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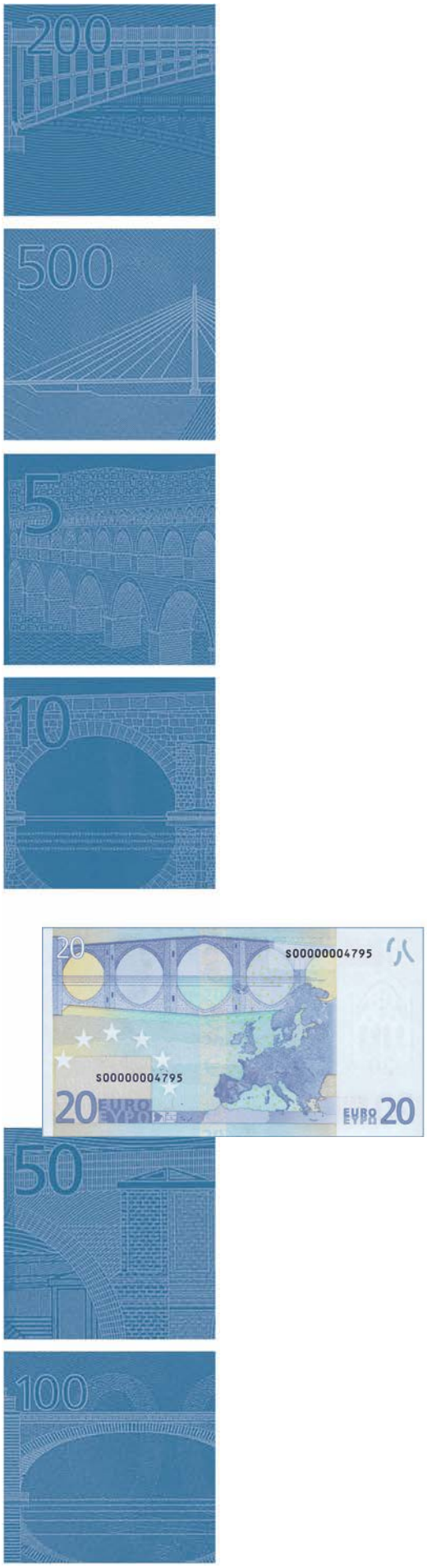
EUROSYSTEM



SSM QUARTERLY REPORT

2014 / 3

Progress in the operational implementation of the Single Supervisory Mechanism Regulation

KEY MESSAGES

This is the third Quarterly Report to the European Parliament, the EU Council and the European Commission on progress in implementing the Regulation on the Single Supervisory Mechanism (SSM Regulation). The report, which is required under the SSM Regulation, covers the three months **between 4 May 2014 and 3 August 2014**[1].

The key messages of this Quarterly Report are the following:

- **The ECB will assume the tasks conferred on it by the SSM Regulation within three months, on 4 November 2014.** There has been considerable progress in the preparatory work thus far to ensure the preparedness of the ECB to assume such tasks, as set out in this report. Several challenges remain to be addressed in the next three months.
- **The SSM governance is fully functional.** The Supervisory Board and its Steering Committee held five meetings during the period under review. The Supervisory Board has already prepared complete draft decisions adopted under the non-objection procedure in line with the SSM Regulation. In particular, the preparation and adoption of more than one hundred decisions determining the significance of supervised institutions was processed in a smooth manner, as indicated below. Based on a selection procedure initiated with a call for expressions of interest on 1 May 2014, the five members and two alternates for the Administrative Board of Review will be appointed in early August by the Governing Council. The ECB Regulation on the establishment of the Mediation Panel was formally adopted in June and steps have been taken for the appointment of its members by the Member States.
- **The Supervisory Board finalised the largest part of the process of determination of the significance of the credit institutions of the Euro area, which will be subject to direct supervision by the ECB.** The determination process was carried out in close cooperation with the NCAs and was based on the criteria set out in SSM Regulation and the SSM Framework Regulation. As a result of this process, around 120 credit institutions or groups were determined as significant, most of which are already covered by the Comprehensive Assessment. These institutions and groups were notified of a draft decision on significance, on which they could provide comments, in line with the due process provided in the SSM Regulation and the SSM Framework Regulation. A very limited number of institutions were determined as less significance since the Supervisory Board considered that there were particular circumstances that justified that classification although the criteria for classification as significant were also fulfilled, in line with Article 70 of the SSM Framework Regulation. The final decisions are being notified to

[1] The first Quarterly Report was published on 4 February 2014, three months after the entry into force of the SSM Regulation on 4 November 2013, the second quarterly report on 6 May 2014.

the credit institutions and the final list of significant and less significant banks will be published on the ECB's website before 4 September. The overall process of assessment, preparation of the decisions, adoption, and notification of decisions in all relevant official languages to more than 120 institutions and groups, involved considerable analytical, legal and logistical challenges which were addressed by the SSM structures in close cooperation with the NCAs. This represented a first major test for the ECB, Supervisory Board and the SSM structures.

