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**Accompanying the document**

**Report from the Commission to the European Parliament and the Council**  
**on the Single Supervisory Mechanism established pursuant to Regulation (EU)**  
**No 1024/2013**

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## GLOSSARY

ABoR	Administrative Board of Review
AT1	Additional Tier 1
BCBS	Basel Committee of Banking Supervisors
BCP	Basel Core Principles for Effective Banking Supervision
BoS	EBA Board of Supervisors
BRRD	Bank Recovery and Resolution Directive, Directive 2014/59/EU, OJ L173, 12.6.2014, p. 190
CCB	Capital Conservation Buffer
CET1	Common Equity Tier 1
CJEU	Court of Justice of the European Union
CRD	Capital Requirements Directive, Directive 2013/36/EU, OJ L 176, 27.6.2013, p. 338
CRR	Capital Requirements Regulation, Regulation (EU) No 575/2013, OJ L 176, 27.6.2013, p. 1
DG MS III	Directorate-General Micro-Prudential Supervision III
DG MS IV	Directorate-General Micro-Prudential Supervision IV
DG-MF	Directorate-General Macro-prudential Policy and Financial Stability
EBA	European Banking Authority
ECA	European Court of Auditors
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
ECON	European Parliament's Committee on economic and Monetary Affairs
EIOPA	European Insurance and Occupational Pensions Authority
EP	European Parliament
ESAs	European Supervisory Authorities
ESCB Statute	Statute of the European System of Central Banks and of the ECB, OJ C 326, 36.10.2012, p.1
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
FOLF	Fail or Likely to Fail
FSAP	Financial Sector Assessment Programme
FSB	Financial Stability Board
FTE	Full-time equivalents
G-SII	Global Systemically Important Institution
IMAS	Information Management System
IMF	International Monetary Fund
IMI	Internal Model Investigation
INM	Internal Models Division
JST	Joint Supervisory Team
LSI	Less Significant Institution
MAP	Model Approval Process
MDA	Maximum Distributable Amount
NCA	National Competent Authority
O-SII	Other Systemically Important Institution

RAS	Risk Assessment System
SAI	Supreme Audit Institution
SI	Significant Institution
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRMR	SRM Regulation, Regulation 806/2014, OJ L/225, 30.7.2014, p.1
SSM	Single Supervisory Mechanism
SSMFR	SSM Framework Regulation, Regulation ECB/2014/17, OJ L 141, 14.5.2014, p. 1
SSMR	SSM Regulation, Council Regulation (EU) No 1024/2013, OJ L 287, 29.10.2013, p. 63
T2	Tier 2
TFEU	Treaty on the Functioning of the European Union, OJ C 202, 07.06.2016
TRIM	Targeted Review of Internal Models

## **Introduction – mandate, scope and methodology of the review**

Pursuant to Article 32 of Regulation (EU) No 1024/2013 (further referred to as SSMR)<sup>1</sup> the Commission is mandated to regularly prepare for the European Parliament and the Council a report on the application of that Regulation. Such mandate requires the Commission to undertake a broad review of the overall application of the SSM Regulation, with an emphasis on identifying the potential impact on the smooth functioning of the internal market. Several aspects of the application of the SSM Regulation are listed non-exhaustively in the mandate.

The first Commission report based on Article 32 of the SSMR briefly analyses the central aspects of the SSM Regulation and of its application, listing the main findings. The present Staff document is accompanying the Commission report, covering in more detail the aspects dealt with in the report. In undertaking its review, the Commission has relied on document analysis, interviews and informal discussions with relevant stakeholders. Both publicly available information,<sup>2</sup> as well as non-public documents requested and received from the European Central Bank (ECB)<sup>3</sup> were included in the analysis. Input was received from members of the European Parliament's ECON committee, national representatives in the Council, ECB staff, European Banking Authority (EBA) staff, Single Resolution Board (SRB) staff, technical experts and senior management and staff from several NCAs in participating and non-participating Member States, a sample of banks categorised as significant institutions (SI) and less significant institutions (LSI), and representatives of banking industry associations. Decisions directly addressed to individual institutions or bank-specific data were neither submitted by the SSM nor requested by the Commission. All samples shared by the ECB were in anonymised form.

Given the early stage of the SSM there was no or not sufficient experience to assess to the same level of detail all the aspects listed in the Commission's review mandate enshrined in Article 32 of the SSM Regulation. For instance, given that no close cooperation arrangements were concluded with Member States outside the euro area, it is not possible to assess the impact of those Articles. Furthermore, as the initial stage of the SSM has required intense efforts for putting in place workable arrangements between the various participating parties, and ensuring the effectiveness of supervisory tools, this report will not focus directly on the interaction between the SSM and competent authorities in non-participating Member States. Also, in relation to the potential impact on national banking systems, although some emerging trends may be noticed, such as an increased use of cross-border branches instead of subsidiaries, there was no sufficient information available to attribute this to a possible impact of the SSM and too early to identify other possible impacts on the structures of the national banking systems. Furthermore, it was too early to grasp the fiscal effects that supervisory decisions may have on participating Member States or the impact of developments in relation to resolution financing arrangements. Such assessment requires observing the interactions between the SSM and the Single Resolution Mechanism (SRM) and ongoing discussions on establishing a fiscal backstop.

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<sup>1</sup> Council Regulation (EU) N° 1024/2013 OJ L 287, 29.10.2013. p. 63.

<sup>2</sup> The documents analysed included, inter alia, ECB regulatory and non-regulatory acts, including the ECB's Supervisory Manual, Reports and Working Documents of various stakeholders, including the European Court of Auditors' "Special report No 29/2016: Single Supervisory Mechanism - Good start but further improvements needed", reports and resolutions by the European Parliament Working Document PE 599.709v02-00 on ECA Special Report N°29/2016, documents shared by the EBA, the national competent authorities and some banks.

<sup>3</sup> Prior to requesting and obtaining any non-public information or documents from the ECB, the Commission and the ECB have concluded a Memorandum of Understanding on the treatment of shared confidential information.

The Staff working document follows closely the structure of the Report providing the underlying analysis for the different sections of the Report.

Part A deals with the fundamental aspects of the SSM setup, and addresses the areas of evaluation mentioned in sub-paragraphs (e), (g), (i), (l) and partly (a) and (b) of the mandate in Article 32 of the SSMR. It contains an evaluation of the practical implementation of accountability and independence arrangements, scrutinises the decision-making process at the ECB, examines the mechanisms for separation between the monetary and supervisory functions, and the division of tasks between the ECB and the NCAs.

Part B covers practical aspects, analysing the effectiveness of the most prominent tools developed by the ECB for performing its supervisory tasks, such as the categorisation of the supervised institutions, the functioning of the Joint Supervisory Teams (JSTs) and the horizontal supervisory functions. It reflects elements falling under the sub-paragraphs (a) and (b) of the mandate in Article 32.

Part C evaluates the performance of the main supervisory tasks. This includes an analysis of the way the ECB performs the common procedures towards all credit institutions in the Banking Union, the way the ECB performs the direct supervision of significant institutions (the fit and proper tests, the approval of capital instruments, the Supervisory Review and Evaluation Process (SREP) for significant institutions, the approval of internal models), the responsibilities carried out vis-à-vis NCAs in the context of the supervision of less significant institutions, the exercise of the macro-prudential tasks conferred on the ECB. Lastly, the ECB's enforcement and sanctioning powers are evaluated. Sub-paragraphs (c), (d) and partly (b) of Article 32 are corresponding to this Part.

Part D is dedicated to the relationship of the ECB with other relevant bodies, examining the role of the ECB in ESFS, and specifically its interaction with the EBA and the SRB and with relevant international bodies. Sub-paragraphs (a) and (f) of Article 32 mandate correspond to this Part.

Part E deals with cost effectiveness of the SSM as envisaged in sub-paragraph (j) of Article 32. It analyses the supervisory fees, indicators of the quality of the supervision, including empirical evidence of the structural changes in the euro area since the establishment of the SSM.

Conclusions and recommendations corresponding to the analysis in this accompanying document are spelled out in the Report itself, and reflect the Commission's views regarding, inter alia, the possible ways of dealing with identified shortcomings. Overall this review sets out a positive assessment of the first two years of the ECB acting in its supervisory capacity. Some difficulties have been identified at this stage, however none of them concerns essential structural aspects that impinge on the functionality of the SSM and that would therefore justify proposing amendments to the SSM Regulation at the current juncture. For addressing some of these difficulties, the report provides interpretations of the regulatory framework, refers to ongoing discussions of amendments to relevant Union law or invites the ECB to take certain measures.

## **A. Governance of the SSM**

### **A.1. Accountability, due process and independence arrangements [Article 32(e) SSMR]**

Significant supervisory powers have been transferred for direct exercise to the European Central Bank (ECB) on the condition that any "shift of supervisory powers from the Member States to the Union level should be balanced by appropriate transparency and accountability requirements"<sup>4</sup>. To that end a framework has been put in place through the SSMR,<sup>5</sup> which aims to ensure that ECB's exercise of supervisory powers is subject to political, judicial and administrative accountability, whilst respecting the independence of the ECB and guaranteeing fair treatment and procedural rights for all those concerned. This section will assess the use and effectiveness of these arrangements during the first two years of Single Supervisory Mechanism (SSM) operation.

#### **A.1.1. Political Accountability [Article 32(e) SSMR]**

The SSMR requires that the ECB shall be accountable to the European Parliament (EP) and to the Council for the implementation of that Regulation and specifies the relation with the EP, the Council, and national parliaments.

#### **Annual Report**

The ECB is required by Article 20(2) of the SSMR to submit on an annual basis to the EP, the Council, the Commission and the Eurogroup a report on the execution of the tasks conferred on it by that Regulation, including information on the envisaged evolution of the structure and amount of the supervisory fees. This report shall also be forwarded to the national parliaments of the participating Member States. Since the SSM became operational, the ECB has submitted 3 comprehensive annual reports, which are also published on its website and presented in the European Parliament and the Eurogroup.

#### **Accountability towards the European Parliament**

Article 20 of the SSMR provides the right of the EP to request the Chair of the ECB's Supervisory Board to participate in hearings on its supervisory tasks. Confidential oral discussions with the Chair and Vice-Chairs of the competent committee of the EP can also be held upon request. Moreover the ECB shall answer, orally or in writing, to the questions referred to it by the EP.

Furthermore, the ECB and the EP signed an inter-institutional agreement to define the practical modalities of the exercise of democratic accountability<sup>6</sup>. Under these arrangements the ECB shall participate in bi-annual ordinary public hearings, may be invited for ad-hoc exchanges and confidential meetings and shall respond to written questions. The ECB shall also forward to the EP a meaningful record of the Supervisory Board proceedings including annotated decisions.

The Chair of the Supervisory Board attended three hearings of the ECON committee in 2015, three in 2016 and one in 2017, two ad-hoc meetings in 2015 and three in 2016. No confidential meeting has been held so far. Additionally, the ECB answered 88 letters on

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<sup>4</sup> Recital 55 SSMR.

<sup>5</sup> Council Regulation (EU) No 1024/2013, OJ L 287, 29.10.2013, p. 63.

<sup>6</sup> 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 (2013/694/EU).

supervisory issues from Members of the European Parliament since the set-up of the SSM (17 so far in 2017, 34 in 2016, 26 in 2015 and 11 in 2013-2014).

The EP has issued two reports on the Banking Union<sup>7</sup>, in which it expresses its views about the functioning of the SSM. These reports generally welcome the efforts made by the ECB while underlying areas that could benefit from further improvement.<sup>8</sup> One of the reports also welcomes "the efficient and open way in which the ECB has so far fulfilled its accountability obligations towards Parliament"<sup>9</sup>.

### **Accountability towards Council and the Eurogroup**

According to Article 20 of SSMR, the Eurogroup may request the Chair of the Supervisory Board to participate in hearings on its supervisory tasks. The ECB shall also answer questions orally or in writing. The Council and the ECB have concluded a Memorandum of Understanding on cooperation which includes the obligation for a bi-annual hearing of the Chair of the Supervisory Board to the Eurogroup, and the duty to respond to oral or written questions of the Euro Group.

The ECB in its supervisory capacity was present at five ECOFIN and informal ECOFIN meetings in 2014, none in 2015 and one in 2016. It attended the Eurogroup once in 2015 and twice in 2016, and the Euro working group twice in 2015 and twice in 2016.

### **Reporting to national parliaments**

Pursuant to Article 21 of the SSMR, national parliaments of the participating Member States may address observations or questions to the ECB on the performance of its supervisory tasks. National parliaments may also invite the Chair or a representative of the Supervisory Board, together with a representative of the national competent authority (NCA), to participate in an exchange of views in relation to the supervision of credit institutions in that Member State.

The SSM was heard six times by committees from national parliaments between 2014 and 2016 and received one direct question from the Latvian Parliament.

These reporting channels allow national parliaments to form an opinion on the functioning of the SSM. Some difficulties may have emerged in those participating Member States where Parliaments can set up investigative committees which under national law may have access to supervisory information<sup>10</sup>.

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<sup>7</sup> Annual Report on the Banking Union 2015, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A8-2016-0033+0+DOC+XML+V0//EN>.

Annual Report on the Banking Union 2016, <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A8-2017-0019&language=EN>.

<sup>8</sup> In the most recent report, the EP calls to ensure higher transparency in supervisory practices, takes note of the findings of the European Court of Auditors' report on the functioning of the SSM and particularly calls to ensure sufficient staffing at the ECB; shares the concern of the ECA that an 'audit gap' has emerged and urges the ECB to fully cooperate with the ECA, calls to achieve a better balance between proportionality and consistency in supervision; underlines that the separation of the supervisory tasks from monetary policy functions should enable the SSM to take an independent position on all relevant matters, including on potential effects of ECB interest rate targets on the financial position of supervised banks.

<sup>9</sup> Annual Report on the Banking Union 2015, paragraph 39.

<sup>10</sup> In this regard, Article 59(2) CRD allows the disclosure of supervisory information to parliamentary enquiry committees, if they have a mandate under national law to investigate supervisory authorities.



### **A.1.2. Judicial accountability [Article 32(e) SSMR]**

Judicial accountability in the SSMR is designed to reflect the judicial control framework applicable to the ECB as laid down in the Treaty on the Functioning of the European Union (TFEU)<sup>11</sup> and the Statute of the European System of Central Banks and of the ECB (ESCB Statute)<sup>12</sup>. Whilst there is no dedicated Article in the SSMR, recital 60 of the SSMR recalls that the legality of ECB acts, other than recommendations and opinions, intended to produce legal effects vis-à-vis third parties shall be reviewed by the Court of Justice of the European Union (CJEU) pursuant to Article 340 TFEU and Article 35.1 ESCB Statute. Equally, Article 24(11) SSMR confirms that the internal review mechanism implemented through the Administrative Board of Review (ABoR) should be without prejudice to rights to bring proceedings before the CJEU. In addition, recital 61 SSMR confirms the extension of the liability regime of the ECB to make good any damage caused by it or its servants in the performance of their supervisory duties.<sup>13</sup>

Judicial review of ECB supervisory decisions has been requested on several occasions since the set-up of the SSM. Until January 2017, 13 actions have been brought to the CJEU by significant and less significant institutions against decisions taken by the ECB, requesting legality checks in light of the SSMR, of Union law, as well as of national law transposing Directives. Whereas to date, only in one of these cases a judgement has been issued<sup>14</sup>, ongoing procedures show that the judicial review is actively used to hold the ECB to account. The liability regime and the legal standing recognised for addressees of ECB decisions might make the ECB prone to be subject to litigation to a larger extent than some national competent authorities, whose liability is more restrained under applicable national law.

### **A.1.3. Administrative accountability [Article 32(e) SSMR]**

Apart from the political accountability arrangements specified in the SSMR, the ECB is subject to various reviews by administrative bodies. The relevant arrangements may be found in the SSMR, as well as in the statutory acts of these bodies. Primarily, these concern the regular review of the functioning of the SSMR by the Commission, the European Court of Auditors' and the European Banking Authority. Moreover, international bodies such as the International Monetary Fund (IMF) assess to a certain extent the ECB when operating in its supervisory capacity.

#### **SSM review by ECA**

Pursuant to its mandate to examine the operational efficiency of the management of the ECB - as provided in the TFEU, the ESCB Statute and the SSMR<sup>15</sup> - the European Court of Auditors (ECA) issued on 18 November 2016 its first audit report on the SSM. The ECA report portrays as a success the set-up of the SSM by the ECB within a narrow timeframe, but criticises what it perceives as over-reliance on national competent authorities. The ECA report points to several aspects of the SSM functioning that could be improved and makes

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<sup>11</sup> OJ C 202, 07.06.2016.

<sup>12</sup> OJ C 326, 36.10.2012, p.1.

<sup>13</sup> The ECB is subject to the liability regime provided in Article 340 TFEU and Article 35.3 ESCB Statute. Such ECB liability regime should not affect the liability incumbent upon NCAs for damage caused in the performance of their duties under national law.

<sup>14</sup> Case T-122/15, Judgment of the General Court (Fourth Chamber, Extended Composition) of 16 May 2017 Landeskreditbank Baden-Württemberg - Förderbank v European Central Bank.

<sup>15</sup> The relevant provisions may be found in Article 287(1) of the TFEU, Article 27 of the ESCB Statute and Article 20(7) of the SSMR.

recommendations in the areas of governance, accountability, off-site supervision and on-site supervision. The ECB has recognised the validity of most of the ECA's recommendations<sup>16</sup> and committed to address them in a constructive way.

In addition, the ECA report emphasises difficulties encountered in obtaining from the ECB information that the ECA considers necessary for performing its audit mandate. This resulted, in the ECA's view, in several areas of the SSM activities not being covered by the audit<sup>17</sup>. The reluctance to share certain documents was justified by ECB on grounds that such documents would not be necessary for the ECA to perform the audit of the operational efficiency of the ECB's management and on the basis of confidentiality rules binding the ECB.

The ECA links problems in accessing ECB information to the "audit gap" signalled by the Contact Committee of the Supreme Audit Institutions (SAIs) in the EU. The Contact Committee of SAIs in the EU, which comprises Member States' heads of national audit offices and the ECA, has issued a statement concluding that "an audit gap has emerged in those euro area countries where previous audit mandates of national SAIs over national banking supervisors are not being replaced by a similar level of audit by the ECA over the ECB's supervisory activities"<sup>18</sup>. At the same time the Contact Committee acknowledged a second dimension to the audit gap, reflecting the fact that in some countries audit mandates of national SAIs over national banking supervisors are limited or absent altogether.

The ECA report has been discussed in both EP<sup>19</sup> and Council<sup>20</sup>, with a special emphasis on the ECA's difficulties in accessing ECB information. Both EU institutions have expressed their concern as regards the disagreement between the ECB and the ECA on the information that should be shared and encourage more cooperation between the two institutions. Following such criticism the ECB has expressed its willingness to discuss with the ECA.<sup>21</sup>

As concerns the more contentious issue of the sharing of information, problems raised by the ECA have a double dimension: different views over the scope of the ECA's mandate to audit the ECB and different views over the concrete information to be exchanged under that mandate.

With regard to the former, the Commission notes that the ECA's mandate of auditing the ECB. This mandate covers the operational efficiency of the management of the ECB (see Article 287 of the TFEU, Article 27.2 of the ESCB Statute, and the SSMR). This is indeed more limited than the mandates of certain national SAIs over national banking supervisory

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<sup>16</sup> The ECB only challenged certain ECA recommendations concerning the role of Supervisory Board in determining the budget for SSM activities and concerning the influence of shared services.

<sup>17</sup> In Annex II to the ECA report the areas are listed that are perceived as not being satisfactorily audited because of no or scarce evidence provided by the ECB. These include several aspects of the comprehensive assessment, decision-making process, operational efficiency of on-site inspections, operational efficiency of planning of off-site inspections, Supervisory Board meetings and accountability.

<sup>18</sup> [http://www.eca.europa.eu/sites/cc/Lists/CCDocuments/CC\\_STATEMENT\\_2015/CC\\_SSM\\_statement\\_EN.pdf](http://www.eca.europa.eu/sites/cc/Lists/CCDocuments/CC_STATEMENT_2015/CC_SSM_statement_EN.pdf). In 9 Member States, national courts of auditors had an extensive mandate to audit the banking supervisors. Since the establishment of the SSM, these national courts are no longer able to audit the supervision of their Member State's largest banks since they are directly supervised by the SSM. The mandate of the ECA is considered rather constrained as compared to the extensive mandates of the respective SAIs.

<sup>19</sup> EP resolution of 15 February 2017 on Banking Union – Annual report 2016 (P8\_TA-PROV(2017)0041; EP Working Document on the ECA' Special Report No 29/2016 (Discharge 2016) PE599.709v01.

<sup>20</sup> Council conclusions of 21 February 2017 on the European Court of Auditors' Special Report No 29/2016: "Single Supervisory Mechanism - Good start but further improvements needed".

