specialised services</td>
<td>184.4</td>
<td>192.0</td>
<td>169.8</td>
<td>165.4</td>
</tr>
<tr>
<td><strong>Total expenditure for banking supervision tasks</strong></td>
<td><strong>517.8</strong></td>
<td><strong>502.5</strong></td>
<td><strong>436.7</strong></td>
<td><strong>382.2</strong></td>
</tr>
</tbody>
</table>

Source: ECB.

Note: Totals and subtotals in the table may not add up owing to rounding.

The ECB groups its costs using a function-based classification. For its supervisory tasks, the principal activity-based groupings are:

- direct supervision of significant banks or banking groups;
- oversight of the supervision of less significant banks or banking groups (indirect supervision);
- performance of horizontal tasks and specialised services.

The classification is determined on the basis of the costs incurred by the business areas of the ECB that are responsible for the respective supervisory tasks. For each grouping the costs reported include the allocation of shared services provided by the ECB’s support business areas. The ECB also uses these classifications to identify the split of the annual costs to be recovered via annual supervisory fees from supervised entities based on their supervisory status as significant or less significant. The methodology defined in Article 8 of the Fees Regulation for the split of annual supervisory fees provides that the costs associated with horizontal tasks and specialised services are allocated proportionally, based on the full cost of the supervision of significant supervised entities and the cost of overseeing the supervision of less significant supervised entities, respectively.

The cost category of “direct supervision of significant banks or banking groups” mostly comprises the costs of the ECB’s participation in JSTs and on-site inspections. It also includes the costs associated with the multi-annual TRIM and the microprudential activities related to the 2018 biennial supervisory stress test for significant institutions. The oversight of the supervision of less significant banks or banking groups encompasses oversight activities and authorisation tasks. Horizontal tasks and specialised services comprise activities such as the work of the Secretariat to the Supervisory Board, macroprudential tasks including those related to stress testing, supervisory policymaking, statistical services and dedicated legal services.

Table 9
Cost of ECB Banking Supervision by expenditure category (2018-2016)

<table>
<thead>
<tr>
<th></th>
<th>Actual expenditure 2018</th>
<th>Estimated expenditure 2018</th>
<th>Actual expenditure 2017</th>
<th>Actual expenditure 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries and benefits</td>
<td>246.0</td>
<td>247.6</td>
<td>215.0</td>
<td>180.6</td>
</tr>
<tr>
<td>Rent and building maintenance</td>
<td>58.8</td>
<td>53.9</td>
<td>53.0</td>
<td>58.1</td>
</tr>
<tr>
<td>Other operating expenditure</td>
<td>213.0</td>
<td>201.0</td>
<td>168.8</td>
<td>143.4</td>
</tr>
<tr>
<td>Actual costs of banking supervision tasks</td>
<td>517.8</td>
<td>502.5</td>
<td>436.7</td>
<td>382.2</td>
</tr>
</tbody>
</table>

Source: ECB.
Note: Totals and subtotals in the table may not add up owing to rounding.

The largest proportion of costs incurred for supervisory activities is related to salaries and benefits, together with the associated expenditure on rent and building maintenance and other staff-related costs such as business travel and training.

The ECB applied a conservative approach when estimating the amount of expenditure for banking supervisory tasks that would be recovered via supervisory fees in 2018. The small overspend of 3% for the most part results from higher consumption rates of approved ECB headcount, which led to a corresponding increase for premises-related costs and activities such as business travel and consultancy services.

In addition to internal resources, it is necessary for the ECB to engage external consultancy services to support it in the performance of its supervisory tasks. These resources are engaged to provide either specialised expertise or integrated consultancy under qualified internal guidance to address temporary resource shortages. In total, the ECB spent €75.8 million on consultancy services for supervisory tasks in 2018. The largest single activity requiring consultancy support in 2018 was the TRIM, with external support costs amounting to €45.7 million for 2018. In 2018, €9.2 million was also spent on external resources for the biennial supervisory stress test, to supplement the FTEs seconded from NCAs and ECB internal staff. As explained in Section 5.5 of this report, the Governing Council has decided to increase ECB headcount as of 2019 to internalise the resources for stress-testing activities that were formerly provided using external consultancy support. The remainder of consultancy expenditure was primarily utilised for the conduct of “regular” on-site supervision tasks including cross-border missions, the assessment of banks’ readiness for the impact of changes to IFRS 9, comprehensive assessments and ongoing Brexit-related preparatory activities.

6.2 Fees framework for 2018

Together with the SSM Regulation, the Fees Regulation provides the legal framework within which the ECB levies an annual supervisory fee for the expenditure it incurs in conducting its supervisory tasks. The Fees Regulation establishes the methods for: (i) determining the total amount of the annual supervisory fee; (ii)
calculating the amount to be paid by each supervised institution; and (iii) collecting the annual supervisory fee.