- **The establishment of Joint Supervisory Teams (JSTs), which will be the main operational structure for the conduct of supervision by the SSM, has reached certain milestones.** The SSM will establish a JST for each significant institution or group, leading to the establishment of 116 JSTs (the discrepancy between the number of 116 JSTs and the around 120 significant institutions or groups is due to the fact that some significant institutions are part of the same group, e.g. some of the institutions determined as significant due to representing the third largest institution in a Member State). In this context, almost all JST coordinators for the 116 JSTs have been selected and nearly all of them will have joined the ECB by the end of the summer. By September the number of staff needed for the JSTs to be operational (around 200) will be achieved, in line with the SSM planning assumptions. Besides adequate staffing, the setting-up of operational JSTs requires the development of infrastructures, training and effective organisational arrangements both within the ECB and with the NCA staff that will also integrate the JSTs. For this purpose, there have been several high-level and staff meetings between the ECB and the NCAs, which have started the operational setting-up of the JSTs. preparations for the JSTs in this period also focused on the transition of supervisory responsibilities to the SSM and on the follow-up to the results of the comprehensive assessment and any supervisory responses that may ensue after the disclosure foreseen for before 4 November.
- **There has been significant progress in the conduct of the comprehensive assessment** which has reached an advanced stage, as the major work blocks of the asset quality review (AQR) are being concluded in August. The ECB held a range of outreach meetings and events with the institutions and groups subject to the comprehensive assessment, as well as with national project management teams and third-parties, such as auditors. The methodology for the join-up of the AQR and the stress test is currently being finalised by the ECB and will be published in the first half of August. On 17 July the ECB has released the templates which will be used to disclose the bank-level results of the comprehensive assessment, together with additional information on methodological issues.
- **The SSM Supervisory Manual and public Guide to the SSM supervisory practices are being finalised.** The Supervisory Manual is an internal document for SSM staff which describes the processes and the methodology for the supervision of credit institutions as well as the procedures for cooperation within the SSM and with authorities outside the SSM. It has been further refined, in particular in relation to the methodology

for the SSM Supervisory review and evaluation process (SREP). The approval process by the Supervisory Board is taking place in several steps, taking into account that the manual is a living document that will continue to be updated regularly. The ECB will publish before 4 November 2014 a Guide on its Supervisory Practices clarifying the features, tasks and processes of the SSM. The Guide complements the SSM Regulation and Framework Regulation and will be translated and made available in all official euro area languages.

- **The draft ECB Regulation on supervisory fees was submitted to a public consultation.** In line with the SSM Regulation, the consultation which covered the arrangements for the collection of fees levied on a credit institution or branch, including underlying calculations was launched on 27 May 2014 with a deadline to submit comments on 11 July. The public consultation was a success and achieved its intended purpose. By the closing date, the ECB had received 31 sets of comments, which are being assessed.
- **The staffing of the SSM is making good progress.** The recruitment of management and professionals for the ECB supervisory function, which has been organised in a top-down fashion, is progressing well towards finalisation. The large number of applications received (more than 14,500 for the positions advertised so far) confirms that there is considerable interest in the SSM positions. It is important to keep up the current momentum, also taking into account a clear commitment not to compromise on quality.
- The **preparatory work** is also well advanced in many areas, such as IT infrastructure, HR, premises, internal and external communication, logistical organisation and legal and statistical services.

1. INTRODUCTION

The SSM Regulation[2] requires the European Central Bank (ECB), as from 3 November 2013, to send quarterly reports to the European Parliament, the EU Council and the European Commission on progress in the operational implementation of the SSM Regulation.

Under the accountability arrangements with the European Parliament[3] and the EU Council[4], these reports should cover, among other things:

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

The first SSM Quarterly Report, which was published on 4 February 2014, covered not only the period from 3 November 2013 to 3 February 2014, but also the preparatory work conducted since the euro area summit of 29 June 2012. The second Report covered the period from 4 February to 3 May 2014. The third Report covers the period from 4 May to 3 August 2014. It was prepared by ECB staff and approved by the Supervisory Board, with the ECB's Governing Council being consulted.

The fourth Quarterly Report will be published in early November 2014.

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

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

[4] Memorandum of Understanding between the Council of the European Union and the European Central Bank on the cooperation on procedures related to the Single Supervisory Mechanism, which entered into force on 12 December 2013.

2. ESTABLISHMENT OF THE SSM GOVERNANCE STRUCTURES

2.1 ESTABLISHMENT OF THE ADMINISTRATIVE BOARD OF REVIEW

Pursuant to Article 24 of the SSM Regulation, the ECB shall establish an Administrative Board of Review (ABoR) for the purposes of carrying out an internal administrative review of the decisions taken by the ECB in the exercise of the powers conferred on it by the SSM Regulation. The scope of such internal administrative reviews shall pertain to the procedural and substantive conformity of such decisions with the SSM Regulation. The ABoR will be composed of five individuals of high repute acting as members and two alternates who meet the eligibility criteria stipulated in Article 24(2) of the SSMR Regulation.

In line with the procedure foreseen for the appointment of the members and alternates of the ABoR, the ECB published on 1 May 2014 a call for the expression of interest in the EU Official Journal. The initial deadline had to be extended from 22 May 2014 to 2 June 2014 due to the lack of a sufficient number of applications. The candidates were assessed against the eligibility and selection criteria foreseen in the call for expression of interested, taking into account gender and geographical diversity. The ABoR selection committee proposed five members and two alternates of the ABoR to the ECB's Executive Board. After hearing the Supervisory Board on the potential nominees, the Executive Board submitted the nominations of the potential ABoR members and alternates to the Governing Council. Given the notification period of one month before the respective Governing Council meeting,[5] the decision for the appointment of the ABoR members is currently scheduled for early August 2014.

2.2 MEDIATION PANEL

To help to ensure the separation between monetary policy and supervisory tasks, the SSM Regulation provides for a further internal body, the Mediation Panel. The purpose of this body is to resolve – if so requested by an NCA – differences of views regarding an objection by the Governing Council to a draft decision prepared by the Supervisory Board. The Mediation Panel must therefore comprise one member per participating Member State, chosen from among the members of the Governing Council and the Supervisory Board.

The Governing Council has formally adopted an ECB Regulation concerning the establishment of the Mediation Panel and its Rules of Procedure on 2 June 2014, which entered into force on

[5] Art. 4(2), ECB Decision ECB/2014/16 of 14 April 2014 concerning the establishment of the Administrative Board of Review and its Operating Rules, OJ L 175, 14.6.2014, p. 47.