<sup>21</sup> See interview of Mrs Nouy in Handelsblatt,

<https://www.bankingsupervision.europa.eu/press/interviews/date/2017/html/sn170418.en.html>.

authorities, although not all national SAIs have mandates over national banking supervisors. Yet, whether this amounts to a potential audit gap affecting the ECB's accountability needs to be assessed in the broader context that accounts also for the fact that the ECB is subject to additional accountability arrangements for its supervisory activities that might not necessarily be found in the national audit frameworks. In this context, it is important that the ECB's accountability is assessed holistically in light of all accountability arrangements to which it is subject.

As for the differences in opinion between the ECB and the ECA on the information to be shared, the Commission notes that Article 27(2) of the SSMR authorises the ECB to exchange information with Union authorities and bodies in the cases where relevant Union law requires national competent authorities to disclose information to those entities and within the limits and conditions provided under such Union law. The Commission notes also that Articles 56 and 57 of the CRD require competent authorities to exchange information with "persons responsible for carrying out statutory audits of the accounts of institutions", but do not list persons in charge of the audit of the competent authority itself. However, the absence of such an explicit reference should not preclude the ECB from sharing information with the ECA, as it is bound directly by the obligation to provide information under Article 287(3) second subparagraph of the TFEU<sup>22</sup>. Consequently the ECB is subject to a clear obligation to provide to the ECA any document or information necessary for the ECA to carry out its task, within the limits of its mandate.

### **EBA review of SSM**

The European Banking Authority (EBA) was entrusted, amongst others, with the essential tasks of contributing to the establishment of high-quality common regulatory and supervisory standards and practices, contributing to a common supervisory culture and conducting peer-review analyses of competent authorities in order to strengthen consistency in supervisory outcomes<sup>23</sup>. Furthermore, under Article 107 of the CRD, the EBA is given a specific mandate to check consistency of supervisory reviews, evaluations and supervisory measures, whilst all competent authorities are obliged to provide the EBA with information to enable it to perform such assessment. Pursuant to these mandates the EBA has so far issued two reports on supervisory convergence. The second report issued in July 2016 considers the state of play at the end of 2015 and includes in the assessment also the ECB.<sup>24</sup> For the purpose of the report, the EBA has performed a thorough review of ECB's supervisory practices, including scrutinising parts of ECB's supervisory manual, its information management system IMAS used by the ECB for supervisory purposes, bilateral discussions and visits. The ECB has been generally cooperative with the EBA for the purpose of this exercise, whilst not always being able to provide all the relevant background documentation to enable an accurate review by the EBA. Following this exercise, the EBA has prepared conclusions and recommended follow-

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<sup>22</sup> According to Article 287(3) second subparagraph " The other institutions of the Union, any bodies, offices or agencies managing revenue or expenditure on behalf of the Union, any natural or legal person in receipt of payments from the budget, and the national audit bodies or, if these do not have the necessary powers, the competent national departments, shall forward to the Court of Auditors, at its request, any document or information necessary to carry out its task." According to Article 27.2 ESCB Statute, the provisions of Article 287 TFEU shall also apply to the ECA examination of the operational efficiency of the management of the ECB. Where there is an exception from Article 287, this is explicitly stated in the TFEU, as in the case of the European Investment Bank (Article 287(3) third sub-paragraph).

<sup>23</sup> See Article 8(1) of Regulation (EU) No 1093/2010 (EBA Regulation).

<sup>24</sup> EBA report on the convergence of supervisory practices, EBA-Op-2016-11, 14 July 2016.

up actions for the ECB, which were partly addressed by the ECB through the review of its Supervisory Review and Evaluation Process (SREP) methodology.

The EBA has been also endowed with tools to discipline competent authorities, especially under its breach of Union law powers.<sup>25</sup> Such procedure allows the EBA to start upon request, or on its own initiative, an investigation over an alleged breach or non-application of Union law by competent authorities, including the ECB, and eventually to address a recommendation to them. It is however noted that the EBA does not use frequently the breach of law tool to issue a recommendation for compliance with Union law. Such procedure could be even more difficult to carry out in the context of the SSM, given the specific voting requirements in the EBA's Board of Supervisors involving a double majority from NCAs in participating and in non-participating Member States.<sup>26</sup> To succeed, such a procedure would require a majority of the competent authorities that are in the Supervisory Board to take a stance different from the one adopted by the same authority in the Supervisory Board. In this context, it seems that one of the key tools of the EBA can be less effective in the case of the ECB than it would potentially be in case of another competent authority.

It results that the ECB is subject to close scrutiny by the EBA as regards its compliance with the Single rulebook, and its efforts of aligning supervisory practices and supervisory outputs within a common supervisory culture. The EBA also disposes of soft but influential tools to require the ECB to take action. However, although possible in theory, the EBA's power to make formal recommendations to the ECB to comply with Union law may hardly be applied in practice due to the potential conflict of interests described above.

### **Review by the IMF**

The IMF periodically assesses countries' financial sectors in an exercise known as Financial Sector Assessment Program (FSAP). They mainly cover the risks to macro-financial stability, the financial stability policy framework and the authorities' capacity to manage financial crises. They include also an assessment of compliance with international financial sector standards such as the Basel Core Principles for Effective Banking Supervision (BCP)<sup>27</sup>.

Since the establishment of the SSM, the ECB is actively involved in the FSAP of the participating Member States, especially regarding the assessment of compliance with the BCP. As a consequence, IMF receives extensive information on, among others, the supervisory methodology applied by the ECB. This information feeds into the IMF's conclusions on compliance with the BCP in that country, which are made public.

In the context of the FSAPs carried out since the SSM became operational<sup>28</sup>, the IMF welcomed the harmonisation and benchmarking of supervisory practices and praised the ECB's supervisory process as "robust and conducive to a more structured, intense and

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<sup>25</sup> Article 17 of the EBA Regulation.

<sup>26</sup> Decisions in the context of Article 17 EBA Regulation require a simple majority of the voting members of the Board of Supervisors, which shall include a simple majority of members from participating Member States and a simple majority of members from non-participating Member States (see Article 44 EBA Regulation). Whilst the ECB itself has a representative in the Board of Supervisors of the EBA, such representative is a non-voting member. At the same time authorities from participating Member States have all contributed to the adoption of the ECB decision, hence it will be unlikely that a majority would change position for the EBA to launch a breach of law procedure against the ECB.

<sup>27</sup> <http://www.bis.org/publ/bcbs230.pdf>

<sup>28</sup> Ireland (update), Germany, Finland, Netherlands and Luxembourg.

intrusive supervision"<sup>29</sup>, while also signalling some areas of further improvement, especially the "time-consuming and cumbersome decision making process."<sup>30</sup>

Until now, the evaluation of the ECB (as supervisory authority) by the IMF has only been carried out as part of the assessment of individual countries. However, the upcoming FSAP of the euro area (part of the ongoing IMF Article IV<sup>31</sup> consultation with the euro area) will focus, as regards banking supervision, on the SSM and especially the ECB as a supervisor.

### **Control by the European Ombudsman**

Citizens of a Member State or undertakings with a registered office in the Union can make a complaint to the European Ombudsman if they think that there can be a case of maladministration in the institutions and bodies of the EU, including the ECB. In this regard, the European Ombudsman has launched so far four investigations in relation with the supervisory functions of the ECB and an exchange of views took place between representatives from the ECB and the office of the European Ombudsman on the transparency of the SREP.

#### **A.1.4. Consultation, due process, internal recourse mechanisms and the Administrative Board of Review [Article 32(i) SSMR]**

When acting in its supervisory capacity the ECB needs to ensure fair treatment and observe the fundamental procedural rights of the parties directly affected by its decisions. This requires that information is provided to such parties, that discussions may take place with such parties, and that this may possibly lead to changes in the approach taken by the ECB. Three important mechanisms have been set up to ensure that fundamental procedural rights of affected parties are observed: consultation requirements, the due process requirement for adopting supervisory decisions and the internal administrative review mechanism.

#### **Consultation of stakeholders**

According to Article 4(3) SSMR, the ECB shall conduct open public consultations before adopting a Regulation. Furthermore, although there is no legal obligation for public consultations in the case of non-binding instruments, the ECB often conducts them (as was the case of the Guide on Options and Discretions<sup>32</sup>). Since the SSM became operational, the ECB has carried out 9 public consultations (some of them including more than one legal instrument). Moreover, during the preparatory phase it released 3 draft regulations for public consultation. Whilst wide public consultations are normally not required to underpin supervisory activities, they are rather common as regards the rule-making component of supervision. The ECB thus appears to develop a welcome consultation culture, where it intends to promote more harmonisation of supervisory practices.

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<sup>29</sup> Finland FSAP, Technical Note – Banking Supervision, paragraph 43.

<sup>30</sup> Germany Financial System Stability Assessment, paragraph 37

<sup>31</sup> Article IV of the IMF's Articles of Agreement requires countries to undergo an assessment by the IMF of its economic and financial developments and policies. The IMF also carries out these discussions at Eurozone level.

<sup>32</sup> [https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ecb\\_guide\\_options\\_discretions.en.pdf](https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ecb_guide_options_discretions.en.pdf)

## **Due process**

Required under Article 22 of the SSMR, and further developed in Articles 25 to 35 of the ECB's SSM Framework Regulation (the SSMFR)<sup>33</sup>, due process shall inform all supervisory decisions taken by the ECB. The essence of due process under Article 22 SSMR consists of the right to be heard,<sup>34</sup> right to defence, right to access to the ECB file, and obligation for the ECB to state reasons for its decisions<sup>35</sup>. These core elements are further developed in the SSMFR with rules on representation of parties, on general obligations in supervisory procedures, on evidence, witnesses and experts to be used in supervisory procedures, on the timing and modalities of the right to be heard through written or oral procedures, on the process and limits of access to files, on the motivation, possible suspension and notification of supervisory decisions. Where the right to be heard applies, the ECB may not take a final decision before the hearing period has elapsed and without taking due account of the arguments made by the parties concerned.

The due process framework appears to be solid and applied consistently. Some concerned parties complained about inadequate deadlines for comments, and insufficient motivation of decisions, which impinge on their procedural rights. Furthermore, there are concerns that ECB uses an extended interpretation of "confidential information" that prevents parties to have access to internal ECB documents relevant for their supervisory file. There was no sufficient documentation available to the Commission to verify such observations.

## **Internal recourse mechanism: ABoR**

The third mechanism aiming to ensure accountability towards addressees of ECB supervisory decisions or other parties directly and individually concerned by such decisions consists of the Administrative Board of Review (ABoR), conceived as an internal administrative review mechanism for ECB decisions. Provided for by Article 24 of the SSMR, the ABoR was set up pursuant to an ECB decision<sup>36</sup> in order to review the procedural and substantive conformity of ECB supervisory decisions with the SSMR. The ABoR is composed of individuals who are subject to high reputational and expertise standards, who have to act independently and in the public interest<sup>37</sup>. Any ECB supervisory decision may be challenged in front of ABoR, without this having automatic suspensory effects. Recourse to ABoR is not compulsory and does not affect parties' rights to bring proceedings before the CJEU<sup>38</sup>. ABoR may organise oral

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<sup>33</sup> Regulation ECB/2014/17, OJ L 141, 14.5.2014, p. 1.

<sup>34</sup> There is a temporary dispense from the right to be heard only where urgent action is needed to prevent significant damage to the financial system and with an explicit obligation for the ECB to consult as soon as possible after (Article 22 paragraph 2 of the SSMR). Furthermore, an exception from the right to be heard also applies in the case of investigatory powers (see scope of Article 22(1) SSMR and Article 31(1) last sentence of the SSMFR).

<sup>35</sup> The ECB is required to indicate the legal basis, set out the relevant facts of the case, include an assessment of the legal and prudential considerations on which the decision is based that should be clear and complete enough to allow for an understanding of the decision without need to resort to supporting documentation. Decisions have to be more detailed when they have an adverse effect on the concerned parties.

<sup>36</sup> Decision of the ECB concerning the establishment of an Administrative Board of Review and its Operating Rules (ECB/2014/16). The ECB has also published a guide to the costs of the review, [https://www.bankingsupervision.europa.eu/organisation/governance/shared/pdf/abor\\_cost\\_guide/guidecostsreview.en.pdf](https://www.bankingsupervision.europa.eu/organisation/governance/shared/pdf/abor_cost_guide/guidecostsreview.en.pdf).

<sup>37</sup> ABoR members operate in line with the Terms and Conditions that refer to the Ethics Framework for ECB staff – to the extent that it is compatible with the Terms and Conditions – as the basis for its conflict of interests requirements.

<sup>38</sup> Proceedings to the CJEU may be brought without requesting an internal review to the ABoR, in parallel to an ongoing review in ABoR or after an ABoR review.

hearings and has to issue a reasoned opinion within maximum 2 months after an application for review. Although the ABoR opinion is not binding (in terms of conclusions) on the Supervisory Board and the Governing Council, the Supervisory Board is compelled to submit a new complete draft decision after each ABoR review.<sup>39</sup>

The internal administrative review mechanism has acquired already some substantial experience through 19 review cases completed by 13 December 2016. Out of these 19 cases, 4 were withdrawn following subsequent agreements reached between the ECB and the parties concerned. 6 ABoR reviews resulted in identical supervisory decisions, whilst 7 ABoR reviews triggered amended supervisory decisions (most of them adding motivation to the initial decision, in one case deleting part of the motivation and in one case extending the deadline). Two cases were considered inadmissible, as they did not concern supervisory decisions, but letters by the Supervisory Board Chair or by ECB senior management. Overall, it appears that the Supervisory Board does react in its decisions to the comments made by the ABoR, but it is not possible for the Commission to assess to what extent such adjustments correspond to the substantial recommendations by ABoR and to what extent these recommendations are adequate. Some of the redrafted decisions are currently under proceedings in front of the CJEU. In its first judgement on a challenge of an ECB supervisory decision<sup>40</sup>, the CJEU confirmed the legality of the ECB's decision which had taken into account the opinion of the ABoR. Furthermore, the ECB maintains that ABoR opinions have had an influence in the ECB's supervisory practice broader than the individual cases to which they relate to.

Overall the due process framework and the internal administrative review mechanism appear to be applied consistently. They are effective in setting relevant procedural standards and giving means for safeguarding the procedural rights of the parties that may be affected by ECB decisions. The ECB appears to be committed to observe due process standards and is willing to review its own decisions in light of dialogue with the parties concerned or of the suggestions given by the ABoR. It is considered important that the ECB strikes the right balance when labelling documents as confidential, so as to thereby avoid any undue restrictions to the right of information of parties concerned by its decisions. ABoR can be held to have had a positive start, and has proven to work professionally. While the ABoR proceedings are subject to confidentiality rules that prevent their publication, it would be useful to take advantage of the growing jurisprudence developed by ABoR by ensuring more transparency over its work, for instance through publication on the ECB's website of anonymised summaries of ABoR decisions.

### **A.1.5. Independence [Article 32(e) SSMR]**

#### **Independence from other EU institutions and bodies**

The independence of the ECB is warranted by Article 130 of the TFUE, which states that the ECB shall neither seek nor take instructions from other Union institutions, bodies, offices or agencies, when performing the tasks and duties conferred to it by the Treaties and the Statute of the ECB<sup>41</sup>. Both the Treaty and the Statute of the ECB lay down a framework that

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<sup>39</sup> The new draft decision may replace the contested decision with an identical decision or an amended decision or may abrogate the contested decision.

<sup>40</sup> Case T-122/15, Judgment of the General Court (Fourth Chamber, Extended Composition) of 16 May 2017 *Landeskreditbank Baden-Württemberg - Förderbank v European Central Bank*.

<sup>41</sup> Protocol No 4 on the statute of the European System of Central Banks and of the European Central Bank, OJ C 326, 26.10.2012, p. 230.

strengthens this independence, mainly through a differentiated legal personality, a separate budget and the functioning of its decision-making bodies.

The independence of the ECB when performing supervisory tasks is confirmed in the SSMR. According to its Article 19, the ECB shall act independently when performing the tasks conferred on it by the SSMR. Moreover, the members of the Supervisory Board and of the steering committee shall act independently in the interest of the EU and without following instructions from the institutions or bodies of the EU.

The rules concerning financing and governance of the ECB's supervisory function also reinforce its independence. On the one hand, the expenditure incurred by the ECB as a result of its supervisory functions shall be covered by fees levied on the credit institutions established in participating Member States, as set forth by Article 30 of the SSMR. On the other hand, Article 26 of the SSMR lays down the rules regarding the appointment and removal of the Chair of the Supervisory Board. The Chair will be appointed on the basis of an open selection procedure from among individuals of recognised standing and experience in banking and financial matters. Once appointed, the Chair will be a full-time professional. The Chair's term of office shall not be renewable and the Chair can be removed only if she/he no longer fulfils the conditions required to perform her/his duties or has been guilty of serious misconduct.

### **Interactions with stakeholders**

The ECB shall also be independent from other stakeholders, and the members of the Supervisory Board and its steering committee shall act without following instructions from any public or private body, as set forth by Article 19 of the SSMR.

The ethics framework of the ECB lays down the rules for interaction with stakeholders. This framework is built upon different elements. Thus, the members of the Governing Council and their alternates, when acting as members of the Governing Council, shall comply with the Code of Conduct for the Members of the Governing Council<sup>42</sup>. The members of the Supervisory Board and their alternates, in the performance of their duties as members of the steering committee or of the Supervisory Board, shall comply with the Code of Conduct for the Members of the Supervisory Board of the ECB<sup>43</sup>. The ECB staff is bound by the Conditions of Employment, the Staff Rules, and specially by the Ethics Framework<sup>44</sup>. This Framework was reviewed in December 2014 to reflect ECB's new tasks in banking supervision.

Moreover, in 2015 the ECB issued a Guideline<sup>45</sup> and a document of Implementation Practices<sup>46</sup> setting the principles for a common ethics framework for the SSM. They are addressed to both the ECB and the NCAs, which are responsible for their implementation.

Finally, the Ethics Committee of the ECB, regulated by Decision ECB/2014/59<sup>47</sup>, provides advice on questions of ethics on the basis of individual requests. Its members shall not be

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<sup>42</sup> OJ C 123, 24.5.2002, p. 9.

<sup>43</sup> OJ C 93, 20.3.2015, p. 2.

<sup>44</sup> OJ C 204, 20.6.2015, p. 5.

<sup>45</sup> Guideline (EU) 2015/856 of the ECB of 12 March 2015 laying down the principles of an Ethics Framework for the Single Supervisory Mechanism (ECB/2015/12), OJ L 135, 2.6.2015, p. 29.

<sup>46</sup>[https://www.ecb.europa.eu/ecb/legal/pdf/additional\\_info\\_final\\_implementation\\_practices\\_ssm\\_ethics\\_framework.pdf](https://www.ecb.europa.eu/ecb/legal/pdf/additional_info_final_implementation_practices_ssm_ethics_framework.pdf)

<sup>47</sup> OJ L 70, 14.3.2015, p. 58.



current staff of the ECB or current members of bodies involved in the decision-making processes of the ECB, the national central banks or the national competent authorities. These ethics rules regulate, among others, conflicts of interests, post-employment restrictions, relations with external parties and private financial transactions.

## **A.2. Decision-making [Article 32(g)]**

This section scrutinises governance arrangements underpinning the ECB's decision-making in relation to supervisory activities, by identifying the typologies of ECB acts, assessing the role of the parties involved in their adoption and the decision-making processes. The governance structure supporting the ECB's supervisory activities is largely constrained by the TFEU's designation of the ECB's decision-making bodies as consisting of the Governing Council and the Executive Board<sup>48</sup>. The SSMR could not amend such fundamental aspect laid down in the Treaty, and developed instead specific supervisory structures and procedures to support the Governing Council, when acting upon the tasks conferred to the ECB through the SSMR.

### **A.2.1. Typology of acts**

Pursuant to the powers conferred through the SSMR, the ECB may take various supervisory actions that can be classified as follows: 1) acts addressed to individual institutions (supervisory decisions and operational acts<sup>49</sup>), 2) horizontal acts addressed to all or groups of credit institutions (regulations, recommendations, guides, decisions of general application), 3) acts addressed to NCAs (regulations, guidelines, recommendations, decisions and instructions), 4) organisational acts (regulations, guides, decisions providing the practical arrangements for the functioning of the SSM), and 5) other acts (e.g. answers to MEP questions, communications with other institutions, etc.).

The core of the supervisory tasks entrusted to the ECB is reflected in the adoption of supervisory decisions, which are legal acts addressed to individual credit institutions, that are binding upon their addressees. Examples of supervisory decisions are the decisions imposing prudential requirements on credit institutions pursuant to the SREP, decisions in the context of common procedures (authorisations, withdrawals, acquisition of qualifying holdings), orders, permissions or other decisions granting, changing or withdrawing rights, decisions defining particular qualifications or characteristics, decisions imposing administrative penalties. In 2015, about 1500 supervisory decisions were adopted, of which most common were 921 approvals (covering more than 2000 individual procedures on authorisation applications, authorisation withdrawals, acquisitions of qualifying holdings, management and supervisory board appointments), 213 SREP decisions and 137 own funds decisions. In 2016, 1835 supervisory decisions were taken, of which most common were 1191 decisions on approval procedures (covering 2686 individual procedures), 192 own funds decisions and 130 SREP decisions. The largest number of approval decisions each year represents the so-called "fit and proper" decisions on the suitability of management and supervisory board members of credit institutions.