Update on the review of the ECB’s supervisory fee framework

The outcome of an ongoing review of the ECB’s supervisory fee framework is intended to be published by April 2019. This publication will explain the amendments to the Fees Regulation proposed by the ECB and launch a public consultation on those proposed amendments. Addressing the comments on the review received as part of the public consultation which took place in 2017, the amendments include further proportionality measures for the smaller less significant banks, process-related improvements, including a more streamlined statistical data (fee factor) collection procedure, and clarifications on certain elements of the framework. The amended Regulation is expected to have entered into force when the annual supervisory fees are calculated for the 2020 fee period.

Total amount levied

In April 2018 the ECB decided on a total amount of €474.8 million in fees for the expenditure it expected to incur by conducting its supervisory tasks. This is based on the expected expenditure for the whole of 2018, amounting to €502.5 million, as adjusted for: (i) the surplus of €27.9 million carried forward from the 2017 fee period and (ii) €0.2 million (net) reimbursed to individual banks for previous fee periods.

The amount to be recovered via annual supervisory fees is split into two parts. This split is related to the status of supervised entities as either significant or less significant, reflecting the varying degrees of supervisory scrutiny applied by the ECB.

Table 10
Total income from banking supervision tasks

<table>
<thead>
<tr>
<th></th>
<th>Actual income 2018</th>
<th>Estimated income 2018</th>
<th>Actual income 2017</th>
<th>Actual income 2016</th>
<th>Actual income 2015</th>
<th>Actual income 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supervisory fees</td>
<td>517.8</td>
<td>474.8</td>
<td>436.7</td>
<td>382.2</td>
<td>277.1</td>
<td>30.0</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>fees on significant entities or significant groups</td>
<td>473.3</td>
<td>428.5</td>
<td>397.5</td>
<td>338.4</td>
<td>245.6</td>
<td>25.6</td>
</tr>
<tr>
<td>fees on less significant entities or less significant groups</td>
<td>44.5</td>
<td>46.3</td>
<td>39.3</td>
<td>43.7</td>
<td>31.5</td>
<td>4.4</td>
</tr>
<tr>
<td>Other</td>
<td>6.0</td>
<td>0.0</td>
<td>15.3</td>
<td>0.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total income from banking supervision tasks</td>
<td>523.8</td>
<td>474.8</td>
<td>452.0</td>
<td>382.2</td>
<td>277.1</td>
<td>30.0</td>
</tr>
</tbody>
</table>

Source: ECB.
Note: Totals and subtotals in the table may not add up owing to rounding.

As explained in Section 6.1, there is a deficit of €15.3 million between the actual expenditure incurred for banking supervisory tasks in 2018 and the amount estimated in the same year. This deficit will be taken into account in the total amount.
to be levied in 2019. It will be allocated to the categories of SIs and LSIs based on the ratio of actual costs that were allocated to the relevant functions in 2018, that is, 91% for SIs and 9% for LSIs.

The total amount levied in previous fee cycles has benefited from the carry-forward of unused amounts collected from the year before, thereby reducing the impact of annual expenditure increases. As the total amount to be levied in 2019 will be collecting a deficit (which increases the amount to be collected) rather than a surplus (which reduces the amount), it should be expected that the total amount to be levied for the next year will rise by more than the annual expenditure increase.

**Individual supervisory fees**

At bank level, the fees are calculated according to a bank’s importance and risk profile, using annual fee factors supplied by all supervised banks with a reference date of 31 December of the preceding year. The supervisory fee calculated per bank is then charged via annual payments due in the final quarter of each financial year.

**Figure 5**

The variable fee component is determined by a bank’s importance and its risk profile

---

The supervisory fee is set at the highest level of consolidation within Member States participating in the SSM. It contains a variable fee component and a minimum fee component. The latter applies equally to all banks and is based on 10% of the total amount to be recovered.78

Article 7 of the Fees Regulation provides that the following changes in the situation of an individual bank require an amendment of the corresponding supervisory fee: (i) a change in supervisory status of the supervised entity, i.e. the entity is reclassified from significant to less significant or vice versa; (ii) a new supervised entity is authorised; or (iii) an existing authorisation is withdrawn. Changes related to previous fee periods which resulted in new supervisory fee decisions by the ECB added up to €0.3 million in 2018.

---

78  For the smallest significant banks, with total assets below €10 billion, the minimum fee component is halved.
More information on supervisory fees is available on the ECB’s banking supervision website. These pages are updated regularly and are published in all official EU languages.

6.3 Other income related to banking supervisory tasks

The ECB is entitled to impose administrative penalties on supervised entities for failure to comply with obligations under EU banking prudential regulation (including ECB supervisory decisions). The related income is not taken into account in the calculation of the annual supervisory fees. The Fees Regulation ensures that neither damages payable to third parties nor administrative penalties (sanctions) payable to the ECB by supervised entities have any influence on the supervisory fee. The administrative penalties on supervised entities are recorded as income in the ECB’s profit and loss account. In 2018 the income arising from penalties on supervised entities amounted to €6.0 million.
7 Legal instruments adopted by the ECB

The following table lists the legal instruments concerning banking supervision that were adopted in 2018 by the ECB and published in the Official Journal of the European Union and/or on the ECB’s website. It covers legal instruments adopted pursuant to Article 4(3) of Regulation (EU) No 1024/2013 and other relevant legal instruments.