20 June 2014. The Mediation Panel will be chaired by the Vice-Chair of the Supervisory Board, who is not a member of the panel.

In order to proceed with the establishment of the Mediation Panel, and taking into account the requirement in Article 4(1) of the ECB Regulation providing that '*The Chair shall facilitate the achievement of a balance between Governing Council and Supervisory Board Members*' steps are being taken by the Chair of the Mediation Panel to facilitate the appointment of its member by each individual Member State.

3. DECISIONS ON THE LIST OF SIGNIFICANT INSTITUTIONS

The SSM Framework Regulation (Art 39.1) states that the ECB shall determine which of the credit institutions throughout the Euro Area should be deemed significant. By 4 September 2014 the individual credit institutions must be notified of their status after having had the opportunity to exercise their right to be heard. In addition, the ECB shall publish a list of significant institutions as well as a list of less significant institutions on its website.

In order to complete the above mentioned process, the Supervisory Board initiated the assessment of significance already in March this year by gathering and analysing the necessary information in close cooperation with the NCAs concerned. Based on this analysis the Supervisory Board decided on the proposed list of significant credit institutions in May and sent out notification letters to all those institutions which are deemed significant, allowing them to send comments to the ECB; the ECB also published a preliminary draft list on the ECB's website in parallel.

Taking into account the comments of the institutions that are deemed significant (they are still being assessed), the Supervisory Board decided on the full list of significant credit institutions. The overall process of assessment, preparation of the decisions, adoption, and notification of decisions in all relevant official languages to more than 120 institutions and groups, involved considerable analytical, legal and logistical challenges which were addressed by the SSM structures in close cooperation with the NCAs.

The ECB will publish the list of significant and less significant banks on the ECB's website before 4 September. According to the SSM framework regulation, this review must be updated at least annually.

The ECB in close cooperation with the NCAs has carried out the assessment of significance based on the criteria set in SSM Regulation (Art 6) and the SSM Framework Regulation (Part IV), namely:

(a) size (total assets on the balance sheet above €30 bn.);

(b) importance for the economy of the Union or any participating Member State (in particular, total assets above €5 bn. and 20% of GDP of a Member State);

(c) significance with regard to cross-border activities (in particular, if the ratio of its cross-border assets or liabilities to its total assets or liabilities, respectively, is above 20%);

(d) a request for or the receipt of direct public financial assistance from the European Stability Mechanism (ESM);

(e) one of the three most significant credit institutions in a participating Member State.

As a result of this assessment, currently 120 credit institutions or groups can be considered as significant. The relevant criteria for significance applied to these institutions according to the order provided in the SSM Framework Regulation (Art 43.7) are:

a) 97 institutions are considered being significant on the basis of size;

b) 13 institutions are in addition considered significant on the basis of importance for the economy;

c) 3 institutions are significant on the basis of cross-border activities;

d) 7 institutions are considered being significant on the basis of the fact that the supervised entity is one of the three most significant credit institutions in terms of total assets in a participating Member State.

Most of these institutions are already covered by the Comprehensive Assessment with the exception of 4 cases, of which 3 correspond to institutions considered significant on the basis of the cross border activities criterion which had not been taken into account when defining the scope of the comprehensive assessment. These are relatively small credit institutions that will be subject to the Comprehensive Assessment after the 4 November 2014. The fourth institution considered significant and not covered by the Comprehensive Assessment is a branch of a non SSM banking group and therefore out of the scope of this exercise.

On the other hand, a total number of 11 institutions covered by the Comprehensive Assessment have been qualified as less significant mainly due to updated information as regards the fulfilment of the size criterion (also taking into account that for the purposes of the

Comprehensive Assessment a buffer range of 10 percent below the formal size threshold had been added in order to capture all potentially significant institutions).

When assessing the significance of the institutions, there can be particular circumstances that may justify the classification of a supervised entity as less significant although the criteria for classification as significant are fulfilled. In this regard, the SSM Framework Regulation (Art 70) establishes that a particular circumstance exists where there are specific and factual circumstances that make the classification of a supervised entity as significant inappropriate, taking into account the objectives and principles of the SSM Regulation and the need to ensure the consistent application of high supervisory standards. The ECB jointly with the relevant NCAs has identified three cases where the application of Art 70 has been considered appropriate and therefore these institutions have been classified as less significant although they comply with the formal significance criteria. For two of the cases the decision has been based on the need to preserve the integrated supervision currently applied in the NCAs. The third application of particular circumstances was to avoid considering an institution as significant that is relatively too small for being supervised by the ECB directly.

For all banks that are part of the Comprehensive Assessment, the exercise will be completed regardless of their current proposed classification.

4. ESTABLISHMENT OF THE SUPERVISORY FUNCTION AT THE ECB

4.1 STAFFING

The recruitment of management and professionals for the ECB supervisory function is progressing well. More than 14,500 applications have been received for the positions advertised so far, showing that there is a considerable interest in the SSM positions, both from staff from national competent authorities and from the private sector. Until the beginning of July altogether 79 managers and 9 advisers have taken up office and another 6 managers will arrive in the next weeks.

Around 280 staff members at the professional levels working in areas in charge of the significant banks have been selected and they are expected to take up their positions in Q3 and Q4. This represents a major milestone in the SSM staffing process, contributing to the timely establishment of the Joint Supervisory Teams (JSTs) (see below). Additional, dedicated recruitment campaigns have been launched to fill in the remaining needs. The major part of the recruitment of the remaining around 260 professionals supporting the work related to the less

significant banks as well as horizontal and specialised functions is expected to be finalised in Q3 and Q4. In the meantime professional experts, seconded from NCAs are supporting the preparatory work in these areas. Overall, more than 550 colleagues have been recruited by the beginning of July for the five SSM business areas on a permanent, fixed-term or short term basis

Notwithstanding the good progress in recruitment, there is no reason for complacency and it is important to keep up the current momentum, particularly in terms of processing applications and completing the selection procedures. To mitigate the related risks regarding the quality and speed of the recruitment process, the ECB is making use of a number of pre-assessment tools (e.g. online testing, remote written tests, and technical pre-selection interviewing), which can be deployed flexibly, depending on the number of applications.