Whilst most supervisory activities involve operational acts taken outside formal decision-making channels, the ECB needs often to make recourse to legally binding decisions, especially supervisory decisions. The number of decisions adopted every year shows that

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<sup>48</sup> Article 129 TFEU.

<sup>49</sup> Operational acts are taken outside formal decision-making procedures, they don't have a specific legal form and reflect day-to-day supervisory interaction (e.g. non-binding requests, statements, informal communication on supervisory expectations).

there is a very high number of formal decisions adopted with regard to individual credit institutions and a vast typology of supervisory decisions.

### **A.2.2. Parties involved in decision making**

There is large panoply of actors involved in the various stages of the ECB's process for adopting supervisory decisions. The originators of draft supervisory decisions are usually the Joint Supervisory Teams (JSTs), which prepare the very first draft based on their ongoing supervisory activities. NCAs may also originate draft decisions especially with regard to common procedures (i.e. authorisation, qualifying holdings) or may be requested by the ECB to prepare draft decisions, given their expertise in national law. Directorates General of the ECB, including those responsible for horizontal services contribute to the preparatory process and are mainly responsible for reviewing, approving or providing quality assurance for draft decisions prepared by JSTs, whilst they may also act as originators (e.g. proposing to take over the supervision of an LSI, initiate common procedures, proposals for instructions to NCAs, enforcement or sanctioning measures). The Secretariat to the Supervisory Board represents the next layer, responsible for ensuring efficient decision-making and institutional quality of the decision-making process. In this capacity it prepares the documentation, procedures and meetings of the Supervisory Board (which includes additional review and preparation of draft decisions) and takes care of the follow up, including the coordination with the Secretariat to the Governing Council, but also the registry and notification of supervisory decisions.

The Supervisory Board is the decision-making body entrusted with the "planning and execution of the tasks conferred on the ECB" in supervision and ultimately responsible for carrying-out the "preparatory works regarding the supervisory tasks conferred on the ECB" (Article 26 SSMR).<sup>50</sup> In this capacity it has to prepare complete draft decisions to be submitted to the Governing Council. The Supervisory Board may approve draft decisions, amend them directly or send them back to the organisational units for revision. Two voting modalities apply to the Supervisory Board. Decisions are usually taken by simple majority with each member of the Supervisory Board having one vote and the Chair having the casting vote in case of draw (Article 26(6) SSMR). By way of derogation, decisions on the adoption of regulations organising or specifying the arrangements for carrying out ECB supervisory tasks conferred through the SSMR require qualified majority<sup>51</sup> in the Supervisory Board (Article 26(7) SSMR and Article 13c ECB Rules of Procedure<sup>52</sup>).

The Governing Council is the final decision-making body that endorses or objects to the draft supervisory decisions. Although the decision making chain is long, ultimately all supervisory decisions adopted prior to the implementation of the delegation framework were taken by the Governing Council, with no final decision adopted at any lower level. Many of the decisions taken by the Governing Council reflect routine decisions or recurrent decisions that prior to

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<sup>50</sup> The Steering committee of the Supervisory Board has been established in accordance with Article 26 SSMR without having any decision-making powers, but mainly in charge of deciding about the meetings and finalising the agenda for the Supervisory Board. Rules of Procedure of the Supervisory Board of the ECB, OJ L 182, 21.6.2014, p. 56.

<sup>51</sup> Qualified majority in the Supervisory Board is based on a double majority system requiring at least 55% of the votes of members, representing at least 65% of the total population. A blocking minority consists of at least the minimum number of Supervisory Board member representing 35% of the total population, plus one member. Each of the four ECB representatives appointed by the Governing Council shall be assigned, under the population criterion, the median population of participating Member States, and one vote under the number of members criterion (an Annex to the amended rules of procedure of the ECB provides the details).

<sup>52</sup> Decision ECB/2004/2, OJ L 080 , 18.3.2004, p. 33.

the creation of the SSM were taken at managerial level by NCAs. No information was available to the Commission as regards the exercise of voting rights; hence it is not possible in this report to assess the effectiveness of voting arrangements.

### **A.2.3. Decision-making process for binding acts**

The ECB in its supervisory capacity acts on the basis of four decision making procedures: 1) the non-objection procedure for the bulk of decisions related to the supervisory tasks transferred to the ECB pursuant to Article 4 SSMR, whereby the Governing Council by non-objection endorses draft decisions adopted by the Supervisory Board or rejects such draft decisions in case of an objection<sup>53</sup>, 2) the procedure for adopting decisions for the purpose of carrying out macro-prudential tasks referred to in Article 5 SSMR, whereby the Governing Council may endorse, object or amend a proposal by the Supervisory Board, may request the Supervisory Board to submit a proposal or may take itself a decision in the absence of a proposal by the Supervisory Board; 3) decisions on the general framework specifying the arrangements for carrying out supervisory tasks, which are taken by the Governing Council on the basis of a proposal from the Supervisory Board, outside the scope of the non-objection procedure and 4) the standard ECB decision making procedure whereby the Governing Council adopts decisions prepared by the ECB's Executive Board on issues affecting the organisational set up of the ECB, such as rules of procedure, the setting up of the Administrative Board of Review and the separation between monetary and supervisory functions. Among these procedures, the non-objection procedure is considered the standard decision-making procedure for tasks conferred under the SSMR as it is required to be used for adopting most of the ECB's acts under the SSMR.

Given the high number of decisions and their varied typology, the involvement of the Supervisory Board and Governing Council in every decision appeared to put an important strain on the resources of these two bodies, involving all NCAs and National Central Banks. There are important differences across supervisory decisions, in terms of complexity, impact and relevance for supervised entities. Such diversity exists across types of decisions (e.g. SREP decisions compared to approval of CET1 instruments), as well as within the same category of decisions (e.g. fit and proper decision for the Board of a major parent company compared to fit and proper decision for the management of an integrated subsidiary). Prior to the implementation of the delegation framework of decision-making powers, such differences were not taken into account in the decision-making process, which appears to imply a disproportionate impact on resources in case of routine decisions, or decisions with a lower overall impact. This situation prevented the ECB's decision-making bodies from focusing on important supervisory matters, and often required a disproportionate amount of efforts and resources from both the ECB and NCAs in preparing the formal decision-making process<sup>54</sup>.

The ECB introduced in 2015<sup>55</sup> the written procedure for decision-making by the Supervisory Board, to speed up and allow bundling of similar decisions. This has become the standard modality for the adoption of routine draft decisions to be endorsed by the Governing Council

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<sup>53</sup> The procedure is detailed in Article 13g of the ECB's Rules of procedure, ECB/2004/2 (2004/257/EC) as amended.

<sup>54</sup> NCAs have complained about the resources they need to dedicate for preparing their position for the Supervisory Board and the Governing Council on issues which are not at all relevant from their point of view and which used to be dealt with at middle management level within their organisations.

<sup>55</sup> Decision (EU) 2015/716 of the European Central Bank of 12 February 2015 amending Decision ECB/2004/2 adopting the Rules of Procedure of the European Central Bank (ECB/2015/8).

under the non-objection procedure, decisions on technical issues, or in case of emergency<sup>56</sup>. Since it is expedient (giving Supervisory Board members maximum 5 days for consideration and allowing for the bundling of certain procedures into single decisions), the written procedure has alleviated time constraints and the decision overload for the Supervisory Board but did not resolve the decision making burden for the Governing Council, nor the time constraints stemming from the length of the non-objection procedure. Some national authorities have raised transparency concerns in relation to the assessment of comments made during written procedures. However, the ECB has put in place procedures that ensure the evaluation of all comments by the relevant business areas within the ECB and effective communication with the NCAs as a follow-up to comments received in written procedures. The application of these procedures could not be verified, as the Commission did not have access to confidential documents related to concrete cases.

Despite some positive effects of measures taken during the first year to address challenges of supervisory decision-making, the volume of decisions to be taken by the Supervisory Board and the Governing Council remains extremely high (about 1500 decisions taken in 2015 and 1800 decisions taken in 2016).

#### **A.2.4. Delegation framework**

Against this background, the ECB has acknowledged that the adoption of each and every supervisory decision by the Governing Council is unsatisfactory from an operational efficiency perspective. To address this, it has envisaged the use of delegation to allow certain supervisory decisions to be taken at managerial level. Upon an explicit mandate given by the ECB's Executive Board and following consultation of the ECB's Legal Committee and of the Supervisory Board, the Governing Council has adopted on 16 November 2016 a legal framework for delegation that has been published on 1 June 2017 in the Official Journal of the European Union<sup>57</sup> and will become operational on 21 June 2017.

The delegation framework adopted by the ECB is based on a layered legal structure consisting of three levels and will initially be applied to a limited type of supervisory decisions. The general framework (first layer) establishes the possibility of delegating decision-making powers to ECB managerial staff carrying out supervisory tasks, on the basis of a delegation decision adopted by the Governing Council under the non-objection procedure (second layer) and a nomination decision issued by the Executive Board (third layer). The general framework clarifies the procedural requirements for adopting a delegation decision, the transparency requirements attached to the exercise of delegation and the revocability of delegations. The general framework does not restrict the application of delegation to specific supervisory activities.

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<sup>56</sup> Whenever a draft decision is susceptible of discussion by Board members or concerns a policy issue decision-making will take place at a meeting. Decisions should be taken at meetings also when at least three members of the Supervisory Board object. In 2015, out of the 800 written procedures 40 were objected and re-submitted for approval.

<sup>57</sup> Decision (EU) 2017/933 of the European Central Bank of 16 November 2016 on a general framework for delegating decision-making powers for legal instruments related to supervisory tasks (ECB/2016/40); Decision (EU) 2017/934 of the European Central Bank of 16 November 2016 on the delegation of decisions on the significance of supervised entities (ECB/2016/41); 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); Decision (EU) 2017/936 of the European Central Bank of 16 November 2016 nominating heads of work units to adopt delegated fit and proper decisions (ECB/2017/16); Decision (EU) 2017/937 of the European Central Bank of 16 November 2016 nominating heads of work units to adopt delegated decisions on the significance of supervised entities (ECB/2017/17)

Delegation decisions are proposed by the Supervisory Board and adopted by the Governing Council under the non-objection procedure. Two areas have been identified as being the most suitable for testing the system, namely fit-and-proper decisions for members of the management board of significant supervised entities and minor amendments to significance decisions. These delegation decisions set out the perimeter of delegation and the substantive criteria for exercising delegated powers, thereby establishing proportionate boundaries to supervisory discretion and ensuring that the procedural rights of the concerned parties are safeguarded.

For example, the delegation of fit and proper decisions covers a broad scope of decisions, applying to all decisions, except for those excluded pursuant to several criteria: size and nature of the supervised entity, the anticipated outcome of the decision (negative decisions are excluded), the timely submission of the proposal by the relevant NCA and a set of specific aspects of the fit and proper assessment (e.g. reputational issues related to criminal proceedings, or administrative actions related to non-compliance with financial services regulation). The envisaged criteria for the performance of the fit-and proper assessment through delegation stem from national laws transposing CRD IV and from the ECB's Guide to Fit and Proper Supervision. The delegation decision in the area of amendments to significance decisions aims at rendering more efficient the regular update of the list of entities subject to ECB's direct supervision. Delegation is excluded for the "initial" determination of significance or whenever the entity at the highest level of consolidation changes, but is possible for changes in status from significant to less significant. Although the declassification of an entity from a significant to a less significant institution implies that the institution will exit the perimeter of direct ECB supervision, such declassification was included in the scope of delegation as it covers situations where there is very little supervisory discretion. Generally such declassification relates to intra-group operations that do not affect the significance of the supervised group at the highest level of consolidation, but the reduction of its perimeter (e.g. a subsidiary is sold but the group remains significant) or to cases where the supervised entity has completed a three consecutive years period during which the criteria for being considered significant have not been met, and therefore the supervisory discretion attached to such a decision is not only very limited but also its implications have been prepared in advance with the relevant national competent authorities (Article 47 of the SSMFR).

The ECB estimates that the implementation of the delegation framework on the basis of these two selected areas would significantly reduce the number of supervisory decisions to be adopted by the Governing Council in a year. The ECB does not expect delegation to affect the quality of the decisions, nor the amount of preparation underpinning them. Yet, delegation would significantly alleviate the burden of the Supervisory Board and the Governing Council and help them concentrate on important supervisory issues. The Commission understands that the ECB needs to make operational adjustments in order to ensure that a dual track decision-making is available in the respective areas that results in legally sound decisions, of the same quality, that respect due process and are adequately notified and registered. Depending on the result of these two pilot cases, the ECB is also willing to consider expanding the framework to other areas.

### **A.3. Separation between monetary and supervisory functions within ECB [Article 32(I) SSMR]**

The SSMR requires that the supervisory tasks of the ECB are carried out separately from its monetary policy function<sup>58</sup>. This means that each function has to be exercised in accordance with its objectives, that there should be organisational separation and separate reporting lines for staff<sup>59</sup> and that the Governing Council should operate in completely differentiated settings as regards monetary and supervisory functions.<sup>60</sup> To implement the separation requirement, the ECB has adapted its procedural rules and adopted a Decision on the implementation of the separation between monetary policy and supervision functions.<sup>61</sup> Separation is primarily reflected in the organisational separation of the ECB staff dedicated to the two functions, separate management lines, specific decision-making procedures entailing different reporting lines, professional secrecy requirements and regulated exchanges of confidential information. Furthermore, potential conflicts resulting from differences of views expressed by the competent authorities regarding an objection by the Governing Council to a draft decision of the Supervisory Board have to be dealt with by the mediation panel<sup>62</sup> set up in the ECB, which has not been used so far in the absence of any objection raised by the Governing Council to draft decisions submitted by the Supervisory Board.

Notwithstanding the separation arrangements, the ECB remains a unitary institution, where in addition to the common decision-making body (i.e. the Governing Council), the Executive Board retains overall responsibility for organisational, human resources and administrative issues, covering both functions.<sup>63</sup> Furthermore, certain internal ECB services that existed prior to assumption of supervisory tasks under the SSMR continue to serve both functions. This is particularly the case of the so-called shared services<sup>64</sup> and of services responsible for tasks related to macro-prudential supervision.<sup>65</sup>

#### **A.3.1. Shared services**

The shared services referred to in the ECB Decision are departments providing support functions within the ECB. At the current juncture, all business areas identified as shared services already existed before the creation of the SSM. They include Administration, Information Technology, Communication, Human Resources, Budget and Organisation,

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<sup>58</sup> Recital (65), Art. 25 of the SSMR.

<sup>59</sup> In this respect, recital (65) SSMR further clarifies that staff involved in carrying out the tasks conferred upon the ECB by the SSMR should report to the Chair of the Supervisory Board. In addition, recital 74 stipulates that professional secrecy requirements should apply to the exchange of information between staff of the ECB carrying out supervisory duties and staff not involved in supervisory duties.

<sup>60</sup> Decision of the ECB of 19 February 2004 adopting the Rules of Procedure of the ECB (ECB/2004/2), OJ L 80, 18.3.2004, p. 33.as amended.

<sup>61</sup> Decision ECB/2014/39 of 17 September 2014 on the implementation of separation between the monetary policy and supervision functions of the European Central Bank (OJ L 300, 18.10.2014, p. 57).

<sup>62</sup> Regulation (EU) No 673/2014 of the ECB of 2 June 2014 concerning the establishment of a Mediation Panel and its Rules of Procedure (ECB/2014/26), OJ L 179, 2.6.2014, p. 72.

<sup>63</sup> Art. 3(3) of Decision ECB/2014/39. Staff carrying out supervisory tasks report to the Executive Board in respect of organisational, human resources and administrative issues, but shall be subject to functional reporting to the Chair and the Vice Chair of the Supervisory Board.

<sup>64</sup> Art. 3(4) of Decision ECB/2014/39. Both the existing and the potential new shared services are subject to restrictions on disclosure of confidential information containing assessments or policy recommendations to the respective other policy function, except on a need to know basis. Ibid Art. 6.

<sup>65</sup> Art. 6 of Decision ECB/2014/39.

Internal audit and Legal service.<sup>66</sup> The SSMR does not preclude that internal ECB support functions be used by both the monetary and supervisory functions. A duplication of internal support functions would arguably undermine efficiency and cost effectiveness within the ECB, therefore, the concept of shared services is in principle compatible with the separation requirement.

At the same time, it is imperative that the support functions are adequately reinforced and equipped to deal with the increased workload stemming from the addition of the new supervisory functions, to prevent competition for resources and to manage potential conflicts. A business area may be identified as shared service because of the technical nature of the support or advice offered, which assumes there is little potential for conflicts of interest. Nonetheless, certain shared services may be more prone to conflicting objectives when exercising both functions, and therefore need to be carefully scrutinised in terms of applicable safeguards, particularly the existence of separate reporting lines. This issue has been identified also in the ECA report on the SSM and as a follow-up the ECB is currently undertaking an assessment of the risks related to the use of shared services, in particular in view of identifying potential conflicts of interest and conflicting needs which shared services may be exposed to, and developing and implementing the necessary safeguards.

The most prominent example of shared services is the Legal Service of the ECB, as it regularly provides input for monetary and supervisory decisions. The ECA and several NCAs raised concerns as to the possible conflicts of interest with which the ECB's Legal Service might be confronted and a potential incompatibility with the separation requirement.<sup>67</sup> In general, issues relating to the ECB's supervisory function appear to be dealt with by the Supervisory Law Division, whose organigram presents separated reporting lines up to Deputy Director General level, and which reports to the Vice-Chair of the Supervisory Board. Nevertheless, there have been instances where questions regarding the interpretation of the SSMR, when they involve also institutional issues, or the interpretation of CRD/CRR<sup>68</sup> have been treated by other divisions within the ECB's Directorate General Legal Services, which report directly to the relevant Executive Board member; in this case it remains unclear how reporting lines to the Vice-Chair of the Supervisory Board are applied and how potential conflicts are solved.

It is noted that NCAs that are also central banks have a single legal department serving all functions of the NCA/CB and that these precedents were considered relevant for maintaining a single Legal Service at the ECB. At this stage there is no evidence available to the Commission as regards concrete conflicts of interest within ECB's Legal Service. However, in light of the fact that the ECB's Legal Service opinions are often used as input for ECB's policy decisions under both functions, it would be necessary to assess in depth whether current separation arrangements within the Legal Service are sufficient or need to be reinforced.

### **A.3.2. Separation of the macro-prudential tasks provided in the SSMR**

In line with its Treaty mandate to contribute to the smooth conduct of policies related to the stability of the financial system the ECB has always performed a macro-prudential oversight

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<sup>66</sup> See also: Special Report of the European Court of Auditors ECA 2016/29 "Single Supervisory Mechanism – Good Start but Further Improvements Needed", page 31. N.B. The titles of the services are consistent with the titles used in the ECA Report and do not correspond to the titles of the ECB organisational units.

<sup>67</sup> One NCA even explicitly stated that it would prefer a separate legal department of the SSM, even if this better separation would lead to higher costs.

<sup>68</sup> Regulation (EU) No 575/2013, OJ L 176, 27.6.2013, p. 1.

function through a dedicated department that became the Directorate-General Macro-prudential Policy and Financial Stability (DG-MF). With the conferral to the ECB of specific macro-prudential tasks (the so-called top-up powers) in Article 5 of the SSMR, the Governing Council decided to leverage on the expertise and capacity of the existing department and anchor these additional tasks within DG-MF.<sup>69</sup> At the same time, the ECB designed a dedicated decision-making process providing for the involvement of the Supervisory Board.<sup>70</sup>

The dedicated process requires the national competent or designated authorities to notify both the Supervisory Board and the Governing Council on the intention to adopt macro-prudential measures. The Supervisory Board should submit its proposal in relation to such initiative, on the basis of input prepared by DG-MF, with the contribution of JSTs and Directorate-General Micro-Prudential Supervision IV (DG MS IV), and of the relevant committees.<sup>71</sup> The Governing Council is responsible for the final decision.

Different from decision-making for other tasks conferred through the SSMR (i.e. micro-prudential tasks based on Article 4 of the SSMR), the dedicated process for adopting macro-prudential decisions gives the Governing Council a more prominent role throughout the whole decision-making process, allowing the Governing Council to request the Supervisory Board to act and to adopt on its own a decision where the Supervisory Board did not propose a draft.

#### **A.4. Division of tasks between ECB and NCAs [Article 32(a) and(b)]**

##### **A.4.1. Distribution of tasks and responsibilities**

The SSM was conceived as a system composed of the ECB and the NCAs, where all components play an active role and where the nature of responsibilities incumbent on the various components is defined. The ECB is in charge of the overall functioning of the SSM as a system, whilst all components of the SSM are subject to the duty of cooperation in good faith. NCAs are responsible for assisting the ECB with the preparation and implementation of acts relating to the tasks conferred on the ECB, and should observe the ECB's instructions when doing so. Whilst the system was built on the idea to fully use the specific knowledge and expertise of the NCAs, the degree of direct involvement of the ECB was conceived to increase with the size, complexity and systemic importance of the supervised entities, as well as to ensure a consistent and coherent supervision within the Banking Union. Such embedded cooperative framework has been further specified in the SSMFR adopted by the ECB.