7.1 ECB regulations

ECB/2018/26

7.2 ECB legal instruments other than regulations

ECB/2017/44

ECB/2018/6

ECB/2018/10

ECB/2018/11

ECB/2018/12
Since December 2016 the ECB has published statistics on the balance sheet composition, profitability, solvency and credit risk of significant institutions on its banking supervision website. Following the introduction of the latest EBA reporting framework and the changing focus of market analysts and participants, the publication was extensively enhanced in 2018 to include new indicators, e.g. level 1, level 2 and level 3 assets, total exposures to general governments and IRB credit risk parameters. These supervisory banking statistics are disclosed on a quarterly basis and include geographical breakdowns and breakdowns according to bank classification.

Some important statistics relevant to the period under review are presented below. It should be noted that the sample of banks used in the various reference periods differs, as the list of significant institutions tends to change throughout the year.

Over the most recent reporting periods, capital ratios have been stable on average (see Table 11). The total capital ratio stood at 17.83% in the third quarter of 2018, slightly down from 17.97% one year previously. A similar development can be observed for the CET1 ratio, while the Tier 1 ratio increased from 15.32% in the third quarter of 2017 to 15.40% in the third quarter of 2018. The leverage ratio has marginally decreased, under both the transitional and fully phased-in definitions. The liquidity coverage ratio stood at 140.93% in the third quarter of 2018, up from 140.34% one year before.

Table 11
Total capital ratio and its components, leverage ratio and liquidity coverage ratio, by reference period

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Q3 2017</th>
<th>Q4 2017</th>
<th>Q1 2018</th>
<th>Q2 2018</th>
<th>Q3 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>CET1 ratio (transitional)</td>
<td>14.32%</td>
<td>14.64%</td>
<td>14.16%</td>
<td>14.10%</td>
<td>14.18%</td>
</tr>
<tr>
<td>Tier 1 ratio (transitional)</td>
<td>15.32%</td>
<td>15.63%</td>
<td>15.34%</td>
<td>15.30%</td>
<td>15.40%</td>
</tr>
<tr>
<td>Total capital ratio (transitional)</td>
<td>17.87%</td>
<td>18.14%</td>
<td>17.81%</td>
<td>17.76%</td>
<td>17.83%</td>
</tr>
<tr>
<td>Leverage ratio (transitional)</td>
<td>5.39%</td>
<td>5.60%</td>
<td>5.37%</td>
<td>5.36%</td>
<td>5.32%</td>
</tr>
<tr>
<td>Leverage ratio (phased-in)</td>
<td>5.17%</td>
<td>5.41%</td>
<td>5.14%</td>
<td>5.14%</td>
<td>5.11%</td>
</tr>
<tr>
<td>Liquidity coverage ratio</td>
<td>140.34%</td>
<td>143.56%</td>
<td>141.90%</td>
<td>140.91%</td>
<td>140.93%</td>
</tr>
</tbody>
</table>

Source: ECB.
Notes: Significant institutions at the highest level of consolidation for which common reporting on capital adequacy (COREP) and financial reporting (FINREP) are available. Specifically, there were 114 banks in the second and third quarters of 2017, 111 in the fourth quarter of 2017 and 109 in the first and second quarters of 2018. The number of entities per reference period reflects changes resulting from amendments to the list of significant institutions following assessments by ECB Banking Supervision, which generally occur on an annual basis, and mergers and acquisitions.

The quality of banks’ assets has also improved, as the overall NPL ratio has been steadily decreasing, from 5.15% in the third quarter of 2017 to 4.17% in the third quarter of 2018 (see Chart 13).
Banks’ total assets and liabilities (see Chart 14 and Chart 15) reflect the data for the (changing) sample of entities at specific points in time. Bearing this in mind, the main balance sheet items have remained stable over time, although the composition of assets shows an upward trend for the item “loans and advances” and a downward trend for the items “equity instruments” and “derivatives”. Moreover, the composition of liabilities shows a decreasing trend in “derivatives” and a slight increase in “deposits”.

**Chart 14**
Composition of assets by reference period

*(€ billions)*

<table>
<thead>
<tr>
<th>Q3 2017</th>
<th>Q4 2017</th>
<th>Q1 2018</th>
<th>Q2 2018</th>
<th>Q3 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans and advances</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash, cash balances at central banks, other demand deposits</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt securities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity instruments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivatives</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments in subsidiaries, joint ventures and associates</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intangible assets and goodwill</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Chart 15
Composition of liabilities and equity by reference period

(€ billions)