An additional risk may be the longer-than-foreseen notice periods, meaning that teams may not be completed as quickly as envisaged (in particular, as a number of releasing institutions are now heavily involved in the comprehensive assessment). Furthermore, in a few cases it has proven difficult to find colleagues with the appropriate profile and positions need to be re-advertised. In view of the very small number of positions concerned, vacancies can be specified in more detail, mitigating the risk of not being able to fill the position also in the second round. In any event, there is a clear agreement not to compromise on quality.

4.2 ESTABLISHMENT OF THE JSTS

The operational supervision of significant banks will be the responsibility of JSTs. Each JST will be managed by a JST coordinator working for the ECB and will comprise a number of supervisors from both the ECB and the NCAs of participating Member States.

The SSM is making good progress in the staffing and preparatory work of the JSTs. The recruitment for the middle management of Directorate Generals Micro-Prudential Supervision I and II (DGs MS I and II) has just finalised, almost all JST coordinators for the 116 JSTs (31 in DG MS I and 85 in DG MS II) have been selected and nearly all of them will have joined the ECB by the end of the summer. The remaining positions will be covered with a targeted campaign.

According to plan, the JST coordinators of DG MS I have been appointed among the Heads of Division and Heads of Section in early-June and those for DG MS II have been very recently assigned, as the Advisers campaign has been finalised in the last weeks. Some of them, particularly the candidates from the latter campaign, are not yet at the ECB but the vast majority of them will be operational by September as envisaged in the plan.

Most of the JST national sub-coordinators were appointed by the NCAs in June; although in some cases they are preliminary as some changes could be considered once the organisational

adaptation to the SSM is finished. The NCAs have updated the number of staff assigned to the JSTs and are providing the specific names.

The recruitment of Principal Supervisors, Supervisors and Analysts (283 positions to fill) is progressing as scheduled. Appointments have been made, ensuring that by September the number of staff needed to be operational (around 200) has been achieved.

More recently, DGs MS I and II have established a number of work streams to define the responsibilities, processes and infrastructure necessary for the JSTs to be fully operational by November 2014.

In recent months the transition of supervisory responsibilities to the SSM has been supported by a series of meetings with different stakeholders.

High level meetings have been held with NCAs from 13 SSM member states including NCA Governors and executives as well as ECB Directors General and Deputy Directors General. High level meetings with remaining NCAs have already been scheduled or will be scheduled in near future. The meetings covered the general structure and objectives of the SSM, the organisation and supervisory approach of each NCA and, finally, the future plans that NCAs could have to adapt their supervisory framework to the SSM.

About 30 JST kick-off meetings with home NCAs of significant institutions have taken place in the meantime. For the remaining significant institutions, NCA kick-off meetings have been scheduled or will be scheduled in near future in line with the arrival of JST coordinators. The main objective of the JST kick-off meetings is to familiarize NCA and ECB staff with each other, to agree on a working plan and on the mode of communication and information exchange, among others.

The kick-off meetings also serve to complement the information received from NCAs regarding supervisory history and risk profile in line with article 33.5 SSM regulation. The information has been consolidated within supervisory dossiers and has been analysed in recent months within DG MS I / II. In the kick-off meetings ECB discussed the information provided in the files provided by NCAs and was given an overview of recent events and developments after submission by the NCAs.

Part of the high level meetings as well as the JST kick-off meetings included introductory meetings with the senior management of the respective banks. A systematic coverage of banks' senior management by JSTs including a presentation of the future supervisory structure, responsibilities and points of entry for decision making processes will be completed over the transition phase.

Since June, the ECB has also participated as observers in more than 10 meetings of supervisory colleges and crisis management groups. Participation in colleges is being used to present the

timeline for the joint decisions on capital and liquidity and to enable NCAs to coordinate the preparatory work for these decisions compliant with the SSM timeline.

As part of the above mentioned processes, DGs MS I and II are making preparations for JSTs to prepare for the implementation of the results of the comprehensive assessment and any supervisory responses that may ensue.

There are a number of challenges that will have to be managed to make the JSTs fully operational by September. On top of risks relating to the SSM staffing in general (including delays in colleagues effectively joining the ECB, need to fill certain gaps in specialty skill areas…), the JSTs will be challenged with a number of key tasks over the coming months, including deepening outreach to the NCAs and banks, acquiring the skills to help oversee the results of the comprehensive assessment, preparing to assume leadership of colleges, and building the necessary infrastructure to manage the day to day tasks of the JST (in close collaboration with DG MS IV, which handles horizontal and specialised services).

4.3 SEPARATION OF THE FUNCTIONAL AREAS

Article 25 of the SSM Regulation specifies aspects of the separation principle such as (i) separation of objectives; (ii) separation of tasks; (iii) organisational separation; and (iv) procedural separation on the level of the Governing Council. The Regulation requires the ECB to adopt and make public any necessary internal rules to ensure the separation between the supervisory function on the one hand and monetary policy functional areas and other tasks of the ECB on the other, including rules regarding professional secrecy and information exchanges.

In addition to the measures already taken in the areas of organisational and procedural separation to implement the requirements, as laid out in the SSMR, work is ongoing with respect to the sharing of information between the supervisory and monetary policy functions. The scope of appropriate information exchanges and the related governance structures are currently being set up. This work is expected to result in a proposal for a legal act specifying the exchange of information between the two policy areas. These rules will be organised in full and strict compliance with the applicable laws and regulations (e.g. Capital Requirements Directive, Council Regulation 2533/98 on the collection of statistical information by the ECB, legal acts governing data protection and banking secrecy) and the general obligations of professional secrecy as laid down in the ESCB statute.