It is within this cooperative framework that the ECB exercises direct supervisory responsibilities, which include not only the overall supervision of significant institutions, but also direct responsibilities as regards the licencing and withdrawal of authorisation for all credit institutions in the participating Member States, the assessment of qualifying holdings, as well as the exercise of the additional macro-prudential tasks over credit institutions in the participating Member States.

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<sup>69</sup> DG-MF is not considered by the ECB as a shared service, as it exercise a specific function.

<sup>70</sup> Article 13h of the ECB's rules of procedure (ECB/2004/2 as amended by ECB/2014/1).

<sup>71</sup> The 'relevant committees and internal structures' referred to in the Article are the Financial Stability Committee (FSC) in SSM composition (which is an expert group composed of both the representatives of the central banks and the national competent authorities), Macro-prudential Coordination Group (MPCG), composed on senior management of DG-MF and the Macro-prudential Forum which is a joint meeting of the Supervisory Board and the Governing Council. The FSC in SSM composition and the MPCG are providing an input for the draft decisions of the Supervisory Board. The Macro-prudential Forum is a platform for joint discussions without the decision-making power. The ECB staff supporting these structures is, according to the ECB, organisationally separated from the staff conducting monetary policy analysis.



NCA's remain responsible for the direct ongoing supervision of less significant institutions, as well as for all other tasks that were not conferred on the ECB via the SSMR. Additionally, they are involved in the tasks directly entrusted to the ECB providing draft decisions (in the case of authorisation, qualifying holdings), undertaking preparatory work (e.g. outsourcing of certain activities to NCAs subject to some materiality threshold is currently discussed) and participating in JSTs, on site-inspections, networks or ad hoc groups to the Supervisory Board and Governing Council. Their key preparatory role with regard to the licencing and withdrawal of authorisation and the assessment of qualifying holdings for all credit institutions is highlighted in the SSMR and is largely justified by the fact that most of the substantial rules are enshrined in national legislation transposing the relevant CRD provisions.

Furthermore, authorities designated for macro-prudential purposes maintain their primary responsibilities in relation to the application of capital buffers and other measures aimed at addressing systemic or macro-prudential risks, whilst the ECB's macro-prudential tasks are supplementary.

NCA's are not only involved in the execution of SSM related tasks in their own jurisdiction, but also participate in decision-making regarding entities in other jurisdictions, through their representative in the Supervisory Board. Thereby a cross-fertilisation of supervisory practices takes place, which is beneficial to all parties and contributes to a bottom-up development of the SSM culture.

The involvement of NCAs in support of ECB's activities has been resource intensive, especially in the set-up phase and resulted in several NCAs increasing their staff to be able to cope with extensive responsibilities in the context of the SSM. In parallel, the ECB has also steadily reinforced its resources and is constantly developing its own expertise at a fast pace. ECB staff is fully in charge of the coordination, overall functioning and coherence of the system, where NCAs contribution is largely limited to preparatory policy discussions and preparation of national representatives in the Supervisory Board and the Governing Council. The ECB is also in lead of all JSTs and has gradually increased its participation in such teams. Most of the JSTs, which account for the largest contribution in terms of NCA assistance, are currently composed of 1/3 ECB staff against 2/3 NCA staff. At this stage of the SSM, such a ratio may be considered to be balanced in view of the statutory distribution of responsibilities and the duty of assistance by the NCAs. Conversely, the composition ratio of on-site inspection teams appears to be problematic, as only 10% of such teams consist of ECB staff.

A specific dimension of the division of tasks between the ECB and the NCAs relates to the supervision of less significant institutions. The ECB's responsibilities with regard to LSIs are integrated in the construction of the SSM<sup>72</sup>. The ECB is entrusted with the overall functioning of the system and its tasks are conferred for all credit institutions, but need to be exercised in accordance with the distribution of responsibilities provided in Article 6. Thus, unless

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<sup>72</sup> Whilst clearly responsible for the authorisation, withdrawal of authorisation and assessment of qualifying holdings in the case of LSIs, the ECB is not responsible for their direct supervision. Instead the ECB may instruct the competent authorities as to how to perform their supervisory tasks and adopt supervisory decisions, including instructions to NCAs as to how to use specific supervisory powers for groups or categories of institutions. The underlying objective is to ensure consistency of supervisory outcomes in the SSM. Furthermore, the ECB may decide at any time to take over the direct supervision of one or more LSIs, may use at any time its investigatory powers towards LSIs. Not a bene, the ECB can only decide to take over full supervision, not only specific supervisory tasks with regard to an LSI. The ECB may also request from NCAs ad hoc or continuous information on the way they perform their tasks to the ECB, and is entrusted with the general oversight over the functioning of the system.

otherwise decided by the ECB, it is for NCAs to perform supervisory tasks over LSIs. The ECB has an oversight function but also an overall duty to ensure consistency of supervisory outputs throughout the Banking Union and to intervene directly by taking over LSI supervision, should this be needed. Given the ECB's ultimate responsibility for the effective and consistent functioning of the SSM, the ECB has, at any point, the right (and obligation) to make use of available tools if deemed necessary for fulfilling its mandate. This implies flexibility, and some uncertainty as to the role of the ECB vis-a-vis LSIs, in terms of both the extent to which the ECB can give instructions to NCAs for the supervision of LSIs and the situations in which it would take over direct supervision of LSIs.

The ECB has spelled out in the SSMFR the criteria to be taken into account for taking over direct supervision of LSIs.<sup>73</sup> However such criteria are not exhaustive and do not reflect for instance developments in the area of resolution.

Whilst there seems to be overall clarity<sup>74</sup> as to the tasks remaining with NCAs<sup>75</sup>, it is legitimate to ask how these remaining NCA tasks affect the capacity of the ECB to perform its competences especially in view of its objective to ensure the stability of the Union's financial system and the unity and integrity of the internal market. This has to be analysed in the context of structural developments in the banking sector, where financial actors are extremely adaptable, including in terms of corporate structure, and ready to exploit any regulatory or supervisory loophole. For instance, third country groups are becoming ever more complex and interconnected, operating through complicated networks, involving a wide range of entities taking often the form of branches or investment firms.

#### **A.4.2. Reliance on national law**

National law has major relevance in the carrying out of ECB's supervisory tasks, as national law not only transposes substantial Union law included in relevant Directives (particularly CRD and BRRD<sup>76</sup>) but also frames the powers and tools available to supervisory authorities for performing their tasks. This is an unprecedented situation, with the ECB being the first Union institution required to apply national law and acting on the basis of national laws.

It is in relation to this interaction between national and EU levels that the precise scope of ECB powers has to be defined, particularly the extent to which the ECB may exercise supervisory powers laid down in national laws transposing or implementing Union law. A clear division of powers between the ECB and the NCAs, which does not depend on the willingness of the ECB and individual NCAs to agree how powers should be exercised, would avoid an inconsistent approach and much legal uncertainty.

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<sup>73</sup> Article 67 of the SSMFR.

<sup>74</sup> There were some misunderstandings as to the exact distribution of the responsibilities and powers between the ECB and the NCAs, where tasks have been conferred on the ECB (which will be discussed in the next section).

<sup>75</sup> Such remaining tasks are generally defined negatively as those that have not been transferred to the ECB through the SSMR. Recital 28 contains a non-exhaustive list of such tasks: receiving notifications from credit institutions in relation to the right of establishment and the free provision of services, supervision of bodies which are not covered by the definition of credit institution under Union law but which are supervised as credit institutions under national law, supervision of credit institutions from third countries establishing a branch or providing cross-border services in the Union, supervision of payment services, carrying-out day-to-day verifications of credit institutions, acting as competent authority in relation to markets in financial instruments, the prevention of the use of the financial system for the purpose of money laundering, terrorist financing and consumer protection.

<sup>76</sup> Directive 2014/59/EU, OJ L173, 12.6.2014, p. 190.

Based on the joint reading of the SSMR and the CRD, the ECB has been clearly endowed with broad supervisory powers for the purpose of performing the tasks conferred to it. This is not limited to the powers explicitly listed in the SSMR but extends to all supervisory powers set in national transposition laws even when these are not explicitly listed in the text of the CRD<sup>77</sup>. Hence, where a supervisory power enshrined in national law is intended to underpin a supervisory function under Union law, the ECB should be capable of exercising such power within the limits of its supervisory tasks set in Articles 4 and 5 of the SSMR.<sup>78</sup> On the contrary, where a supervisory power enshrined in national law is purely provided to underpin functions that a competent authority has under national law (but not under relevant Union law) the power should be exclusively exercised by the national competent authority, such as the power to approve mergers or acquisitions for competition purposes. Nor does the ECB have powers conferred to national authorities under the relevant Union law, but which do not relate to the specific tasks conferred to the ECB under Articles 4 and 5 SSM-Regulation, such as for instance supervision of credit institutions as regards markets in financial instruments and anti-money laundering. However, the ECB may instruct national authorities to exercise their powers if and insofar this proves necessary to carry out the tasks conferred on the ECB under Article 4 and 5 SSMR (in accordance with Article 9(1) third subparagraph).

## **B. Supervisory tools [Article 32(a), (b) SSMR]**

This section assesses the main tools that the ECB has developed in view of performing its supervisory tasks. During the first two years of existence of the SSM, the following instruments and processes have proved essential to ensure the effectiveness of the exercise of ECB competences and the smooth functioning of the SSM itself: categorisation of institutions within the Banking Union, based on the distinction in the SSMR between significant and less significant institutions, the setup of joint supervisory teams, the roles of horizontal services, on-site inspections, the participation in colleges of supervisors and the harmonisation of options and discretions.

### **B.1. Categorisation of supervised entities**

In view of performing its supervisory tasks, the ECB has developed the concept of "supervised entity", which includes the following entities established in a participating Member State: credit institutions, financial holding companies, mixed financial holding companies and branches of credit institutions established in non-participating Member States. In addition, the ECB uses the concept of "supervised group" to refer to groups whose parent

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<sup>77</sup> In accordance with Article 9(1) second subparagraph of the SSMR, for the exclusive purpose of carrying out the supervisory tasks conferred on it by the SSMR, the ECB shall have (i) all the powers and obligations set out in the SSMR; and (ii) all the powers and obligations, which competent authorities shall have under the relevant Union law. The relevant Union law assigning supervisory powers to competent authorities in relation to credit institutions consists mainly of the CRD, CRR and BRRD. Under Section IV on Supervisory powers, Article 64 of the CRD requires that competent authorities be given "all supervisory powers to intervene in the activity of institutions that are necessary for the exercise of their function" under the CRD and the CRR. It therefore results from Article 9 of the SSMR and Article 64 of the CRD that the ECB should not only have the powers explicitly listed in the CRD and the CRR, but also all supervisory powers to intervene in the activity of credit institutions that were given to national authorities for performing their broad supervisory function under the CRD and the CRR.

<sup>78</sup> Where individual supervisory powers are provided in national law they must be first assessed with a view to establish whether they underpin one of the tasks conferred to the ECB via the SSMR. To this end, characteristics, purpose and nature of supervisory powers under national law and of the corresponding supervisory functions under relevant Union law should be assessed. It should be taken into account that the tasks conferred to the ECB pursuant to Articles 4 and 5 of the SSMR are broad in nature and cover crucial prudential supervisory aspects enshrined in the CRD and CRR, as well as the early intervention mechanism in the BRRD.

undertakings are located in a participating Member State. Such concepts are useful for the ECB to identify the perimeter of entities under SSM supervision, including at consolidated level.

On the basis of the criteria and conditions listed in Article 6 of the SSMR<sup>79</sup>, the ECB assesses on an annual basis whether a supervised entity or supervised group is significant. Such assessment is done at the highest consolidated level in the participating Member States. A list of significant and less significant supervised entities is published every year on the ECB website, with regular updates to reflect changes in banking groups composition; as of 1 January 2017, it comprised 125 significant entities or groups. This list constitutes a transparent communication tool distinguishing between entities under direct ECB supervision and entities supervised by NCAs.

Although the default criteria for determining significance are enshrined in the SSMR, the ECB has some discretion to change the default qualification. It may ascertain the existence of particular circumstances that would qualify a supervised entity as being less significant even where it meets the size criteria. The ECB has broadly specified how it assesses "particular circumstances".<sup>80</sup> In a few instances<sup>81</sup> the ECB exercised its discretion to exempt entities from being considered significant, without however rendering public the justification for such assessment. According to the ECB, the few cases where particular circumstances were applied represented outlier situations. As a matter of principle, a re-qualification of an institution as a LSI could be considered as reasonable as long as there are specific factual circumstances to support that decision, and the objectives of the SSM are not affected. Re-qualification was conceived to remain exceptional, which requires the notion of "particular circumstances" to be interpreted restrictively. To be transparent about the way it exercised its discretion, the ECB has disclosed the institutions benefitting from particular circumstances, but did not make public detailed information justifying the application of particular circumstances.

Branches of credit institutions established in non-participating Member States that fulfil the significance criteria are also considered significant supervised entities. They are however not signalled in the ECB's list of supervised entities. The ECB exercises for such branches the powers granted under Union law to the competent authorities of the host Member State, whilst NCAs in host Member States remain competent for branches that are less significant.<sup>82</sup> Significant supervised branches do not necessarily coincide with significant branches determined in accordance with Article 51 CRD or with 'significant plus' branches, a subcategory currently envisaged by the EBA as part of its revised Guidelines on supervision

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<sup>79</sup> The following criteria are necessary to be met by a supervised entity to be considered as significant: 1) the total value of assets exceeds EUR 30 billion; 2) the ratio of total assets over the GDP of the participating Member State of establishment exceeds 20 %, unless the total value of assets is below EUR 5 billion; 3) the supervised entity is, in the Member State where it is established, one of the three largest institutions; 4) upon notification by the NCA that it considers such an institution of significant relevance with regard to the domestic economy, the ECB takes a decision confirming such significance following a comprehensive assessment by the ECB, including a balance-sheet assessment, of that credit institution; 5) the ECB considers on its own initiative an institution to be significant where it has subsidiaries in more than one participating MS and cross-border assets or liabilities represent a significant part of its total assets and liabilities; 6) institutions having received financial assistance from the EFSF or the ESM.

<sup>80</sup> Articles 70 and 71 SSMFR.

<sup>81</sup> The published list of significant and less significant institutions identifies by an asterisk the institutions which are exempted by the SSM from being a significant institution.

<sup>82</sup> Branch supervision is entrusted to the authority in the home country, with the host country supervisor having limited powers, in accordance with Articles 40-46, 49-52 CRD.

of significant branches. The two sets of concepts have to be considered in conjunction for identifying the involvement of the ECB in the supervision of such branches.

The ECB uses further categorisations of supervised entities in view of conducting proportionate supervision, enabling peer comparisons and defining the level of supervisory engagement. Based on institutions' systemic importance and complexity, the ECB divides SIs into 5 different clusters, with cluster 1 institutions representing the highest systemic impact and the highest supervisory complexity.<sup>83</sup> These clusters should not be confused with the different scores assigned by the ECB to institutions reflecting their "riskiness".<sup>84</sup> These, as well as further categorisations developed by the ECB appear to be instrumental to the performance of various supervisory activities, especially within the SREP. Their relevance and interaction is however not always straightforward, especially when used to determine the level of supervisory engagement or the choice of supervisory output. Also, the EBA noted in its supervisory convergence related work that the ECB's categorisations may not be fully aligned with the categorisation developed in the EBA's Guidelines on the Supervisory Review and Evaluation Process.

As the LSI sectors across participating Member States differ significantly in terms of the number of banks per Member State and the size of those banks,<sup>85</sup> a proportionate approach was warranted. Thus, a categorisation based on riskiness and potential impact of institutions on the relevant domestic market, has been developed by the ECB together with NCAs to determine supervisory engagement by the ECB and the level of information to be provided by the relevant NCA to the ECB. This prioritisation framework qualifies LSIs as high, medium or low priority, whereby the medium and low priority categories are used only for statistical and internal purposes and not subject to approval by the SSM decision-making bodies, whilst the high-priority category requires more intense communications from the NCAs to the ECB and increased vigilance from the ECB.<sup>86</sup> It proves useful for a better understanding of the ECB's engagement in LSI supervision, and for shaping cooperation of NCAs with the ECB.

## **B.2. Joint Supervisory Teams (JSTs)**

The Joint Supervisory Teams (JSTs) are representative of the SSM as a system; they constitute the tool whereby the ECB leverages on the expertise of NCA staff for performing its direct supervisory responsibilities towards SIs. The JST were created on the basis of the SSMFR and are not mentioned in the SSMR. They are responsible for the ongoing supervision of the SIs, that is, they are entrusted with the implementation of the tasks listed in

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<sup>83</sup> To determine the impact of an SI, the ECB uses size, complexity and geographical diversification as leading indicators, further refined with more bank specific analysis on substitutability, interconnectedness and implicit groups. On the basis of such analysis the systemic impact of an institution is considered. This impact categorisation is then further adjusted in relation to the complexity involved in supervising the institution (e.g. whether it is a conglomerate or an institution using sophisticated internal models).

<sup>84</sup> The ECB uses a four-grade scale with qualifiers for the overall Risk Assessment System (RAS) scores, which are based on the analysis of various categories of risks. Higher scores reflect an increased risk to the viability of the institution stemming from one or several features of its risk profile, including its business model, its internal governance framework, and individual risks to its solvency or liquidity positions.

<sup>85</sup> See regularly updated list of LSIs, [https://www.bankingsupervision.europa.eu/ecb/pub/pdf/intro\\_list\\_sse\\_201730.en.pdf?b9e9406ffa95250a604e4bce6b0185cf](https://www.bankingsupervision.europa.eu/ecb/pub/pdf/intro_list_sse_201730.en.pdf?b9e9406ffa95250a604e4bce6b0185cf).

<sup>86</sup> LSIs may be qualified as high priority for various reasons: their size – when they are close to being classified as SIs; for the intrinsic riskiness, their interconnectedness. Each participating Member State is designating at least three high-priority LSIs. The number of LSIs classified as high-priority LSIs remained stable at around 100 institutions, going from 108 institutions in 2015 to 93 in 2016 to 101 in 2017.

the Supervisory Examination Programme, including performing the SREP, coordination with on-site inspections, liaising with NCAs.

A JST is established for each SI and comprises staff from both the ECB and the NCAs of the participating Member States in which the parent credit institution, subsidiaries or cross-border branches of that banking group are established. Whilst approximately 2/3 of JST members are NCA staff, each JST is led by a coordinator from the ECB and one or more sub-coordinators from the NCAs (one per NCA involved in the supervision of that SI). For large JSTs, a core JST is also established. A core JST is composed of the JST coordinator and sub-coordinators, and it organises the allocation of tasks among JST members, prepares and revises the Supervisory Examination Programme and monitors its implementation.

The development of the framework for JSTs has been a learning-by-doing process, which still undergoes adaptations. Challenges relate to the fact that JSTs represent a new form of supervisory cooperation that requires resources integration within a new institutional set-up. Existing supervisory teams have been enriched through the JSTs with a new European dimension, which adds a cross-border perspective and offers mutual learning experience. During these first years of functioning, JSTs have proved to be functional and credible, doing most of the groundwork for supervisory decisions. However, they have also shown some structural weaknesses that could hinder their efficiency in practice. The main concerns relate to the following aspects:

- Double uncoordinated reporting lines: NCA staff report to the JST coordinator for tasks related to the JSTs and to their NCA superior for any other task. However, the ECB has no formal managerial control over the NCA members of the JST, and human resources matters are managed by the NCA. These double reporting lines (functional and hierarchical) may expose NCA staff in the JST to possible conflicts in terms of staff issues (workload, appraisals etc), and may also interfere with due information sharing.
- Language: Although within the JSTs the working language is mainly English, this may not be the case for the supervised institutions, which, in accordance with the SSMFR often opt for the use of their national language in their relations with the ECB. This means that fundamental information generated by SIs for internal use will not be written in English. JSTs' functioning may be affected by this language difference. It may be envisaged to condition the appointment of ECB coordinators to knowledge of the language used by the supervised institution.
- Insufficient staff allocation: The staff allocated to JSTs by both the ECB and the NCAs is not always sufficient, especially as some tasks have proven to be more complex and resource-demanding than anticipated. As a consequence, JSTs may be understaffed. Better allocation of resources and more flexibility in adjusting staff levels to supervisory needs should be possible.

### **B.3. Horizontal functions**

One of the objectives of the SSM is to ensure harmonised supervision in the Banking Union. To this end, a dedicated Directorate-General (DG IV) hosts the so-called 'horizontal functions', which define the ECB's supervisory policies, ensure convergence of supervisory approaches among JSTs and coordinate the execution of other essential specialised tasks. The scope and nature of tasks of DGIV is reflected in its organisational structure, where each

division is responsible for a separate area<sup>87</sup>. Given the nature of the tasks of the DG IV, its interaction with the NCAs also follows special arrangements different than for JSTs. Thus, the SSM has established a number of informal Networks under the auspices of DG IV, which serve as platforms for discussion and development of new policies and procedures related to supervision.