4.4 CODE OF CONDUCT FOR THE ECB STAFF AND MANAGEMENT INVOLVED IN BANKING SUPERVISION

Under the SSM Regulation, the ECB's Governing Council is to establish and publish a Code of Conduct for the ECB staff and management involved in banking supervision. For that purpose, the ECB has prepared draft rules of ethical conduct as part of a general review of the Ethics Framework that applies to all ECB staff. These new rules will take account of the requirements laid down in the SSM Regulation and the Inter-institutional Agreement. A proposal has been submitted to the Supervisory Board and staff representatives for their consideration. Thereafter, the proposal will be submitted to the ECB's decision-making bodies. In line with the Inter-institutional Agreement, the ECB will inform the European Parliament about the main elements of the envisaged Code of Conduct before it is adopted. It is expected that the new rules will be adopted before the ECB fully assumes its supervisory responsibilities in November 2014.

4.5 CODE OF CONDUCT FOR THE MEMBERS OF THE SUPERVISORY BOARD

Under Article 13e of the Rules of Procedure of the ECB, the Supervisory Board is to adopt and update a Code of Conduct for the guidance of its members which shall be published on the ECB's website. The ECB is currently preparing such rules of ethical conduct for the members of the Supervisory Board. These rules will take account of the requirement laid down in Article 31(3) of the SSM Regulation according to which comprehensive and formal procedures and proportionate periods shall be established and maintained in order to assess in advance and prevent possible conflicts of interest of members of the Supervisory Board resulting from subsequent employment within two years.

5. LEGAL FRAMEWORK

5.1 PUBLIC CONSULTATION ON THE DRAFT ECB REGULATION ON SUPERVISORY FEES

Article 30(2) of the SSM Regulation establishes that the amount of the fee levied on a credit institution or branch shall be calculated in accordance with the arrangements established, and published in advance, by the ECB. Before establishing those arrangements, the ECB shall conduct open public consultations and analyse the potential related costs and benefits, and publish the results of both. In addition, pursuant to Article 4(3) of the SSM Regulation, the ECB

must conduct public consultation on ECB regulations adopted for the purposes of carrying out the tasks conferred upon it by the SSM Regulation.

After transmission to the European Parliament's Economic Affairs Committee, in accordance with the relevant provisions of the Inter-institutional Agreement, the public consultation on the draft ECB Regulation on supervisory fees was launched on 27 May 2014 and the deadline to submit comments ended on 11 July. In addition, a public hearing was held at the ECB on 24 June, which gave stakeholders a first opportunity to ask questions on the draft legal act.

The public consultation achieved its intended purpose. By the closing date, the ECB had received 31 sets of comments. Respondents included European and national market and banking associations, financial and credit institutions and lawyers. The ECB will evaluate the comments received and assess their impact, including potential related costs and benefits, on the draft proposal. The comments will be published on the ECB website together with a feedback statement. The ECB Regulation on supervisory fees will be adopted and enter into force before the ECB assumes its supervisory tasks on 4 November 2014.

5.2 FOLLOW-UP TO ECB DECISION ON CLOSE COOPERATION

The SSM Regulation provides Member States whose currency is not the euro with the possibility to participate in the SSM under a regime of close cooperation. While Article 7 of the SSM Regulation sets forth the main conditions for the establishment of close cooperation between the ECB and the competent authorities of a requesting Member State, procedural aspects have been specified by Decision ECB/2014/5[6] which further clarifies timing and content of a request to enter into close cooperation, its assessment by the ECB and the eventual adoption of ECB decision.

Decision ECB/2014/5 entered into force on 27 February 2014 but no requests to enter into close cooperation have been so far notified in line with the prescribed procedure. Nonetheless, the ECB received informal expression of interest from some Member States and is currently organising bilateral meetings aiming at discussing issues of mutual interest in view of their possible entry into close cooperation arrangements.

[6] ECB Decision ECB/2014/5 of 31 January 2014 on the close cooperation with the national competent authorities of participating Member States whose currency is not the euro (published on the ECB website, not yet published in the Official Journal).

5.3 ECB RECOMMENDATION TO AMEND COUNCIL REGULATION (EC) N° 2532/98

The Recommendation for a Council Regulation amending Regulation (EC) No 2532/98 concerning the powers of the European Central Bank to impose sanctions which had been adopted on 16 April 2014 (ECB/2014/19) to ensure that Regulation (EC) No 2532/98 and the SSM Regulation operate effectively and consistently in the context of the SSM, was published in the Official Journal on 14 May 2014[7].

6. SUPERVISORY MODEL

6.1 FINALISATION OF THE SUPERVISORY MANUAL

The Supervisory Manual is an internal document for SSM staff which describes the processes and the methodology for the supervision of credit institutions as well as the procedures for cooperation within the SSM and with authorities outside the SSM. The Supervisory Board endorsed a preliminary version of the Supervisory Manual at its first meeting in January 2014. Since then the Supervisory Manual has been further refined and the manual is being submitted for approval to the Supervisory Board in several steps.

Modifications to the Supervisory Manual have been made to further improve and detail the various processes. The main amendments included in the Supervisory Manual concentrate on the following: (1) JST composition and staffing, (2) supervisory processes, (3) the roles and responsibilities within the ECB, (4) the methodology for on-site inspections, and (5) the methodology and process for the SSM Supervisory review and evaluation process (SREP).

The SREP methodology developed for the SSM is consistent with the EBA SREP Guidelines. Data have been gathered in order both to develop risk indicators and to continue their calibration. These data collection exercises have been conducted with the NCAs on a best effort basis.

The updated version of the Supervisory Manual will serve to support the planning of the 2015 activities. The Supervisory Manual is expected to be a dynamic document continuously developing based on new market developments and supervisory practices.

[7] OJ C 144/2 of 14.5.2014.

6.2 PREPARATION OF A PUBLIC GUIDE TO SSM SUPERVISORY PRACTICES

The SSM is subject to publication requirements in order to ensure that there is an adequate level of information about its supervisory model available to both the public and supervised entities. In particular the Inter-institutional Agreement (IIA) between the European Parliament and the ECB foresees the publication of a "Guide to supervisory practices and methodologies" on the ECB website.

Against this background, the ECB has elaborated a user friendly, high level document, entitled *"Guide to the SSM Approach to Supervision"*, which explains the SSM overall functioning. More specifically, the Guide gives an overview of the main supervisory processes and methodologies applied to significant and less significant credit institutions by the ECB and national supervisors within the SSM. For example, it describes the work of the joint supervisory teams and sets out how SSM functions interact with each other to develop the planned comprehensive supervisory cycle.

The Guide complements the SSM Regulation and Framework Regulation and will be translated and made available in all official euro area languages. The Guide has not been developed to establish any legal requirements. Therefore, it cannot create any legal obligations neither for the credit institutions, nor for the ECB.

As mentioned in the previous issues of the Quarterly Report, the ECB plans to publish the Guide before the ECB officially takes over the supervisory responsibilities on 4 November 2014. Early publication should help the supervised entities to develop their proper views of the key SSM supervisory processes, and, where relevant, adjust their own internal procedures.

7. PREPARATION OF OTHER RELEVANT STRANDS OF WORK

7.1 SUPERVISORY DATA REPORTING FRAMEWORK

Following the approval by the Supervisory Board in April 2014 of the SSM Supervisory Reporting Manual, which will provide the data framework to support the conduct of supervision, the period under review focused on the third data collection pilot exercise (SPE-3).

This exercise, which was launched at the beginning of March in order to continue and refine the preparatory work for the centralised Risk Assessment System (RAS) and further improve its methodologies, has been nearly completed. Besides the development of the RAS, data also

plays an important role in the development of the model infrastructure for future horizontal risk analyses.

The content of the data collection was closely coordinated with NCAs; in order to closely accommodate their needs and those of banks the original deadline was extended for two weeks (from mid to end May 2014). Another important on-going task is the design of the reporting framework for non-harmonised data categories (in particular data that are requested to assess interest rate risk) and the preparation of the relevant legal acts for reporting requirements.

Significant progress has been made to implement the Supervisory Banking (SUBA) data system required for supervisory data and metadata collection, storage, quality analysis/enhancement and dissemination to supervisors. The user requirements have been prioritised to allow for the collection of the first wave of supervisory data from significant institutions as of 31 July 2014. The SUBA system will be further developed to enhance its reporting capabilities and data quality enhancement. From 2015, the ECB will collect ITS data also for the less significant institutions. The SUBA data system will gradually accommodate other regular supervisory data needs.

Datasets that have been developed for monetary and other policy purposes will also support supervisory tasks. Examples include the Register of Institutions and Affiliates Database (RIAD) which supports the mapping of significant banking groups, and a large dataset on granular credit data "Analytical Credit" which is currently being developed as a multi-purpose tool.

7.2 INFORMATION TECHNOLOGY

The creation of new business processes and a new operational model for the SSM is supported by the following IT work streams and activities. New IT needs have been identified.

- ***Shared IT services***: new computer equipment continues to be delivered in the temporary site for the SSM staff, to be completed by the end of autumn 2014. Some NCAs are outside of the ESCB/Eurosystem IT infrastructure and are currently working on establishing connectivity to the corresponding NCBs (AT, LU, LV, MT). There are two NCAs (DE & AT) which have expressed the preference to have a dedicated connectivity link, which will be possible only after the rollout of the CoreNet3 infrastructure towards Q1 2015.

  A new requirement for a secure means to exchange confidential emails between Significant Institutions (SIs) and the ECB for SSM purposes has been registered. The most feasible solution in the envisaged timeframe for the secure communication is

based on the email communication protocol called Transport Layer Security (TLS) and a proposal has been elaborated.

- ***Collaboration, workflow and information management***: the IT project for managing contact data and the handling of enquiries is currently being implemented, with first functionalities going live in July 2014. In anticipation of the expected load increase due to SSM, IT shared services & document management system capacity assessments are underway.
- ***Enterprise resource planning:*** the development of the fee collection and the SSM budget, organisational structure and reporting are in progress and will be delivered in Q3/Q4 2014. As requirements are not yet fully elaborated, fee calculation will not be ready in 2014 – however this does not prevent the initial installation and customisation, thus allowing delivery early in 2015, ahead of the process to produce fee notices.
- ***Data collection, data quality management and analytics***: First functionalities of the SUBA data system have been developed and deployed. The key objective of the project is to enable the ECB to receive specific supervisory data from all SSM countries based on XBRL format in line with the EBA's Implementing Technical Standards framework. Following the user requirements for SUBA, the EXDI messaging channels from SSM NCAs via ECB to EBA have been designed, realised and tested. Furthermore, the XBRL processor and the analytical platform for data validation and analysis have been developed using commercial software products. The first release of SUBA went live in July 2014. Additional iterations and releases are planned by end 2014.
- ***Information Management System (IMAS)***: IMAS will provide the basis to ensure harmonised processes and consistency in the supervision of banking institutions. Especially in the starting phase of SSM, it will be a crucial element in ensuring the application of the common methodology and standards by all JSTs. The software development is progressing on track and the project team is now focusing on preparing the test and training for JST members and users in the horizontal functions of the SSM. The availability of JST members from NCAs for test and training will be a crucial element for the successful roll-out of IMAS to the SSM by 4 November 2014.