### **B.3.1. Convergence and consistency**

The horizontal services play a key role in the conduct of the ECB's supervisory tasks, especially in ensuring the convergence of supervisory practices. They assume the main responsibility in the development of the policies supporting the ECB's direct and indirect supervisory tasks and largely shape the ECB's methodologies. Horizontal services also directly carry out procedures that are common for all credit institutions in participating Member States, such as authorisation, withdrawals of authorisation and the assessment of qualifying holdings. Furthermore, they coordinate international cooperation, determine supervisory priorities<sup>88</sup>, benchmarking and quality assurance across the supervised entities, conduct analysis of systemic risks etc.

It is worth highlighting the specific role of horizontal services in ensuring the consistency of supervisory decisions. Based on the groundwork of the JSTs or NCAs, the horizontal services review certain decisions with a view to ensure the quality of the decision, but also consistency with the relevant ECB policy and with decisions already applied to peer institutions. DG IV thus contributes substantially to the content of supervisory decisions. This is much welcomed as it appears to be an efficient way to ensure coherent, high-quality supervision for all banks in participating Member States. Questions have been raised as to the transparency related to substantial interventions by DG IV over JST draft decisions. In this sense, some NCAs have raised concerns that changes operated by horizontal functions are not always explained to NCA staff participating in the relevant JST. Sharing timely such information with NCAs is important for the NCAs to prepare their position for the Supervisory Board. To prevent any bottlenecks and ensure transparency, more systematic and timely communication should be ensured to JST coordinators and sub-coordinators about changes proposed by the ECB's horizontal services to the substance of JST proposals for draft decisions.

### **B.3.2. Support Networks**

The SSMR does not envisage the establishment of formal Committees apart from the Steering Committee which supports the functions of the Supervisory Board.<sup>89</sup> Instead, the SSMR provides for the general duty of assistance by NCAs. To incorporate NCAs' input with regard to supervisory policy developments, the ECB has set up a variety of structures to support its supervisory activities. These structures take different forms (i.e. task forces, working groups, networks, expert groups), may be temporary or long term, dedicated to specific projects or to broad policy areas. The most representative structure consists of informal Networks, a

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<sup>87</sup> The divisions are the following: Authorisation, Centralised On-Site Inspections, Crisis Management, Enforcement & Sanctions, Internal Models, Methodology & Standards Development, Planning & Coordination of SEP, SSM Risk Analysis, Supervisory Policies and Supervisory Quality Assurance. Their functioning will be assessed in more detail in part C.

<sup>88</sup> For the list of 2017 priorities, see:

<https://www.bankingsupervision.europa.eu/banking/priorities/html/index.en.html>.

<sup>89</sup> Article 26(10) SSMR.

majority of which function under the auspices and in the areas of competence of DG IV.<sup>90</sup> The Networks are chaired by the representatives of the ECB and include participants (predominantly on managerial level) from the NCAs. They cover a wide range of topics and constitute, for NCAs, the main tool to influence policy stances on horizontal areas of supervision, as the most important issues and stances of the ECB and NCAs are discussed in these structures.

Networks are heterogeneous in terms of the dynamics of their work, as well as in their ultimate influence on the ECB's processes and decision-making. The absence of formal mandates, accountability, common governance processes and practices makes it difficult to assess and compare their relative effectiveness and impact. Some NCAs signalled that policy stances agreed in the Network by a majority of the members are sometimes not reflected in the corresponding policy proposal presented to the Supervisory Board. Another criticism from NCAs is that issues are not always sufficiently discussed in the Networks before proposals are made to the Supervisory Board.

The ECB's use of networks to request NCA's input on policy issues represents a flexible tool of cooperation within the SSM. Whilst there is no need for formalising all such networks, a clearer status for stable and influential networks could give a better overview of their mandate, governance and reporting lines. Furthermore, it would be useful that the proliferation of networks is avoided by streamlining existing structures and identifying areas that would most benefit from output of such cooperative structures.

#### **B.4. On-site inspections**

Prior to the establishment of the SSM, national practices with regard to on-site inspections differed widely among competent authorities. Some NCAs had separate organisational structures specifically dedicated to the conduct of on-site inspections, and independent from the so-called 'account teams', or on-going supervision.<sup>91</sup> Other NCAs did not have a dedicated on-site unit at all, and the on-site inspections were carried out by the members of the accounting teams of each specific bank.<sup>92</sup>

In this context, and building on best practices, the ECB has established a dedicated centralised ECB division for on-site supervision. The ECB followed a mixed model where the need for on-site inspections is determined by the JSTs, but the on-site division is responsible for the planning and staffing of the on-site teams. Although the JST members can participate in on-site inspections, they cannot lead an on-site mission.<sup>93</sup> It is the head of the mission (who may be ECB or NCA staff) who signs the inspection report, on the basis of which the JST is responsible for preparing recommendations. The creation of the SSM led a number of NCAs to adjust their own organisational structure to reflect the ECB's approach to on-site inspections.

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<sup>90</sup> At the moment, ECB relies on 10 Networks some of which have their own sub-structures (expert groups that hold technical-level discussions). The main Networks roughly correspond to the divisional structure of the DGIV.

<sup>91</sup> E.g., France, Germany. The special independent status of on-site inspection teams was reinforced by various safeguards such as separate reporting lines to ensure that the on-site report of independent examiners was not influenced by any input of account team supervision.

<sup>92</sup> E.g., Spain, the Netherlands.

<sup>93</sup> JST staff is routinely invited to participate in on-site mission. However, due to the high workload, JST staff is only able to accept participation in about 25% to 30% of all on-site inspections.



As already pointed out above<sup>94</sup>, the ECB staff dedicated to on-site inspections represents a small proportion of the staff dedicated by NCAs to on-site inspections.<sup>95</sup> In the start-up phase of the SSM, this situation could be justified by the organisational difficulties and higher costs of setting up cross-border inspection teams, the difficulties in finding staff with the necessary language skills for direct interaction with institutions and the importance of local knowledge for on-site inspections compared to on-going supervision. This situation is however not tenable in the long run and a more balanced staff contribution from the ECB and the NCAs is needed, reflecting the same ratio as in the case of JSTs.<sup>96</sup>

Furthermore, given that the staff resources for on-site missions are planned by the ECB in advance, it is difficult to accommodate ad-hoc needs for on-site inspections. Allocation of NCA staff for on-site inspections of SIs appears currently not to be sufficiently addressed by joint ECB-NCA planning of resources. The ECB also considered addressing shortages in staff for on-site inspections by increasing reliance on external consultants in on-site inspection teams, but without allowing such external consultants to take the lead on on-site inspections.

Notwithstanding the staff shortage for effective inspections, it is important to underline that the dedicated ECB division has successfully developed the framework for conducting on-site inspections. A dedicated chapter of the supervisory manual sets out the processes and activities in relation to on-site supervision, completed by an extensive description of methodologies for each risk category. In addition, the ECB is currently setting up a comprehensive training curriculum for on-site inspectors across the SSM in cooperation with the EBA.

## **B.5. Supervisory colleges**

As declared by the ECB, "colleges of supervisors are key to coordinating the supervision of cross-border banking groups."<sup>97</sup> This is particularly the case for banking groups with a presence in non-euro area countries. The ECB currently participates in 45 colleges of supervisors and, in its capacity of consolidating supervisor, is responsible for the organisation and functioning of 26 of these colleges. The ECB is particularly valuing college participation where it is the competent authority for subsidiaries of groups headquartered outside the euro area, as well as where it is competent to perform host country supervisory tasks in relation to branches that are considered significant institutions. The JSTs have developed processes and procedures to ensure that colleges are functioning, in line with relevant technical standards.<sup>98</sup> The ECB has also agreed or is in the process of negotiating Memoranda of Understanding with EU and third country authorities to ensure, amongst others, appropriate information exchange, cooperation in ongoing supervision and in emergency situations, conduct of on-site inspections and internal models investigations.

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<sup>94</sup> See part on interaction between ECB and NCAs.

<sup>95</sup> Currently, the relevant ECB division has an official staffing level of 41 full time experts (FTEs), which may increase to about 50 full-time equivalents (FTEs) when including job-rotations and temporary staff. This compares to about 650 FTE employed in on-site inspection in NCAs, which translates into a significantly lower ratio of ECB staff/NCA staff compared to the off-site supervision. With the current staff level, the ECB is able to participate in about 8% of all inspections of SIs within participating member states.

<sup>96</sup> In order to enable ECB to participate in about 25% to 30% of all SI on-site missions, around 100 additional FTEs would have to be recruited.

<sup>97</sup> ECB Annual Report on Supervisory Activities 2016, p.44.

<sup>98</sup> Commission Delegated Regulation (EU) 2016/98 and Commission Implementing Regulation (EU) 2016/99.

Competent authorities outside the euro area that chair supervisory colleges, as well as the EBA<sup>99</sup>, are very positive about the ECB's performance in supervisory colleges, arguing that the ECB carries more weight as a single authority compared to when several authorities from participating Member States were members of these supervisory colleges. Furthermore, they appreciate the quality of the ECB's contributions to supervisory colleges, which contributes to raising the level of discussions.

For supervisory colleges chaired by the ECB, supervisors outside the SSM indicated that the ECB has improved the way the colleges work compared to the pre-SSM period, when colleges were hosted by NCAs. Particularly praised were better prepared agendas and high quality discussions. On the shortcomings side, some authorities and the EBA noted that differences remain in the functioning of colleges depending on the jurisdictions involved and that some issues have persisted, such as the failure to adopt Joint Decisions for group recovery plans.<sup>100</sup> Furthermore, on certain topics the ECB does not always communicate clearly within the college as long as final decisions were not taken.<sup>101</sup>

Overall, colleges remain the key tool for coordinating the supervision of cross-border banking groups with activities outside the euro area. They are currently the main tool for interaction with NCAs from non-participating Member States. The colleges are also an important tool for the ECB to perform its tasks in relation to branches of credit institutions from non-euro area countries, for which it acts as a host supervisor.

## **B.6. Options and discretions**

CRR, CRD<sup>102</sup> and the LCR Delegated Act<sup>103</sup> provide for options and discretions that competent authorities may exercise. As those texts entered into force before the SSM was in place, NCAs determined initially how those options and discretions would be applied in their respective Member States. In 2015 the ECB started to work towards the harmonisation of the exercise of those options and discretions, with a view to promote a prudent and harmonized treatment for institutions in the Banking Union. This process was structured in various stages.

First, the ECB identified over 120 options and discretions attributed to competent authorities. Following an individual analysis, the Supervisory Board agreed on policy recommendations that were reflected in a draft regulation for options and discretions of a general nature (such as the transitional arrangements for own funds calculations), and a draft guide for options and

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<sup>99</sup> The EBA has also the task of facilitating the functioning of supervisory (and also resolution) colleges. As an observer, the EBA participates in the so-called closely monitored colleges (on the basis of a yearly selection of several EU banking groups) and assesses their functioning in light of a list of criteria which include compliance with the requirements in the relevant EU acts. In particular, the EBA monitors adoption of the group risk assessment reports, joint decisions on group recovery plans, and joint decisions on capital and liquidity. In addition, EBA is appraising the overall functioning of the colleges against the requirements laid down in the implementing technical standards on operational functioning of colleges. It takes into account the overall interaction and cooperation within the college, dynamics of college meetings etc. Subsequently, EBA provides its feedback to supervisory authorities and conducts comparative assessment between various colleges, highlighting best practices as well as areas where improvement is needed. The main findings are also publicly available in the form of annual Reports.

<sup>100</sup> It should be noted that the BRRD envisages a possibility to adopt recovery plans for individual entities or a number of entities in the group, instead of the group recovery plan. However, it is important for the SSM to strive to address all EBA recommendations on the improvement on the colleges functioning.

<sup>101</sup> This was for instance the case with ECB's communication in colleges about its approach to internal model approval.

<sup>102</sup> Directive 2013/36/EU, OJ L 176, 27.6.2013, p. 338.

<sup>103</sup> Commission Delegated Regulation (EU) 2015/61, OJ L 11, 17.1.2015, p.1.

discretions for which a case-by-case analysis is required (such as capital waivers). Those draft texts were released for public consultation in November-December 2015 and finalised in March 2016. The ECB Regulation<sup>104</sup> that entered into force on 1 October 2016 and the Guide apply exclusively to the exercise of options and discretion in relation to significant institutions supervised by the ECB.

In a second phase, the ECB identified 8 additional options and discretions attributed to competent authorities that, given their case-by-case nature were addressed through policy recommendations added to the Guide on options and discretions.<sup>105</sup> In parallel, the ECB developed criteria for assessing the eligibility of institutional protection schemes (IPS).<sup>106</sup> The final Guide that is applicable to all IPS in the Banking Union was published on 12 July 2016.<sup>107</sup> A consolidated version of the Guide covering the initial set of options and discretions, the policies for the 8 additional options and discretions and the criteria for the IPS eligibility assessment was published in November 2016.

Finally, in order to enhance the consistency of the rules applied within each participating Member State, the ECB has extended the harmonisation exercise to LSIs<sup>108</sup>. It reviewed the options and discretions applied to SIs with a view to determine whether LSIs should be subject to the same policy recommendations, or whether a different approach is warranted (for example, to ensure proportionality in supervision). Consequently, the ECB prepared two different texts: a draft Guideline, of binding nature, for those options and discretions for which a specific policy rationale justifies the adoption of a common approach; and a draft Recommendation, non-legally binding, for other options and discretions where a common approach would help to promote consistent supervisory practices. The two ECB instruments addressed to NCAs were subject to public consultation between November 2016 and January 2017, and were finally published on 13 April 2017<sup>109</sup>. The NCAs are expected to comply with the Guideline from 1 January 2018.

Some stakeholders raised concerns as to whether the ECB is empowered to issue a regulation for this purpose, and on how this exercise would interact with national provisions exercising such options. The ECB is empowered to adopt regulations to the extent necessary to perform specific tasks concerning policies relating to the prudential supervision of credit institutions, in accordance with Article 132 of the Treaty on the Functioning of the European Union and Articles 34 and 25.2 of the Statute of the ECB. Regarding options exercised through national provisions, the ECB must apply national legislation according to Article 4.3 SSMR, where the exercise of options was attributed to Member States. By contrast, options granted only to competent authorities fall within the remit of the ECB as far as they affect SIs. Member States should ensure that national legislation does not constrain the exercise of options given to

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<sup>104</sup> Regulation ECB/2016/4, OJ L 78, 24.3.2016, p. 60.

<sup>105</sup> An amendment to the ECB Guide on options and discretions was released for public consultation in May-June 2016 and the final addendum was published on 10 August 2016.

<sup>106</sup> CRR lays down a specific regime for IPS, provided that they comply with certain requirements and subject to supervisory authorisation.

<sup>107</sup> The Supervisory Board approved the approach of the ECB when assessing those requirements and a draft Guide was released for comments between February and April 2016.

<sup>108</sup> Although the ECB is not the competent authority for direct supervision of LSIs, it is responsible for the effective and consistent functioning of the SSM, according to Article 6.1 of the SSMR. In order to ensure this consistency, it can issue regulations, guidelines or general instructions to NCAs, as set forth in Article 6.5 SSMR.

<sup>109</sup> Guideline ECB/2017/9, OJ L101, 13.4.2017, p. 156. And Recommendation ECB/2017/10, OJ C120, 13.4.2016, p. 2.

competent authorities, which derive their competence to exercise such options directly from Union law.<sup>110</sup>

The ECB made great efforts to foster harmonisation and has gone a long way in achieving a uniform exercise of options and discretions enshrined in Union law. However, the approach agreed for some options or discretions is not always the most conservative, nor fully harmonised. For instance, regarding the transitional arrangements for own funds calculations, stricter national rules applicable prior to the entry into force of the ECB Regulation shall prevail over the harmonized treatment set forth by the ECB Regulation. Those cases could have benefited from a more ambitious approach.

### **C. Evaluation of performance of the main supervisory tasks**

This section assesses the performance by the ECB of the core supervisory tasks conferred to it by the SSMR. Given their relevance in terms of substance or workload, the following tasks will be analysed in detail: common procedures (authorisation, withdrawal of authorisation, assessment of qualifying holdings), the ongoing supervision of SIs (involving fit-and proper assessment, own funds and internal model approvals, the supervisory and evaluation review process), the oversight of supervision of LSIs by the NCAs, additional macro-prudential tasks.

#### **C.1. Common procedures [Article 32(d) SSMR]**

The ECB has been conferred three specific tasks with regard to all credit institutions in the Banking Union (SIs and LSIs): authorisation, withdrawal of authorisation and assessment of acquisitions and qualifying holdings (referred to as "common procedures"). Their specificity relates not only to the broad scope in terms of entities covered by such ECB tasks, but also to the prominent role given to NCAs in preparing the relevant decisions. Common procedures are particularly relevant to assess the effectiveness of the cooperation between the ECB and the NCAs.

##### **C.1.1. Authorisation of credit institutions and withdrawal of authorisations**

The SSMR provides the ECB with ultimate responsibility for the authorisation ("licensing") and withdrawal of authorisations for all credit institutions established in a participating Member State.<sup>111</sup> Given that the corresponding substantial rules on authorisation are only subject to minimum harmonisation in the CRD, and are extensively developed in national laws, the NCAs hold a central role in preparing the related decisions in accordance with the special procedure laid down in Article 14 of the SSMR. Credit institutions submit applications for authorisations to the NCAs<sup>112</sup>, which assess compliance with national laws. If the NCA is satisfied from the perspective of compliance with relevant national law, it will send a proposal to the ECB, which has to make its own assessment, and shall object to authorisation where compliance with relevant Union law is not ensured.

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<sup>110</sup> The ECB's exercise should prevail, given that "the principle of the primacy of European Law may be invoked and consequently national legislation conflicting with the provisions of EU law becomes inapplicable" [https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/reporting/feedback\\_statement\\_options\\_discretions.en.pdf?8f290fb3d019af7b9f801f38d60f5157](https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/reporting/feedback_statement_options_discretions.en.pdf?8f290fb3d019af7b9f801f38d60f5157), p.10.

<sup>111</sup> Until 31 December 2016, the ECB adopted 95 decisions related to authorisation of institutions or withdrawal of the authorisation.

<sup>112</sup> NCAs shall inform the ECB of an application for authorisation within 15 working days after obtaining it.

Unlike authorisations, withdrawals of authorisation may not only be initiated on the basis of NCAs proposals, but also by the ECB, following consultation of the relevant NCA. Furthermore, resolution authorities may object to the ECB's intention to withdraw an authorisation, if they consider that this would affect resolution or financial stability. In such cases, the ECB shall abstain from proceeding to the withdrawal for the period agreed by both authorities. It is noted that resolution authorities may only object withdrawing the authorisation of an institution entering resolution, whilst competences for authorisation of any institution issuing from the resolution (including bridge institutions) follow the distribution of tasks for authorisation in the SSMR.

Concrete time limits for authorisation or withdrawal of authorisation are based on national law, as the CRD only requires that a decision be taken within 12 months after the application was lodged. By contrast, the SSMR clearly frames the ECB's timeline, providing that drafts proposed by NCAs are deemed to be adopted unless the ECB objects within 10 working days, extendable once in justified cases. This deadline is not coordinated with deadlines for authorisation set out in national law and may be challenging for the ECB in its current decision making environment, where approval by the Supervisory Board and the Governing Council are likely to consume most of the 10 days. This supposes that the ECB's assessment is done in parallel and in close cooperation with the relevant NCA. In the start-up phase of the SSM, the ECB had difficulties with some NCAs that were reluctant to coordinate their assessment process of an application for authorisation with the ECB in the absence of a specific requirement for cooperation.<sup>113</sup> The obligation of cooperation in good faith is incumbent on all parties in the SSM and the duty of assistance by the NCAs, made explicit in Article 6 of the SSMR, is a fundamental principle for the functioning of the SSM, which does not need to be repeated throughout the SSMR in relation to specific tasks.

### **C.1.2. Assessment of acquisitions and disposals of qualifying holdings**

The acquisition of a holding of a certain size ("qualifying holding") in a bank allows the acquirer to access the banking business, similarly to the access that would be achieved by the creation of a new credit institution. Therefore, the CRD requires that acquisition of qualifying holdings is notified to the authority that authorised the acquired institution, which can object to the acquisition.<sup>114</sup>

Within the SSM, the ECB is the competent authority for assessing acquisitions and disposals of qualifying holdings in both SIs and LSIs.<sup>115</sup> However, unlike the responsibility for authorisations in the context of resolution, the ECB is not competent to assess acquisitions and disposals in the case of a bank in resolution.<sup>116</sup> According to the SSMR, the potential acquirer notifies the NCA of the institution it intends to acquire, which shall submit to the ECB a draft decision to oppose or not the acquisition at least 15 working days before the expiry of the assessment period set in the CRD.<sup>117</sup> Given that in the absence of a reaction by

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<sup>113</sup> As opposed to Article 15(2) SSMR where NCAs are explicitly required to assist the ECB, Article 14 SSM, does not contain any such explicit clause.