8. COMPREHENSIVE ASSESSMENT

The Comprehensive Assessment is well underway and progress has been achieved on multiple fronts. The major work blocks of the asset quality review (AQR) have been concluded in July. Banks have submitted preliminary bottom-up stress test results to the NCAs and EBA, which

are subject to a quality assurance process that will continue until early September. The methodology for the join-up of the AQR and the stress test is currently being finalised and will be published in the first half of August. The templates for disclosure of the bank-level results of the comprehensive assessment, which were subject to a consultation period with the banks, have been published on 17 July. Upon the publication of the final results, banks facing a capital shortfall will be requested to submit capital plans within a period of two weeks, to be evaluated by the SSM. The JSTs will then closely track the implementation of these plans.

8.1 COMPREHENSIVE ASSESSMENT WORK BLOCKS: STATE OF PROGRESS

Overall, the Asset Quality Review (AQR) is on schedule for completion of Phase 2, i.e. the actual execution by the end of July/early August 2014. The results of the AQR will feed into the stress test. Major milestones which have been achieved in Phase 2 include the generation and submission of bank loan tapes, the completion of the data integrity validation process, the processes, policies and accounting review, the submission of credit files by the banks and the core trading book processes review. In addition, the collateral valuation, credit file review, revaluation of non-derivative level 3 assets, and the level 3 derivative pricing model review are very close to completion. By 1 August the bank inspections teams have submitted the filled-in templates for the overall capital adjustment based on the AQR, which incorporates the findings of all work blocks. Those will be subject to quality assurance and then used in the join up with the Stress Test.

As regards the stress test, the ECB has been cooperating closely with the EBA. In July and August, a thorough quality assurance of the bottom-up stress test results as provided by the banks is taking place by the ECB and NCAs. In September/October the AQR and stress test will be combined. The methodology for this join-up is currently being finalised and will be published in the form of a Manual in the first half of August. It will reflect a hybrid approach in the sense that part of the join-up will be performed by the banks, whilst the majority will be conducted by a centrally-led team of NCA and ECB experts.

All of the findings discovered in the AQR will be included in the stress-test by i) adjusting the year-end 2013 starting balance sheet/capital ratio based on all AQR findings, and ii) adjusting the parameters to forecast total losses in the stress test to reflect material differences between the banks' numbers and AQR findings for those portfolios that have gone through the AQR.

Following the formal approval by the EU Council of Ministers on XX July 2014 for Lithuania to join the eurozone on 1 January 2015, and in order to be in line with the rest of the euro area,

the Lithuanian banks likely to be determined as significant are completing a Comprehensive Assessment with the same project management approach, methodology and final deadline as for the euro countries.

8.2 INTERACTION WITH BANKS BEFORE THE DISCLOSURE OF FINAL RESULTS

Over the coming months until the publication of the comprehensive assessment results in October the interaction between supervisors and banks as part of the normal supervisory process will intensify further in order to check facts and to validate specific findings of different work blocks of the assessment. Findings communicated to the banks during this process will be of partial and preliminary nature and clearly labelled as such, underlining that they are not to be disclosed to the public.

When the calculation of the "AQR-adjusted CET1%" is concluded in August as mentioned above, its outcome will only be communicated to banks in cases where it has a very severe capital impact (for instance, implying a fall in capital ratios below the applicable regulatory minimum capital requirement). In those cases the respective NCA will then need to require the institution concerned to take corrective measures without delay.

In the second half of September/beginning of October, a review of partial and preliminary AQR and stress test results (including elements regarding the join-up of both components) will be conducted with the banks as part of a so-called 'supervisory dialogue'. These meetings will be organised under the auspices of the ECB and will allow for discussions which are essential to have a common understanding between banks and supervisors on the key elements and main individual drivers of the outcome of the exercise, while not addressing the full final impact on banks' capital ratios. No bank (except if it falls below the regulatory minimum capital requirements based on AQR findings) will be given certainty concerning its full overall result on this occasion.

During the second half of October, prior to publication, the comprehensive assessment results will need to be endorsed by the Supervisory Board and Governing Council.

Banks will be informed of the full and final results only shortly before communicating to the markets.

8.3 DISCLOSURE OF THE COMPREHENSIVE ASSESSMENT RESULTS

The templates for disclosure of the bank-level results of the comprehensive assessment have been published by the ECB on 17 July. Prior to the publication, a consultation period with banks

was held, providing them with an opportunity to comment both in written form, as well as in a series of physical meetings of the CFOs/CROs with ECB and NCA representatives at the ECB in Frankfurt.

The templates as published comprise the following main sections:

a. **Main Results & Overview:** A summary of the comprehensive assessment results for each bank, showing the overall impact of the exercise on the bank's CET1, also split into the individual CET1 adjustments stemming from each of its key components (AQR, baseline scenario and adverse scenario of the stress test). The Sheet also includes an overview of major capital measures which have been taken by banks between 1 January and 30 September 2014.

b. **Detailed AQR Results:** specific insights into the different findings of the AQR which are reflected in the overall CET1. The adjustments shown are split into those resulting from the work blocks dedicated to accrual accounted assets and those resulting from the fair value review. The sheet also provides disclosure on the portfolio selection underlying the exercise and the impact of the AQR findings on key asset quality indicators.

c. **Detailed stress test results:** This part of the template will be identical to the EBA disclosure template of the stress test, with the results shown for SSM banks incorporating adjustments based on the AQR.

In addition to the bank-level results, the ECB will publish an aggregated report presenting a broader perspective on the outcome of the exercise across the full sample of banks, as well as aggregate analyses of specific issues and methodological explanations.

8.4 PREPARATION, ASSESSMENT AND IMPLEMENTATION OF REMEDIATION ACTIONS

Upon the publication of the results in the second half of October 2014, banks facing a capital shortfall will be requested to submit capital plans within a period of two weeks, to be evaluated by the SSM. The ECB-led SSM joint supervisory teams (JSTs) will then closely track the implementation of these plans. As communicated in several instances, in case banks face a capital shortfall arising from the AQR or the baseline stress test scenario they will be expected to restore their capital position within 6 months, and in the case of the adverse stress test scenario within 9 months.

The Terms of Reference on shortfalls and burden-sharing following the comprehensive assessment as published by the Ecofin and the Eurogroup on 9 July will apply. As outlined in the former, the first port of call to address capital shortfalls is private sources. Public recapitalisations may be required in certain situations, but should be used only when strictly necessary to remedy a serious disturbance in the economy of a Member State and preserve financial stability.

The submission of capital plans by banks will be based on a specific template developed by the ECB. As a general expectation, shortfalls revealed by the AQR and the baseline stress test scenario should mainly be covered by new issuances of CET1 capital instruments. The use of Additional Tier 1 (AT1) capital instruments to cover shortfalls arising from the adverse stress test scenario will be limited depending on the trigger point of conversion or write-down, as outlined in the ECB press release of 29 April 2014. As was described in this press release, there will be no limits put on the eligibility of existing convertible instruments that are subject to unconditional pre-defined conversion into CET 1 within the stress test horizon, as well as existing state aid instruments used by Member States in the context of financial assistance programmes.

Asset sales and their impact on P&L, RWA and deductions from CET1 will be eligible only as extraordinary measures where they can be clearly identified as distinct from normal business operations. Typically, large asset sales programs of clearly separated portfolios (e.g. disposal of securitisation portfolios) and sales of subsidiaries will fall into this category. The impact of formal deleveraging or restructuring plans (those agreed with the European Commission) will be taken into account, however, also considering the extent to which it is already accounted for in the stress test.

Reductions in risk weighted assets due to pillar 1 risk model changes and switches in pillar 1 approaches will not be deemed eligible for addressing a capital shortfall, unless these changes had already been planned and approved by the competent authority before the disclosure of the comprehensive assessment results.

The joint supervisory teams (JSTs) will assess all planned capital measures with regard to their feasibility, viability and credibility. If a capital plan is found not to be sufficient or credible, the ECB will decide about possible supervisory measures according to Article 16 of the SSM Regulation. Those will be implemented as part of the decision emerging from the annual Supervisory Review and Evaluation Process (SREP) for 2014, which will be based on the

results of the comprehensive assessment, the assessment of the capital plans and the outcome of the annual review and evaluation conducted by national competent authorities.

After the submission of this decision to the banks, foreseen for December 2014, the JSTs will start monitoring the implementation of the capital plans based on a continuous dialogue with the bank, involving existing colleges of supervisors as appropriate. This monitoring process will involve the review of the incorporation of the findings from the AQR into accounts by the bank and its statutory auditor. The overall range of supervisory measures to address weaknesses identified in the comprehensive assessment includes quantitative measures, such as capital add-ons to the minimum pillar 1 requirements, restrictions to the distribution of dividends and specific liquidity requirements, for instance limiting maturity mismatches between assets and liabilities. In addition, pillar 2 includes a number of qualitative measures, addressing for instance management and reporting issues, internal controls and risk management practices. The SSM will make use of the full pillar 2 tool box as appropriate, using the whole range of instruments to address the specific situation of each institution.

9. ACCOUNTABILITY

This section briefly presents the main elements of the discharging of accountability towards the Council and European Parliament during the period under review.[8]

With regard to the Council, the Chair of the Supervisory Board, Ms Danièle Nouy, reported on progress with the establishment of the SSM and the comprehensive assessment in particular at the meetings of the Eurogroup on 7 July 2014 and of the ECOFIN Council on 8 July 2014. Once the ECB has assumed fully its supervisory tasks on 4 November 2014, SSM accountability will be discharged towards the Eurogroup in the presence of representatives from non-euro area Member States participating in the SSM.

With regard to the European Parliament and in line with the relevant sections of the Interinstitutional Agreement between the ECB and the European Parliament, the ECB transmitted to the competent committee (Committee on Economic and Monetary Affairs) the draft Supervisory Fees Regulation on 26 May, in advance of the public consultation launched on 27 May, and the legal acts already adopted by the ECB in the context of the SSM. The

[8] An overview of the accountability framework is presented in Section 8 of the first SSM Quarterly Report.

committee also received the confidential records of proceedings of the Supervisory Board meetings held between end-March and June 2014.

The next regular hearing with the Chair of the Supervisory Board in the Parliament's Committee on Economic and Monetary Affairs, one of the key channels of accountability towards the European Parliament, is scheduled to take place on 7 October.

10. NEXT STEPS AND CHALLENGES

Before the fourth and last Quarterly Report, scheduled for publication at the beginning of November 2014, the ECB intends to address in particular:

- the availability of the 200 ECB staff working in areas in charge of the significant banks needed for the JST teams to be operational;
- the finalisation and approval of ECB internal rules on the separation of functions and exchange of information;
- the finalisation of the draft ECB Regulation on supervisory fees following the public consultation.

The table below outlines the important milestones in the last quarter of the transition phase until 4 November 2014, when the ECB will assume supervisory powers.

Important milestones

Action	**Time frame**
Publication of list of significant banks	before 4 September 2014
ECB internal rules on separation of functions and exchange of information	September 2014
Review of the ECB Ethics Framework (including ethical conduct for ECB staff and management involved in banking supervision)	September – October 2014
Supervisory dialogue with banks on partial and preliminary AQR and stress test results	Second half of September – beginning October 2014
ECB Regulation on supervisory fees	October 2014
Publication of ECB guide to supervisory practices	before end-October 2014
Fourth Quarterly Report to the European Parliament, EU Council and European Commission	*Beginning of November 2014*
Start of supervisory activities	4 November 2014