<sup>114</sup> Articles 22-27 CRD. Unlike the case of authorisation, the procedure for objecting to acquisitions of qualifying holdings and the applicable timelines are provided for in detail in the CRD, leaving to Member States more reduced margin of transposition.

<sup>115</sup> Until 31 December 2016, the ECB adopted 193 decisions related to proposed acquisitions of qualifying holdings.

<sup>116</sup> Article 4(1)(c) SSMR

<sup>117</sup> The CRD gives 60 days for the assessment by the competent authority of acquisitions of qualifying holdings, whose running may be suspended up to 30 days where further information is necessary. Article 22 CRD.

the competent authority the acquisition is deemed to be approved, such timelines have proved challenging for the ECB, as in the case of authorisations. The approval of qualifying holdings is made even more complex in the context of group-wide restructurings, where the ECB has to align and synchronise assessments with regard to related acquisitions in several Member States. In this context coordination and common procedures are crucial to avoid the risk of taking conflicting decisions on related qualifying holdings or being constrained to give unjustified approvals for the sake of avoiding conflicting decisions. To address these challenges the ECB has developed various tools and work processes with NCAs setting out clear procedures and timelines, including for early reporting.

An issue that appeared in the context of approvals of acquisitions of qualifying holdings relates to the allocation of roles between the ECB and the NCAs in connection to the on-going supervisory tasks concerning qualifying holdings. In accordance with Article 26(2) of the CRD, competent authorities shall take the appropriate measures where persons with a qualifying holding are likely to affect the prudent and sound management of an institution or otherwise cease to meet the criteria in the CRD. The SSMR conferred to the ECB the task of assessing notifications of acquisitions of qualifying holdings, except in the case of a bank in resolution. Interpreting such task as being limited to the moment of acquisition, but not as referring also to the ongoing assessment of qualifying holdings in accordance with Union law, would defeat the purpose of conferring the task to the ECB in the first place. As in the case of granting of authorisation, which is paired with the ECB task of withdrawing authorisation, the ECB's competence to approve qualifying holdings would be ineffective in the absence of a pairing competence to verify compliance with the conditions for approval and the power to take the necessary remedying measures.

## **C.2. On-going supervision of significant institutions (SIs) [Article 32 (c) SSMR]**

The bulk of supervisory tasks transferred to the ECB are related to the ongoing supervision of credit institutions. In accordance with the distribution of tasks between the ECB and the NCAs, the ECB performs directly such tasks in relation to significant institutions (SIs)<sup>118</sup>. NCAs are involved in the preparation and implementation of the ECB's decisions, in accordance with their duty to assist the ECB. The involvement of NCAs takes mainly the form of participation in the JSTs, which undertake the ground work for most of the direct responsibilities incumbent on the ECB. The way in which the ECB carries out its supervisory tasks is largely influenced by the work undertaken by the EBA in developing the single rulebook and forging convergence of supervisory practices. Hence, there is a clear link between ECB's performance of on-going supervision and EBA's efforts to foster the level-playing field in regulation and supervision throughout the internal market.

### **C.2.1. Fit and proper assessments**

The ECB has been entrusted with the task of ensuring that credit institutions have robust governance arrangements, which includes checking compliance with the fit and proper requirements for the management of SIs.<sup>119</sup> Given that the ECB has to assess the suitability of the managers of all subsidiaries of SIs, the amount of procedures is extremely high, with fit and proper approvals representing the largest part of supervisory decisions adopted by the ECB. Until 31 December 2016, the ECB adopted 1.767 decisions related to 4.253 fit and

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<sup>118</sup> Within the ECB, DG Micro-Prudential Supervision I and DG Micro-Prudential Supervision II are responsible for the direct day-to-day supervision of SIs.

<sup>119</sup> Article 4(1)(e) SSMR.

proper procedures, whilst there is still a backlog compared to the number of notifications received.

The substantial requirements for fit and proper assessments are laid down in broad terms in the CRD and have been implemented through more detailed criteria in national law. Thus the details of the different criteria, as well as the procedural rules, such as deadlines, the type of supervisory procedure applicable (e.g. ex ante supervisory approval or ex post notification of an appointment) are laid down in national law transposing the CRD. The EBA has developed guidelines to streamline the application of fit and proper assessments,<sup>120</sup> which still leave some room for competent authorities to add detail. The ECB remains therefore confronted with a large diversity of rules and procedures stemming from 19 different legal systems. To bridge to the extent possible differences in supervisory practices, the ECB has prepared its own guide aiming to harmonise the implementation of assessment criteria for fit and proper assessment. The ECB clarified when consulting on such guide that it is not intended to substitute requirements stemming from Union or national law, nor to replace the EBA Guidelines, but to achieve common supervisory practices. The ECB published the Guide on 15 May 2017 and committed that once the revised guidelines of the EBA will be finalised the ECB will consider whether it is necessary to change the Guide to bring it in line with the final version the EBA Guidelines.

In parallel, the ECB has developed a delegation framework, including a delegation decision setting out the limits and criteria for allowing certain fit and proper decisions to be delegated to management level. Such limits are directly linked to the fit and proper Guide developed by the ECB. This new development is expected to substantially alleviate the decision-making burden (in terms of number of decisions to be adopted) for the Supervisory Board and the Governing Council. It will however only partly alleviate the complexity of the analysis to be performed by the ECB, as long as relevant national laws develop in a non-harmonised way.

The area of fit and proper assessment is illustrative for the relationship between the ECB and the EBA. The ECB has been actively involved when the EBA developed its revised guidelines on fit and proper assessments, but the ECB has been much less communicative on the way it developed in parallel its own guide on fit and proper assessment. There do not seem to be divergences on the substance of the rules, whereas the timing of their finalisation and publication was not aligned, which may require subsequent updates of the ECB Guide.

### **C.2.2. Own funds approvals and waivers**

According to Article 4(1)(d) SSMR, the ECB is entrusted with the task of ensuring compliance by SIs with own funds and liquidity requirements. The quality of instruments used by banks to comply with capital requirements is essential for their effectiveness. Hence, one of the key tools related to this task is the approval of own funds instruments. Such prior approval by the competent authority is mandatory for institutions to consider capital instruments as CET1 (Article 26(3) CRR), while for AT1 and T2 instruments pre-approval processes can be envisaged by the competent authorities (Recital 75 CRR). Reductions, repurchases or redemptions of own funds instruments also require prior approval by the competent authority (Article 78 CRR). The Supervisory Manual sets out the methodology that JSTs must follow when assessing CET1 instruments. For AT1 and T2 instruments, the ECB

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<sup>120</sup> Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2012/06) and Guidelines on Internal Governance (GL 44). On the former the EBA is working on a revised version that was published for consultation on 28 October 2016 and is currently finalised.

has also released Guidance<sup>121</sup>, laying down the ECB's assessment methodology and procedure<sup>122</sup> and the documentation that institutions must submit as part of their application. In terms of numbers, supervisory decisions in relation to own funds instruments represent the second largest category after fit and proper decisions.<sup>123</sup>

The EBA is required to monitor the quality of own funds instruments issued by institutions, on the basis of information provided by competent authorities (Article 80 CRR). During this exercise, the EBA has noted that the ECB has submitted for review to EBA a relatively small amount of cases, taking into account the large number of directly supervised institutions. This appears to be the consequence of the absence of an internal procedure that would allow a regular and consistent check of JST's draft decisions on own funds instruments before they are submitted to the Supervisory Board. Such procedure could contribute to consistency between JST's work on own funds instruments and could also allow for more proactive participation by the ECB in the EBA's monitoring of the high quality of capital.

In relation to own funds and liquidity requirements, competent authorities have the discretion to waive their application in the case of institutions belonging to a group (Article 7 CRR for own funds, large exposures, securitisations, disclosure and leverage; and Article 8 CRR for liquidity). Capital and liquidity waivers have been largely discussed as part of the ECB work on options and discretions, with the ECB's policy stance to the application of such waivers being published in the ECB's Guide on options and discretions. This includes detailed guidance about the criteria that the ECB will follow in its assessment and about the documentation that institutions are expected to provide. In this regard, it is worth noting that in the case of cross-border liquidity waivers, the Guide foresees the application of partial liquidity requirements after granting the waiver. This regime will be reviewed before 2019 with a view to reduce such requirements and thus "ensure the safety and freedom of cross-border intragroup liquidity flows". Moreover, the Supervisory Manual describes the methodology to be applied by JSTs when assessing these applications.

The ECB carried out 40 waiver proceedings in 2016 and none in 2015. The harmonisation of criteria in relation with waivers will likely have a positive impact on the Banking Union.

### **C.2.3. Internal models**

Institutions may use internal models to quantify the risk weighted assets in relation to certain portfolios. Contrary to the so-called standardised approaches, these more sophisticated approaches allow banks to estimate the relevant risk parameters – and on that basis calculate minimum capital requirements – internally. When the ECB became operational, several thousands of such internal models were already employed by institutions.

Competent authorities and, in case of SIs, the ECB have to approve internal models before their first use, as well as any material changes to previously approved models, and also have to review approved models on an ongoing basis. The approval of new models and changes to existing models are dealt with by the ECB through the so-called "Model Approval Process" (MAP), while an example of ongoing review of existing models is the so-called "Targeted Review of Internal Models" (TRIM) currently conducted by the SSM.

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<sup>121</sup> Public Guidance on the review of the qualification of capital instruments as Additional Tier 1 and Tier 2 instruments [https://www.bankingsupervision.europa.eu/ecb/pub/pdf/public\\_guidance\\_at1\\_and\\_t2.en.pdf](https://www.bankingsupervision.europa.eu/ecb/pub/pdf/public_guidance_at1_and_t2.en.pdf).

<sup>122</sup> The ECB has opted for an ex-post assessment of AT1 and T2 instruments.

<sup>123</sup> The ECB adopted 62 decisions on classifications of capital instruments in 2015 and 76 in 2016. Regarding reductions of own funds, the ECB adopted 84 decisions in 2015 and 121 in 2016.



Initially the ECB's efforts have focused on the MAP,<sup>124</sup> which has been successfully launched, and is constantly improving performance. 120 out of 201 Internal Model Investigations (IMIs) have been finalised so far by the ECB.<sup>125</sup> The investigations conducted so far cover a wide range of risks and approval types. 82% of the model assessments related to credit risk models, 12% to market risk models and 6% to operational risk models. The majority of investigations concerned material changes to previously approved models, whilst about 13% of model assessments related to new models.<sup>126</sup> The whole model approval process takes about 40 to 45 weeks on average<sup>127</sup>. The ECB has constantly increased its staff engaged in model approvals and now has sufficient capacity to cover pending cases and new cases, which should eliminate the backlog from the start-up phase in due course. In this respect, SSM data clearly shows a significant increase in concluded cases for the last two quarters of 2016,<sup>128</sup> suggesting further progress in terms of speed of the process.

As of late 2015 the ECB has also stepped up its efforts concerning the review of existing models. The TRIM focuses on the most critical models. Criticality of models has been assessed in terms of amount of assets covered by the model and deviation of model results from observed outcomes in reality. The ECB, in cooperation with NCAs and supported by external contractors, has developed a methodological framework for TRIM, codified in a TRIM handbook. One of the goals of TRIM is to communicate supervisory expectations and make recommendations to institutions to ensure that internal models give consistent results. The ECB relies on TRIM to inform its positions in international fora, as well as a tool to channel the implementation of regulatory developments in this area. The objective in this respect is to develop a methodology that can be used after finalization of TRIM for regular model supervision.

There are mixed views among stakeholders as regards the ECB's efforts in relation to model approval and review. Some credit institutions consider the ECB as being too intrusive or criticise the length of the approval procedure, which is perceived to have increased compared to model approvals before the establishment of the SSM. At the same time, the Secretary General of the Basel Committee on Banking Supervision praised the SSM commitment in reviewing internal models at a hearing on 12 October 2016 at the European Parliament's ECON committee.<sup>129</sup>

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<sup>124</sup> In general, the MAP is composed of four stages: assessment phase, central consistency check, draft decisions phase and decision phase. In the assessment phase, an on-site assessment and review of the model (or changes) based on a centrally defined consistent methodology and an agreed assessment plan is conducted. The findings and their severities are captured in an assessment report. The central consistency check of the assessment report is performed by the SSM Internal Models Division (INM) in order to ensure a comparable and harmonised assessment of the models and the findings including their severities. In the draft decision phase JSTs and the INM prepare a draft decision which contains the remediating activities the institution has to initiate in order to be permitted to apply the model. In the decision phase, the draft decision is reviewed and approved. In this phase, the institution concerned has the chance to comment on the draft decision before it becomes final.

<sup>125</sup> For 2017, an additional 92 IMIs are scheduled, of which 39 IMIs have already been launched in 2016 and 53 are to be started in 2017.

<sup>126</sup> 51% of the model assessments were related to approvals of material changes, 13% to initial internal model approvals, 11% to approval of internal model extensions, and 15% are IMIs triggered on SSM initiative.

<sup>127</sup> There is a large dispersion in terms of length of investigations though, ranging from under 5 weeks to over 25 weeks, since the length of the investigation heavily depends on the number of models or exposure classes that are in scope of an investigation.

<sup>128</sup> 47% of all finalised cases have been concluded in the last two quarters of 2016.

<sup>129</sup> <http://www.europarl.europa.eu/news/en/news-room/20161005IPR45669/committee-on-economic-and-monetary-affairs-meeting-12102016-%28pm%29>.

The approval of models and their review by the ECB constitute a major step in harmonising supervisory practices. It is therefore important that this harmonised practice applied to the approval and review of internal models within the SSM is spread across the EU. In this sense, it is noted that the ECB has closely cooperated with the EBA in areas covered by EBA's mandate for draft RTS Guidelines, and although ECB issued its TRIM Guide before the finalisation of the RTS on the assessment methodology for market risk, the ECB committed to update its Guide so as to reflect the final RTS. At the same time, it is noted that the ECB was less active in cooperating with the EBA in areas where the EBA does not have a mandate for developing draft RTS but is considering issuing guidelines, such as for the development of convergent supervisory practices on the materiality assessment for internal model methods for counterparty credit risk.

#### **C.2.4. Supervisory Review and Evaluation Process**

One of the core supervisory tasks consist of the performance of the SREP. Through the SREP, competent authorities analyse the risks incurred by every institution, its business model, governance structure and its capital and liquidity adequacy. As a result, competent authorities may impose additional capital requirements or other supervisory measures on individual institutions, through the so-called SREP decision. Until the establishment of the SSM, each NCA had developed its own SREP methodology, based on the CRD as well as on guidelines gradually developed by the EBA.<sup>130</sup> Yet, large divergences were still noticed.

The SSM carried out its first SREP exercise based on a common methodology in 2015. This methodology was further refined for the 2016 SREP exercise and is expected to be stable in 2017. The ECB's SREP methodology requires banks to be assessed along 4 elements: business model, governance and risk management, risks to capital and risks to liquidity and funding. The assessment of each element is based on quantitative and qualitative elements, combining automated anchoring with constrained expert judgement by JSTs, and results in the determination for each institution of the so-called overall SREP score.<sup>131</sup> Based on the SREP score, the JSTs suggest a capital add-on, liquidity related measures and qualitative measures to be imposed on institutions.<sup>132</sup>

The proposals of the JSTs are complemented with the horizontal analysis by DG MS IV (such as peer group analysis and benchmarking), with a view to ensure consistent outcomes across JSTs. According to the ECB, the methodology applied horizontally is discussed with the NCAs, via the horizontal network on methodologies and standards, the High-Level Group on SREP and Supervisory Board and that NCAs should be able to fully retrace the methods employed based on the information tabled to the Supervisory Board for approving the SREP decisions. Several NCAs complained that this would not be possible in practice since not all SREP decisions are discussed individually or in detail at the Supervisory Board, as often such

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<sup>130</sup> More precisely, the EBA Guidelines on common procedures and methodologies for the supervisory review and evaluation process [https://www.eba.europa.eu/documents/10180/935249/EBA-GL-2014-13+\(Guidelines+on+SREP+methodologies+and+processes\).pdf](https://www.eba.europa.eu/documents/10180/935249/EBA-GL-2014-13+(Guidelines+on+SREP+methodologies+and+processes).pdf).

The ECB has endorsed these Guidelines, therefore the ECB's methodology should comply with the common standards set by the EBA.

<sup>131</sup> Each of the four elements was assigned a risk score from 1 to 4 (1 corresponding to lowest risk and 4 corresponding to highest risk). These four scores were then translated into a single overall risk score.

<sup>132</sup> The current CRD leaves it to the full discretion of supervisors to impose a specific composition of Own Funds with which the supervised institution has to meet its Pillar 2 capital add-on. This discretion has been confined by the EBA SREP Guidelines, which stipulate that at least 56% of the add-on should be met with CET1 and at least 75% with Tier 1. The ECB has adopted the most conservative approach in this regard by requiring banks to meet the full capital add-on with CET1 only.

decisions are approved in batches. The draft SREP decisions are approved by the Supervisory Board and sent to the relevant institutions for comments. Taking into account the input received, the decisions are finalised by ECB staff and submitted for adoption to the Governing Council through the non-objection procedure. The final SREP decisions are communicated to the supervised institutions.<sup>133</sup>

The development by the ECB of a common methodology for all SIs in participating Member States and its unitary application is a remarkable achievement<sup>134</sup>. Such methodology and its application have steadily improved showing the ECB's learning capacity and willingness to adapt. With regard to the 2015 SREP exercise, the first based on a common ECB methodology, several banks complained that the justification for the capital add-on provided in the SREP decisions was insufficient to understand the underlying rationale. This made it allegedly difficult for institutions to challenge these decisions or to assess what changes they should implement in order to reduce their capital add-ons in the future. However, many banks also admitted that the ECB's SREP decisions were more detailed and better justified than the previous SREP decisions adopted by NCAs.

Another criticism of the banking industry regarding the 2015 exercise was the lack of clarity on the interaction between the communicated Pillar 2 capital add-on and the capital buffers set forth by CRD. More precisely, it appeared that the ECB frontloaded the full Capital Conservation Buffer (CCB) through the Pillar 2 capital add-on, despite the different phase-in arrangements implemented by many Member States. By doing so, the ECB also changed the consequences of an eventual breach of the CCB (as breaching the buffer requirement has specific consequences envisaged in CRD – namely restrictions to distributions based on the Maximum Distributable Amount (MDA), which are not applicable for a breach of Pillar 2 capital add-ons) and the relevant stacking order for triggering consequences in case of breach (given that buffers sit on top of Pillar 2 requirements, and would be breached first where there is not sufficient capital). This fuelled concern in the market for AT1 capital instruments, given the uncertainty as to the pay-out of distributions in case of a bank close to breaching the buffer requirement.

As much of such uncertainty related to the equivocal wording of the relevant CRD provisions, the Commission reacted by developing a staff note clarifying its view on the correct interpretation of the relevant CRD Articles and outlining plans for streamlining the Pillar 2 framework. The Commission's November 2016 legislative proposal on the review of CRD and CRR includes some targeted amendments to clarify the applicable framework and to foster convergence in the way different supervisory authorities implement Pillar 2.

Based on the Commission's clarifications, the ECB implemented several changes to its methodology for the 2016 exercise. The main change was the introduction of Pillar 2 capital guidance. It now captures certain elements of risk that in the 2015 SREP were included in the Pillar 2 requirement, such as the frontloading of the CCB or the outcome of supervisory stress tests. Pillar 2 guidance is a supervisory expectation, and thus does not affect the calculation of the MDA and the triggering of automatic restrictions on distributions. Should an institution fail to meet its Pillar 2 guidance, the ECB will adopt corrective measures that are adapted to

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<sup>133</sup> For the 2015 exercise, along the SREP decision the ECB also issued letters to encourage banks to promptly inform the supervisors should the capital position of the bank get too close to the SREP requirement (reaching the so-called early warning threshold) or should its financial situation deteriorate.

<sup>134</sup> Until 31 December 2016, the ECB adopted 343 SREP decisions for SIs.

the bank's individual situation.<sup>135</sup> Another relevant change in the 2016 SREP exercise was related to the communication policy. The ECB increased the level of detail provided on the justification of SREP decisions and included additional information to enable institutions to understand where their risk exposures are in relation to their peer group. Furthermore, the ECB has published a "SSM SREP Methodology Booklet"<sup>136</sup> which provides insight into the ECB SREP methodology and procedures. The ECB does not foresee major changes to the SREP methodology in 2017.

The results of the 2016 SREP have kept the overall SREP CET1 demand for 2017 at 10.1% (excluding systemic buffers), the same level as in the previous year. However, in the 2016 SREP, capital shifted from the Pillar 2 add-on requirement to Pillar 2 guidance and, as a consequence, the MDA trigger decreased substantially, from an average of 10.2% to 8.3%. SREP decisions also included, where necessary, liquidity measures (such as the requirement of minimum survival periods or minimum amounts of liquid assets) and other qualitative measures (related to, for instance, the quality and independence of the management body).

The substantial improvement of the 2016 SREP process is very much appreciated and proves the SREP to be the most efficient and effective supervisory convergence tool available to the ECB. Notwithstanding its overall positive assessment, some aspects of the SREP could benefit from further refinement, especially in light of the EBA SREP Guidelines and the feedback given by the EBA in the context of its convergence assessment work. The ECB follows a holistic approach in order to define the overall SREP score based on the aggregation of scores attached to the different SREP elements, and links the overall SREP scores to specific ranges for Pillar 2 capital requirements serving as a constrain for the final level of additional own funds requirements under Pillar 2. The risk-by-risk approach to the setting of additional own funds requirements in EBA's Guidelines provides no link between scores and the amount of additional capital requirements, and does not consider that concerns related to all SREP elements (e.g. business model and strategy) should be addressed with additional capital requirements. Also, ECB is currently developing its own methodology on Pillar 2 guidance, a concept that is being discussed by the legislators on the basis of the Commission's November 2016 proposal. Pending the finalisation of the legislative work and in view of avoiding creating uncertainty and divergent practices, it is important that such ECB methodology is developed in close cooperation with the EBA and the Commission.

Lastly, it is observed that the risk analysis under SREP mainly triggers the application through the SREP decision of supervisory powers related to capital and liquidity requirements and to qualitative measures including governance arrangements. However, Article 16(2) SSMR provides the ECB with a larger toolbox of supervisory powers to address supervisory concerns, including those arising from its SREP process. The toolbox also includes the possibility for the ECB to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements.<sup>137</sup> This power could prove particularly useful in the context of addressing banks exposures related to non-performing loans. It enables the ECB to require banks to adjust their level of provisioning within the boundaries of the accounting framework. This would not amount to a power to adjust bank's balance sheets for accounting purposes, but may be equally influential given that it entitles the

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<sup>135</sup> After the introduction of Pillar 2 guidance, the stacking order of requirements adopted has Pillar 2 guidance as a top layer (breached before capital buffer requirements), followed by capital buffers, Pillar 2 capital add on requirement and Pillar 1 capital requirements.

<sup>136</sup> [https://www.bankingsupervision.europa.eu/ecb/pub/pdf/srep\\_methodology\\_booklet\\_2016.en.pdf](https://www.bankingsupervision.europa.eu/ecb/pub/pdf/srep_methodology_booklet_2016.en.pdf)

<sup>137</sup> Article 16(2)(d) of the SSMR.

ECB to influence a bank's provisioning level within the limits of the applicable accounting framework and to apply the necessary adjustments (deductions and similar treatments) in case, for example, accounting provisioning is not sufficient from a supervisory perspective.<sup>138</sup>

### **C.2.5. Enforcement and sanctioning**

The ECB distinguishes between enforcement and sanctioning measures. Enforcement measures refer to coercive measures that are exercised in order to compel compliance and have no punitive character,<sup>139</sup> whereas sanctioning measures have in addition a punitive dimension and are applicable in the case of misconduct. According to Article 18(1) SSMR, the ECB may impose administrative pecuniary penalties on credit institutions, financial holding companies and mixed financial holding companies in case of breach of requirements under relevant directly applicable acts of Union law. Thus ECB's sanctioning powers are limited to legal persons only and to imposing pecuniary sanctions. For other cases the ECB may require NCAs to open proceedings (for instance, if an institution breaches a requirement laid down in the national transposition of a relevant EU Directive, if the sanction is imposed to a member of the board of the institution, or in cases of non-pecuniary sanctions).<sup>140</sup> Moreover, the ECB may impose sanctions in case of breach of ECB regulations or decisions. Last but not least, the ECB may impose pecuniary enforcement measures (i.e. periodic penalty payments) against legal persons, as well as any other enforcement measures provided in national laws for ensuring compliance with the CRD-CRR.

In 2015 the ECB focused on the set-up of a dedicated division and the preparation of the necessary sanctioning framework, whilst it had initiated only one sanctioning proceeding and one enforcement proceeding. In 2016, the ECB initiated 41 direct sanctioning proceedings and one enforcement proceeding.<sup>141</sup> Since it became operational, the ECB has submitted to different NCAs eight requests to open proceedings with a view to taking action in order to ensure that appropriate penalties are imposed. So far, two of the national administrative proceedings opened upon ECB request have been completed by the NCAs.

This framework may give rise to some implementation issues. First, it may be problematic that the scope of the ECB's sanctioning powers differs from the scope of its supervisory tasks. For infringements concerning requirements falling under the scope of the ECB's supervisory functions but not covered by its sanctioning powers, the ECB is thus forced to rely on NCAs. In some cases, there may be an ECB sanctioning proceeding against an institution and a parallel sanctioning proceeding against an individual initiated by the NCA on the same

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<sup>138</sup> Such powers are enshrined in Article 16(2)(d) of the SSM Regulation, which has the same wording as Article 104(1)(d) of the CRD. They do not amount to accounting powers that would allow the ECB to impose a specific provision, but they allow the ECB to influence the provisioning policy of a bank within the limits of accounting standards, for instance where such framework allows for flexibility in selecting policies or requires subjective estimations, and the specific implementation chosen by the institution is not adequate or sufficiently prudent from a supervisory point of view. Furthermore they allow the ECB to require credit institutions to apply specific adjustments (deductions, filters or similar measures) to own funds calculations where the accounting treatment applied by the bank is considered not prudent from a supervisory perspective.

<sup>139</sup> This would include periodic penalty payments for non-compliance, cease and desist orders, etc.

<sup>140</sup> The SSMFR lays down additional rules on the proceedings for imposing penalties, and on the cooperation with NCAs. In this regard, the SSMFR determines that NCAs shall open sanctioning proceedings against a SI only at the request of the ECB.

<sup>141</sup> On 31 December 2016, 34 sanctioning proceedings and one enforcement proceeding were still pending.

breach.<sup>142</sup> Furthermore, launching proceedings in cases not covered by the ECB's sanctioning powers depends on NCA action, an additional step that prevents quick reactions and leaves room for forbearance. In this context, the principle of cooperation in good faith is crucial, and it is important that NCAs work together with the ECB in order to ensure the proper functioning of the sanctioning framework.

Secondly, as the CRD only provides the general rules for sanctioning and requires transposition, the actual framework applicable to credit institutions supervised by the ECB is largely dependent on national regulation. This means that important elements of the sanctioning framework, such as the catalogue of sanctions or enforcement measures and methods for calculating pecuniary sanctions (depending on loose concepts in Union law, as "annual turnover") may differ throughout the participating Member States, thus raising major questions from a level playing field perspective. Furthermore, substantial national differences may also arise in relation to the interplay between sanctioning and enforcement powers, with the effect that the same measure may pertain to the ECB as long as it is qualified by national law as an enforcement power, but be outside of ECB's remit if qualified as non-pecuniary sanction.<sup>143</sup>

The current sanctioning framework in the CRD and the SSMR allows for the necessary adaptation to national regimes given that sanctioning measures and powers are only subject to minimum harmonisation by Union law. Therefore, close cooperation is essential to allow a smooth implementation of this framework. In any case, and regardless of the specific sanctioning regime applicable in each participating Member State, the ECB is entrusted with the task to ensure compliance by credit institutions with relevant Union law (in this regard, see Recital 23 SSMR) and hence is entitled to adopt the necessary enforcement measures.

### **C.3. Oversight of NCA supervision of LSIs [Article 32(b) SSMR]**

The LSI population is made of a very diverse group of banks of different sizes, riskiness and business models. In addition, the proportion of LSIs in the banking system varies significantly from Member State to Member State, and so do the approaches and staffing levels of NCAs with regard to LSI supervision. Furthermore, the majority of LSIs have a regional or national focus and consequently compete with banks in other Member States to a significantly lesser extent than SIs. However, LSIs still do compete with SIs active in their Member States. Furthermore, the failure of some more systemic LSIs or the simultaneous failure of a larger number of smaller LSIs (e.g. because they are linked via an IPS) may destabilise domestic financial systems and create negative spill-over effects for other Member States.

For these reasons, the ECB has been entrusted with an oversight function in relation to LSIs that would allow it to ensure the consistent application of high supervisory standards throughout the Banking Union. Moreover, according to Article 6 of the SSMR, the ECB, on its own initiative and after consulting the relevant NCA or at the request of the NCA, may at

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<sup>142</sup> Within the SSM, the application of sanctions to individuals is entrusted to NCAs because Union law does not harmonise the conditions for engaging the responsibility of individuals involved in a breach are actually responsible for that breach, and thus the sanctions in such cases can be imposed only on the basis of national rules. Moreover, the imposition of fines of a significant level on individuals would raise issues relating to the respect of fundamental rights – see ECJ Judgment of Judgment of 5 June 2012, *Bonda*, C-489/2010, ECHR, *Engel and Others v. the Netherlands*, 8 June 1976, Series A no. 22, and *Sergey Zolotukhin v. Russia*, no. 14939/03, 10 February 2009.

<sup>143</sup> For instance, cease-and-desist orders are an enforcement measure under some national frameworks and a non-pecuniary sanction under others, the latter being out of the scope of the ECB powers.

any time take over the responsibility for the direct supervision of LSIs. Furthermore the ECB may issue regulations, guidelines or general instructions to NCAs on how they should perform the supervisory tasks with regard to LSIs, or on how to exercise specific powers for groups or specific categories of institutions.

DG Micro-Prudential Supervision III (DG MS III), with around 80 FTEs, is responsible for ECB's oversight function.<sup>144</sup> The involvement of the ECB in LSI supervision conducted by NCAs consists mainly of organising and analysing notifications from NCAs on LSIs, and cooperating with NCAs. The ECB has issued guidance to NCAs setting out, on the basis of the proportionality principle, rules on notification of supervisory activities by NCAs. With regard to high-priority LSIs, NCAs are requested to notify ex-ante any material supervisory procedures and material supervisory draft decisions, whereas, with regard to other LSIs, the submission of institution-specific templates, of the NCAs annual report on LSIs and of the supervisory examination programme is sufficient. Instances of a deterioration of the financial situation as well as the imposition of administrative penalties are to be notified for all LSIs. The notifications are seen by the ECB as a key tool to gain better insight into the LSI sector and its supervision by NCAs.<sup>145</sup> Until December 2016, the ECB received 179 notifications of NCAs in relation to LSIs, of which 141 were notifications of material draft decisions or procedures, and 38 were related to the deterioration of the financial situation of the LSI.

Despite the efforts undertaken by the SSM, capital-add on decisions by NCAs are still communicated in a non-harmonised way. Furthermore, SREP decisions also show differences in the implementation of the SREP throughout Member States, notably in terms of the capital requirement definition,<sup>146</sup> which make it difficult for the ECB to aggregate and compare capital add-ons via simple statistics such as average add-ons per country or variance of SREP add-ons per country. A common SREP methodology would facilitate also the reporting and comparison.

As part of its oversight function, the ECB is also determined to increase cooperation with regard to LSI supervision by exchanging staff with NCAs and by participating in on-site supervision. However, at this stage these initiatives still appear in their infancy as there were only few exchanges in 2016.<sup>147</sup> Furthermore, the ECB conducts "road shows" in participating Member States to inform NCAs about its initiatives. However, overall the ECB believes that the numerous bilateral contacts between ECB and NCAs and the cooperation in common procedures provide valuable information for it to have a good picture of how LSI supervision is conducted by NCAs in the participating Member States.

To ensure a level playing field in the exercise of supervisory powers by NCAs in relation to LSIs and to ensure consistency of supervisory outcomes within the SSM, the ECB can issue regulations, guidelines, general instructions, recommendations or act through other means, such as its Supervisory Manual, or by developing specific standards related to LSIs together

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<sup>144</sup> DG MS III is organised along the following lines: (i) oversight of NCAs' supervisory practices for LSIs and cooperation between NCAs (ii) institution-specific and sectoral oversight of LSIs; and (iii) analysis provision and methodological support.

<sup>145</sup> Notifications help the ECB to gain knowledge on LSIs and on NCAs supervisory practices; enable the ECB to receive early warning and detect emerging issues on specific LSIs; but also create synergies by combining knowledge from NCAs and the ECB, identifying and sharing best supervisory practices, thereby promoting consistency of supervisory outcomes; and fostering high quality supervision.

<sup>146</sup> E.g. for certain banks there are pillar 2 requirements set below their current level of total capital, or some include the capital conservation buffers while others do not.

<sup>147</sup> There were staff exchanges only between two NCAs and ECB in 2016. Only one ECB full time staff was dedicated to LSI on-site supervision and the ECB cooperated with NCAs in only five LSI on-site inspections.



with NCAs. So far, the ECB has published three recommendations<sup>148</sup> on dividend policies and two guidelines<sup>149</sup> on the supervision of institutional protection schemes, addressed to NCAs. In addition, the ECB has issued several non-public guidelines, recommendations and general instructions that are addressed to NCAs and not to LSIs directly. For instance, the ECB has issued recommendations on supervisory planning, recovery planning and on-site inspections. Furthermore, apart from its efforts to extend the harmonised exercise of options and discretions to LSIs, the ECB is developing in cooperation with the NCAs a SREP methodology for LSIs to foster convergence in the way NCAs conduct their SREP for LSIs. This methodology is developed under the umbrella of the SSM SREP methodology and will apply to LSIs in a proportionate manner and adjusted to the LSIs' specificities. In 2015 and early 2016, the main achievement of the project was the definition of a common, harmonised Risk Assessment System (RAS), that was put on trial. The subsequent steps, which are currently being taken, consist of developing methodologies for the quantification of capital and liquidity requirements, and methodologies for the assessment of capital and liquidity adequacy. Once finalised, this methodology should enable the NCAs to run a comprehensive and harmonised SREP from 2018 onwards.

The ECB did not yet take over direct supervision of any LSI. There was also no information available that would allow assessing the involvement of the ECB as regards LSIs whose situation deteriorates. According to the SSMFR and the ECB's guidelines, the ECB should be able to gather extensive information on such LSIs, and the NCAs are obliged to engage in more intense cooperation and information sharing.

#### **C.4. Performance of macro-prudential functions [Article 32(d) SSMR]**

Article 5 of the SSMR entrusts the ECB with certain macro-prudential powers within the Banking Union, so as to ensure a proper coordination and information flow between the ECB and national authorities responsible for macro-prudential tasks (i.e. NCAs or national designated authorities) in the participating Member States, and so as to enable the ECB to object to or strengthen macro-prudential measures proposed by such national authorities.

Therefore, within the Banking Union, an appropriate layer of coordination has been built into the macro-prudential framework. Macro-prudential powers remain at national level with national authorities responsible for applying requirements for capital buffers, including countercyclical buffer rates, and any other measures aimed at addressing systemic or macro-prudential risk provided for in the CRR/CRD IV. Macro-prudential action within the Banking Union is, however, subject to specific internal upfront coordination with the ECB. The ECB can endorse, object or strengthen the proposed measure.<sup>150</sup> The national prerogative is hence complemented by the power of the ECB to apply higher requirements than the ones

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<sup>148</sup> Recommendation of the European Central Bank of 28 January 2015 on dividend distribution policies (ECB/2015/2), Recommendation of the European Central Bank of 17 December 2015 on dividend distribution policies (ECB/2015/49) and Recommendation of the European Central Bank of 13 December 2016 on dividend distribution policies (ECB/2016/44).

<sup>149</sup> Guideline (EU) 2016/1993 of the European Central Bank of 4 November 2016 laying down the principles for the coordination of the assessment pursuant to Regulation (EU) No 575/2013 of the European Parliament and of the Council and the monitoring of institutional protection schemes including significant and less significant institutions (ECB/2016/37) and Guideline (EU) 2016/1994 of the European Central Bank of 4 November 2016 on the approach for the recognition of institutional protection schemes for prudential purposes by national competent authorities pursuant to Regulation (EU) No 575/2013 of the European Parliament and of the Council (ECB/2016/38).

<sup>150</sup> The relevant national authority has to notify its intention to the ECB ten working days prior to taking its decision. The ECB may object within five working days.



established by the national authority and apply a more stringent measure, if deemed necessary.

All national competent or designated authorities within the Banking Union notify the ECB of their decisions on the activation of the following instruments: countercyclical capital buffers, Global Systemically Important Institution (G-SII) and Other Systemically Important Institution (O-SII) buffers, systemic risk buffers, and measures under Article 458 of the CRR. So far the ECB objected once to a national notification, but did not decide to strengthen the proposed measures as its objection was reflected in the relevant final decision of the notifying national authority.<sup>151</sup>

In response to the Commission's consultation on the review of the EU macro-prudential framework, the ECB has publicly expressed certain concerns in relation to the framing of its macro-prudential tools. The ECB highlighted the uncertainty as regards the sequencing of the coordination on the specific activation procedures for the use of the various macro-prudential instruments in the CRD IV/CRR<sup>152</sup> and called for clarifying that the notification mechanism to the ESRB should start only after the requirements set by the SSMR are met. Furthermore, the ECB claimed that the timeline for internal upfront coordination within the Banking Union (10 or 5 working days, respectively, pursuant to Article 5 SSMR) is challenging.<sup>153</sup> However, the principle of cooperation in good faith should smoothen the implementation of this procedure, while allowing a quick reaction by national authorities to address systemic risks.

When assessing the shared responsibilities of the ECB/SSM and national authorities designated for macro-prudential policy within the Banking Union, the vast majority of stakeholders that responded to the public consultation on the review of the EU macro-prudential policy framework noted that the current asymmetric nature of the ECB powers is appropriate, given that it adequately deals with a potential inaction bias concern at the national level when systemic risks may be building up.

The different allocation of responsibilities in the Banking Union for micro-prudential and macro-prudential supervision responsibilities is worth noting. Whereas micro-prudential supervision is organised along the lines "significant" versus "less significant" institutions, macro-prudential supervision is a prerogative extending over all institutions regardless of their significance. Furthermore, there may be some uncertainty concerning the scope of the "macro-prudential tasks and tools" covered by Article 5 SSMR,<sup>154</sup> since there is no definition

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<sup>151</sup> Each quarter the ECB publishes the Governing Council statement on Macro-prudential Policies, which provides updates on the macro-prudential measures activated during the quarter and on its own decisions relative to these measures.

<sup>152</sup> This is currently only specified in Recital 24 to the SSMR but not in the legislative text "[...] National competent authorities or national designated authorities and the ECB shall only act in respect of any coordination procedure provided for in such acts after having followed the procedures provided for in this Regulation."

<sup>153</sup> In its response to the public consultation on the review of the EU macro-prudential policy framework, the ECB suggests that the deadline for the ECB to object to an intended macro-prudential measure by national authorities should be extended to 30 days.

<sup>154</sup> The "macro-prudential tasks and tools" pursuant to Article 5 SSMR comprise the application of "capital buffers to be held by credit institutions" and of "any other measures aimed at addressing systemic or macro-prudential risks". The definition in Article 101(1) of the ECB Framework Regulation does not provide much clarity either: "For the purpose of this Part, macro-prudential tools means any of the following instruments: (a) the capital buffers within the meaning of Articles 130 to 142 of Directive 2013/36/EU; (b) the measures for domestically authorised credit institutions, or a subset of those credit institutions pursuant to Article 458 of Regulation (EU) No 575/2013; (c) any other measures to be adopted by NDAs or NCAs aimed at addressing systemic or macro-prudential risks provided for, and subject to the procedures set out, in Regulation (EU) No 575/2013 and Directive 2013/36/EU in the cases specifically set out in relevant Union law."

of macro-prudential tools it is not entirely clear whether some measures fall within the scope of the Article 5 SSMR.<sup>155</sup> Additional uncertainties arise in relation to the possibility of using Pillar 2 capital add-ons as a macro-prudential tool. In its response to the public consultation on the review of the EU macro-prudential framework, the ECB advocated for a clearer separation of responsibilities and allocation of tools.

## **D. Relationship with other relevant bodies**

### **D.1. Interaction with the ESAs and the ESRB [Article 32(a)(d) and (f) SSMR]**

The SSM was envisaged in the context of the well-established European Supervisory Authorities (ESAs) and takes full advantage of their work. Therefore, the taking up of supervisory tasks by the ECB "should be consistent with the framework of the European System of Financial Supervision (ESFS) and its underlying objective to develop the single rulebook and enhance convergence of supervisory practices across the whole Union"<sup>156</sup>. The SSMR explicitly requires the ECB to cooperate closely with the EBA, the European Securities and Markets Authority (ESMA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Systemic Risk Board (ESRB).

#### **D.1.1 Interaction with the EBA**

The EBA is undoubtedly the most relevant ESA interacting with the ECB, whilst interaction with the other ESAs is more sporadic. Since the ECB's control by the EBA has been already discussed in the context of the assessment of the ECB's accountability, the present section focuses more generally on the respective roles of the ECB and the EBA and on practical aspects of their interaction, building on observations made in the context of ECB's exercise of supervisory tasks.

#### **Regulatory dimension**

The SSMR reaffirms the EBA's role as an EU-wide independent regulatory agency entrusted with the development of the Single Rulebook for the banking sector and specifies that the SSM "should not replace the exercise of those tasks by EBA"<sup>157</sup>. Moreover, the SSM should exercise its own powers in compliance with binding technical standards developed by the EBA. Lastly, the SSM is "subject to Article 16 of the EBA Regulation"<sup>158</sup>, which means that it also has to follow the Guidelines and Recommendations developed by the EBA, or explain why it chooses not to follow them.

Whereas in law, the functions of the EBA and the ECB are clearly differentiated, in practice it is not as straightforward to separate regulatory and supervisory competences. Unlike national competent authorities, the ECB's rules adopted in its supervisory capacity cover the banking population in 19 Member States, which sets the ECB's exercise of competences for implementation of rules in a different perspective compared to the NCAs exercising such implementation functions. Therefore, whenever the ECB takes an implementation initiative this clearly affects the EBA, especially where an ECB initiative predates final regulatory

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<sup>155</sup> The uncertainty about whether some measures are within the scope of Article 5 SSMR concerns, in particular, measures under Article 124 and 164 CRR, and the identification of G-SIIs and O-SIIs.

<sup>156</sup> Recital 31 of the SSMR.

<sup>157</sup> Recital 32 of the SSMR.

<sup>158</sup> Ibidem.

output by the EBA<sup>159</sup>. Also, in practice there is for end-users of regulation some equivoque as to the hierarchy of norms, as the ECB may use directly applicable Regulations or other binding instruments to specify rules, including where EBA Guidelines and Recommendations apply.

Specifically with regard to EBA Guidelines and Recommendations, which have a comply-or-explain status, the ECB has implemented a process of reporting its compliance where it exercises direct supervision for significant institutions. However, this does not help creating more transparency for end users. The ECB demonstrated that it is striving to comply with all the Guidelines that fall within its areas of competence.<sup>160</sup> In some instances it appears that the ECB has however taken different views from the EBA as regards the content of specific provisions in EBA's guidelines.

Last but not least, the EBA questions and answers (Q&A tool) is an important instrument to achieve convergence in the interpretation of the Single Rule Book. The ECB has launched its own Q&A tool, to clarify questions by ECB and NCA staff related to practical aspects of supervision, as well as regulatory issues linked to the ECB's regulatory and policy instruments. It is of outmost importance that such ECB tool avoids any overlap and conflict with the Q&As published by the EBA (which include Q&As for which the Commission is responsible as they concern interpretation of Union law). Reportedly, such conflicts have unfortunately occurred in a few instances. The ECB has committed to fixing such conflicts.

### **Governance dimension**

In terms of governance arrangements, the EBA Regulation grants the SSM an observer status in the EBA Board of Supervisors (BoS)<sup>161</sup>, whereas the BoS members representing the SSM countries retain their independent full membership status. This may be perceived as an anomaly, as the ECB is ultimately a competent authority that should have an equal saying within the EBA's BoS.

The EBA can participate in the Supervisory Board only upon invitation. In practice, it participated on some occasions, with regard to selected topics discussed by the Supervisory Board. It could be beneficial for the EBA to participate more often in the Supervisory Board where topics of common interest are discussed, given that supervisory convergence, which the EBA is tasked to promote and facilitate, can be achieved more easily and effectively if the EBA and the SSM cooperate closely.

### **Participation in EBA activities**

The SSM actively participates not only in the EBA BoS, but also in all of its sub-structures and technical groups. The EBA deems the SSM's participation extremely helpful, as it often helps to bridge the differences between individual representatives of national competent authorities. In addition, the SSM brings valuable additional expertise and a broad euro area-wide (as opposed to narrow national interest-centred) perspective to the table. Overall, in the

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<sup>159</sup> This was for instance the case with ECB's consultation on a ECB Guide guide on materiality assessment for changes to counterparty credit risk models published in December 2016, which was prepared independently from the EBA's parallel work on this topic. The EBA had sent out questionnaires to the competent authorities – which were not answered by the ECB.

<sup>160</sup> Some EBA Guidelines are adopted in the areas where the ECB is not a competent authority, e.g., Anti-Money Laundering.

<sup>161</sup> Article 40(1)(d) of the EBA Regulation.

context of the development of EBA Binding Technical Standards, Guidelines and Recommendations, the ECB has demonstrated its added value by both active involvement at all stages of the drafting process and facilitating a common understanding and, in some cases, common stances among NCAs.

However, the EBA observed that the ECB's involvement is not equally intense in all areas covered by the EBA groups, with the ECB sometimes being in a driving position, whilst being less active in other instances. It would be welcomed if the ECB would ensure responsiveness and pro-active participation consistently, especially where the EBA calls for its intervention.

### **EU-wide stress test exercises**

The ECB is also closely involved in the context of other important EBA tasks, such as the EU-wide stress test. The EBA is responsible for the development of a complete methodology (where the ECB provides its input and expertise as well) whereas the competent authorities (including the ECB) are responsible for the quality. The success of the exercise thereby heavily depends on coordinated efforts of the EBA and competent authorities and the introduction of the SSM made the interaction and coordination easier. However, despite the absence of direct control by EBA over performance of the quality assurance process, the EBA is often perceived as the body accountable for the EU-wide stress test. Hence any weaknesses identified and inevitably reported in the media, both in the methodology and in the process, are often attributed to the EBA, not the competent authorities. Given that the stress test is mainly a joint exercise where responsibilities are clearly distributed, it is necessary that all competent authorities involved (including the ECB) and the EBA cooperate closely with each other and make every effort to avoid reputational damage for each other.

#### **D.1.2. Interaction with the ESRB and the other ESAs**

The cooperation between the SSM and the other two ESAs is particularly important and best manifested in their mutual agreements or formally concluded Memoranda of Understanding on information exchange. Such cooperation is crucial for the ECB to exercise supervision on a consolidated basis, as well as to deal with other topics that fall under the remit of ESMA or EIOPA, such as cross-sectorial regulation and policy, specifically where Technical Standards, Guidelines and Recommendations are developed by the Joint Committee of the three ESAs. The Memorandum of Understanding that ESMA has concluded with the ECB in 2015 envisages cooperation in the field of statistics, risk management, supervision, market infrastructures and regulation. It covers arrangements related to the supervision of Central Securities Depositories and includes a template Memorandum of Understanding to be used between national authorities responsible for markets in financial instruments and the ECB.<sup>162</sup> Arrangements on structural cooperation with EIOPA were discussed on a number of occasions between the Chair of the Supervisory Board and the Chair of EIOPA. Whilst a letter of agreement on the exchange of statistical data between the ECB and EIOPA was signed in 2011,<sup>163</sup> this has not been finalised yet by a Memorandum of Understanding, which would include also the necessary cooperation arrangements with the ECB acting in its supervisory capacity.

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<sup>162</sup> For more information, see <https://www.esma.europa.eu/press-news/esma-news/esma-national-securities-regulators-and-ecb-exchange-information>.

<sup>163</sup> [https://eiopa.europa.eu/Publications/Letters/EIOPA\\_LETTER\\_AGREEMENT\\_ECB%20\(Exchange\\_Stat\\_Data\).pdf](https://eiopa.europa.eu/Publications/Letters/EIOPA_LETTER_AGREEMENT_ECB%20(Exchange_Stat_Data).pdf).

The European Systemic Risk Board (ESRB) is entrusted with macro-prudential oversight.<sup>164</sup> To fulfil its tasks, the ESRB collects and analyses relevant information (including statistical or aggregated supervisory data), issues warnings and recommendations<sup>165</sup>, monitors follow-up to its recommendations etc. In addition, the ESRB is responsible for developing the macro-prudential scenarios for the EU-wide stress tests carried out by the EBA and EIOPA.

The institutional representation of the ECB in its supervisory capacity in the ESRB's General Board is not yet formalised,<sup>166</sup> as the ESRB was established prior to the introduction of the Banking Union. Cooperation between the ECB in its supervisory capacity and the ESRB is necessary in view of the ECB's micro- and macro-prudential tasks. The interaction and cooperation between the ESRB and SSM technical committees has improved over time, notably as regards information sharing and the avoidance of work duplication, but their scope and focus remains different.

## **D.2. Cooperation with the SRB**

The Single Resolution Board (SRB) was established as an independent EU agency and is operational since January 2016 as the euro area resolution authority. The SRB is tasked with drawing the resolution plans, and carrying out the resolution of banks that cannot be wound down in accordance with regular insolvency proceedings. The cooperation between the ECB and the SRB has started intensively, with a Memorandum of Understanding being signed that allows for the exchange of information necessary for the SRB to prepare and take resolution actions. An intensive interaction between the ECB and the SRB takes place when early intervention measures are planned to be taken by the ECB with regard to an institution for which SRB is the resolution authority. Such measures should be notified to the SRB, which may prepare for the resolution of the institution in question and, together with the ECB, shall closely monitor the compliance with the early intervention measures.

Further, the ECB as the competent authority is empowered to make the determination when an institution under its supervision is failing or likely to fail (FOLF). This determination is a pre-condition for triggering resolution<sup>167</sup> and therefore the transfer of powers to the SRB. Importantly, the conditions for the determination of FOLF<sup>168</sup> are rather broad and therefore leave a large margin of discretion to the competent authority.

As the SRMR was agreed after the SSMR, there is no explicit mentioning of the SRB in the SSMR, nor a clear definition of the role of the ECB in relation to early intervention and resolution, but rather generic references to such role. Hence there may be a few inconsistencies in the terminology as well as in some of the provisions. One notable divergence concerns the difference between the scope of the direct supervision of the ECB and the remit of entities falling under the competence of the SRB. The latter has a more extended scope that includes cross border LSIs not directly supervised by the ECB.<sup>169</sup>

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<sup>164</sup> Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board.

<sup>165</sup> the Recommendations can be addressed to the EU as a whole or to Member States, the European Commission, the European supervisory authorities or national authorities.

<sup>166</sup> On 20 September 2017, the Commission put forward legislative proposals that propose to formalise the role of the ECB's Supervisory Board in the ESRB. See [https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-538\\_en](https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-538_en).

<sup>167</sup> Article 32 of BRRD and 18 of the SRMR.

<sup>168</sup> Listed in Article 32(2) of BRRD.

<sup>169</sup> Art. 7(2) of the SRMR.

Furthermore, there is some overlap between the early intervention powers in the BRRD and the supervisory powers listed in the SSMR, each backed by different procedures. In light of the fact that the BRRD early intervention powers need to be transposed in national legislation that the ECB should apply, there appears to be a clear case for the ECB to choose to exercise the same power on the basis of the SSMR, which in practice results in circumventing procedural requirements attached to the use of early intervention powers under the BRRD.

### **D.3. Participation in the BCBS and the FSB**

The Financial Stability Board (FSB) and the Basel Committee of Banking Supervisors (BCBS) are important standard-setting bodies that determine the global regulatory agenda for the banking sector.

The FSB monitors and makes recommendations about the global financial system and brings together national authorities responsible for financial stability, international financial institutions, international regulatory or supervisory bodies, and committees of central bank experts.<sup>170</sup> To a large extent, the FSB determines the regulatory agenda for the BCBS and therefore serves as a political compass of the required reforms, including in the area of prudential supervision, such as the finalisation of the post-crisis reform agenda. The ECB is represented at FSB in both its capacities, as a central bank and as a supervisory authority. On behalf of the ECB, the Vice-Chair of the Supervisory Board is a member of the FSB Plenary.

In contrast with its observer status in the Board of Supervisors of the European Banking Authority, the ECB has obtained the status of a full member of the BCBS in 2014, extending the EU representation in the Committee<sup>171</sup>. The membership status allows it to be directly involved in the development of international standards in the area of banking supervision. In cooperation with the EBA (which has an observer status), the ECB contributes to coordination of the positions among EU Basel members with regard to key developments and reforms currently deliberated at the Basel table.

## **E. Cost-effectiveness of the Single Supervisory Mechanism [Article 32(j) SSMR]**

This section focuses on the cost-effectiveness of the SSM, assessing the developments in the effectiveness of the supervisory process and in the cost of supervision in the first years of existence of the SSM.

### **E.1. Effectiveness of supervision**

The decision by the co-legislators to confer supervisory powers to the ECB, rather than establishing a new authority, and the possibility to hire qualified staff from existing national supervisory authorities has ensured overall a relatively smooth setting-up of the Single Supervisory Mechanism.

Despite the challenges inherent to the first years of SSM functioning, a vast majority of banks under direct supervision of the ECB noticed an improvement in the quality of supervision in 2015, particularly in terms of supervisory consistency across entities of a banking group. This positive development has also been confirmed by NCAs, which observed marked improvements in the functioning of the supervisory colleges thanks to the effective leadership

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<sup>170</sup> See <http://www.fsb.org/about/>

<sup>171</sup> Next to the supervisory authorities of Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden, and the UK.

of the ECB. Moreover, significant institutions have signalled improved interactions with the ECB in 2016. The informal meetings with the ECB provide banks with an opportunity to raise potential issues.

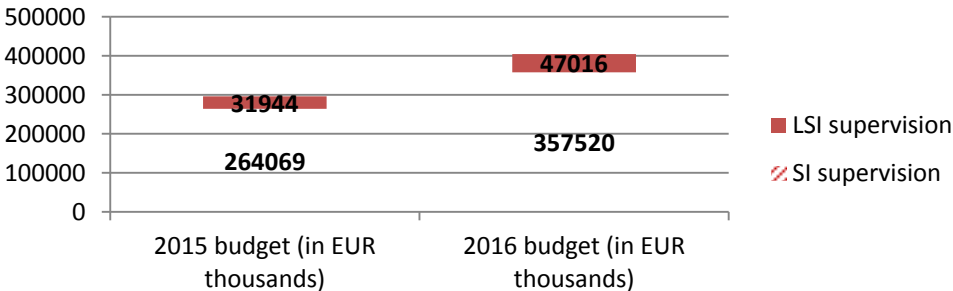
The set-up of the SSM is leading to enhanced harmonisation of the supervisory practices applied in the different participating Member States. This harmonisation may, in turn, foster financial integration in the Euro area. In this regard, the ECB believes that the SSM contributed to re-establish financial integration after the financial and sovereign debt crises between 2007 and 2011.<sup>172</sup>

**E.2. Analysis of supervisory fees**

There has been a growing trend over the last decades, both within the EU and globally, to change the financing structure of regulators and supervisors, moving from public financing to a fee-based system where institutions that are subject to supervision contribute to the budget of supervisory authorities. The mandatory nature of supervisory fees, which is typically established by law, ensures that the fee-based funding structure does not compromise the financial independence of regulators and supervisors. Fee-based financing arrangements also internalise the costs of supervision into the decision making of institutions, thus potentially discouraging them to enter into complex businesses, the supervision of which were too costly.

The budget of the ECB for supervision, which in 2016 exceeded EUR 400 million, is exclusively financed through supervisory fees. It is divided into two parts on the basis of the underlying activity, i.e. supervision of SI or LSIs. These sub-budgets are then financed by SIs and LSIs respectively<sup>173</sup> (see Figure 1). The share of the budget for the supervision of LSIs in the ECB budget was between 10.8% and 11.6%. This largely corresponds to the proportion of staff working on SI and LSI supervision respectively (421 vs. 69 average FTEs in 2015; 504 vs 80 average FTEs in 2016). Indirect costs, such as shared services, have also been distributed in similar proportions.

**Figure 1.** ECB budget for supervision in 2015 and 2016 (EUR thousands)



Source: ECB

The ECB decided that the allocation of the supervisory budget through supervisory fees is based on a bank's average of risk weighted assets and asset values. One might argue that a simple average of total assets and risk-weighted assets does not necessarily fairly reflect an

<sup>172</sup> See the Report on the Financial Integration in Europe 2016, page 5, <https://www.ecb.europa.eu/pub/pdf/other/financialintegrationineurope201604.en.pdf>.

<sup>173</sup> ECB Regulation of 22 October 2014 on supervisory fees<sup>173</sup> lays down the allocation of the annual supervisory budget to banks and branches from non-participating Member States established in the banking union.

institution's risk profile<sup>174</sup> and that, as a matter of principle, bank risk-weighted assets should be primarily an indication of the institution's riskiness. However, currently this view is not yet fully shared among bank supervisors. There is currently no clear agreement to which extent risk weights applied by banks can truly reflect bank riskiness. The ECB intends to review its methodology on supervisory fees in 2017.

The interviews and workshops undertaken with SIs have not indicated any issues with regard to supervisory fees. They overall accept supervisory fees as a "cost of doing business", even though fees increased slightly in 2016. Only a few smaller significant institutions from smaller EU Member States were concerned that the cost of supervision has overall gone up (25% in some specific cases). The overall increase in supervisory costs for institutions was also confirmed by some national supervisors, who indicated that their costs have increased. The increase in costs has largely been a result of two factors. Firstly, NCAs continue to provide the majority of resources for the JSTs and on-site inspections. According to some interviewed NCAs, they were willing to reduce their resources, and thus costs, allocated to supervision of significant institutions, but were unable to do so as the SSM continued to request the NCAs to devote more human resources to the JSTs. Secondly, NCAs indicated that even though savings could potentially have been achieved in the supervision of significant institutions, the creation of the SSM required NCAs to increase their supervisory budgets due to attendance of Supervisory Board meetings at the SSM and the need to get thereby involved in supervisory decision making for all SIs in the Banking Union. The build-up of resources at ECB level was hence not offset by a reduction of resources and costs in NCAs.

As far as the costs of supervision of LSIs are concerned, some small euro area banks, which responded to the Commission's Call for Evidence<sup>175</sup>, claimed that they were disproportionately affected by the mandatory fees charged for ECB oversight. However, as shown in Figure 2, the average ECB supervisory fees per EUR 1 million assets for LSIs were roughly twice as low as for SIs in 2015; thus, for the same amount of assets, the supervisory fees paid by LSIs were much lower than for SIs. The difference of supervisory costs for SIs and LSIs narrowed slightly in 2016.

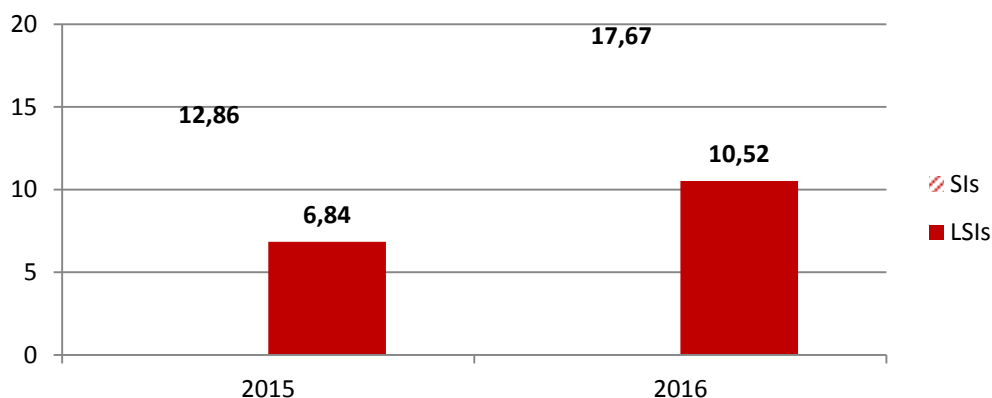
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<sup>174</sup> According to Article 30(3) of Regulation (EU) No 1024/2013, the fees are to be based on objective criteria relating to the importance and risk profile of the credit institutions concerned, including risk weighted assets.

<sup>175</sup> [http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index\\_en.htm](http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm).



**Figure 2.** Cost of supervision: SI and LSI supervisory fees<sup>176</sup> (EUR) for EUR 1 million of bank assets<sup>177</sup>



Source: Commission computations

### E.3. Performance management system in SSM

The SSM has launched its supervisory dashboard as a key instrument of performance measurement in the second half of 2015. The 2015 supervisory dashboard was presented for the first time in the Supervisory Board meeting in Spring 2016 and is discussed on a quarterly basis by senior managers. It includes key performance indicators on ECB-SSM resources, outputs and outcomes, facilitating the assessment of the effectiveness of business processes in the SSM.

The dashboard covers a wide range of indicators covering human and financial resources; output (duration of decisions / communication; supervisory activities, including SREP progress; on-site inspections; internal model investigation; thematic reviews; assessment of recovery plans; fit & proper assessments; breach reporting assessments) and outcome (SI risk indicators; RAS automatic ratings; financial indicators of SI).

The expansion of the ECB's performance measurement could enable monitoring in a systematic way more dimensions of supervisory effectiveness. In this regard results and impact indicators could be considered, which would allow measuring the progress achieved in harmonisation of supervisory practices for LSIs, robustness and consistency of internal models. It could be also considered to set desirable targets for the effectiveness indicators, such as the reduction of NPLs the ECB would like to see among the directly overseen SIs.

Given that the SSM is a unique mechanism covering resources of both ECB and NCAs, the performance measurement system could also include NCA resources and dimension as far as this is relevant for monitoring the cost-efficiency and cost-effectiveness of the SSM. Moreover, the EBA has a statutory interest in monitoring the effectiveness of supervision in the whole EU. Last but not least, it is noted that the quantitative data used for the dashboard and other performance measurement purposes are not disclosed widely, thereby potentially affecting the transparency and the confidence of stakeholders in the SSM.

<sup>176</sup> Source: ECB decisions on the total amount of annual supervisory fees.

<sup>177</sup> Total assets applied as published by the ECB:

<https://www.bankingsupervision.europa.eu/organisation/fees/calculator/html/index.en.html>.