REGULATION

The ECB publishes the Guidelines to Banking Supervision

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The guide is an important milestone in the implementation of the Single Supervision Mechanism (SSM). It explains how the supervisory pillar will function and gives some guidance of the SSM's supervisory practices. These guidelines represent a practical tool and will help to define a common supervisory culture within the euro area. Some of the content is already covered in current SSM regulations however; it gives a very interesting hint of how the supervision will be pursued from November the 4th onwards.

Supervisory Principles

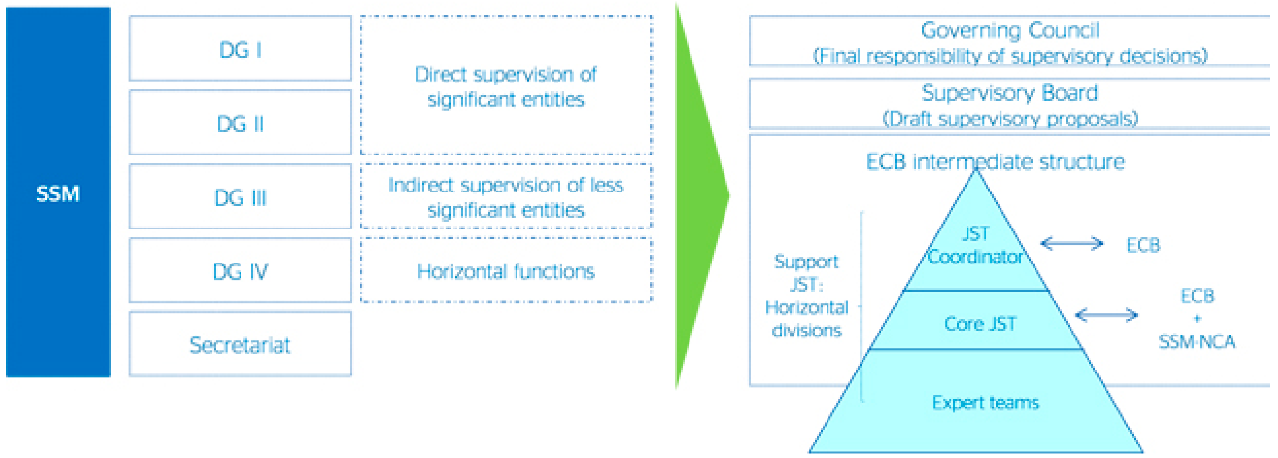
The SSM Supervisory Guidelines define nine principles: i) use of best practices; ii) integrity and decentralization; iii) homogeneity within the SSM; iv) consistency with the Single Market; v) independence and accountability; vi) risk-based approach; vii) proportionality; viii) adequate levels of supervisory activity for all credit institutions and ix) effectively and timely corrective measures) that will govern the supervisory practices going forward. Even if every principle is of utmost importance, it is worth mentioning that the supervisory culture will not be dominated by just one supervisory practice coming from a specific country but on the contrary it will try to import the best practices from the different participating Member States. In addition, the aim of these guidelines is to ensure some sort of homogeneity in the supervisory practices within the euro area ensuring therefore the so-called level playing field.

Functioning of the SSM

The SSM will be responsible for the supervision of around 4,900 financial institutions, directly when the financial institution is significant [1] (around 120 entities covering 85% of total banking assets in the euro area) or indirectly when the financial institution is less significant. In the latter case, National Competent Authorities (NCA) will continue to conduct direct supervision. However, the ECB can take direct supervision of less significant institutions if this is required to ensure high supervisory standards.

Graph 1

Organizational structure of the SSM and decision-making process



Source: ECB (2014)

From the decision-making process, the final responsible of the supervisory decisions will be the ECB´s Governing Council. Meanwhile the Supervisory Board (composed by a Chair, a Vice Chair, four representatives of the ECB and one representative of the NCA in each participating Member State) will propose draft decisions. Apart from these bodies there will be a Mediation Panel to resolve the differences of views expressed by the NCA regarding a Governing Council decision and an Administrative Board of Review that will "check the suitability" of decisions taken by the ECB in the exercise of its supervisory powers.

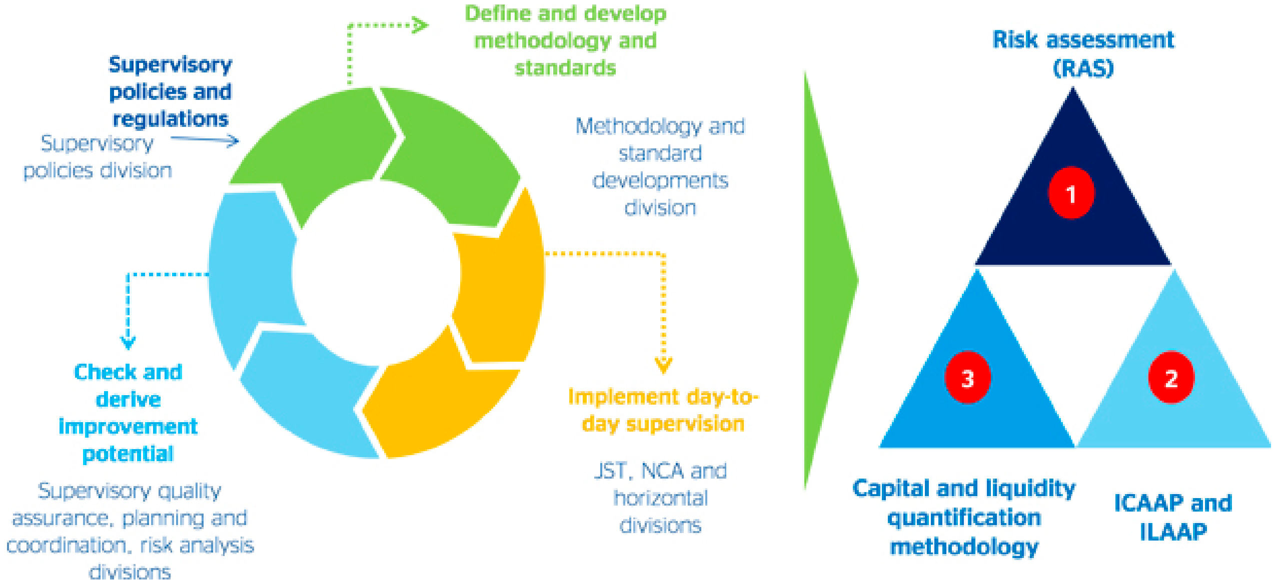
From an organizational point of view, the SSM will be formed by four Directorates Generals (DGs) and one Secretariat. Regarding the DGs, DGI and DGII will be in charge of direct supervision meanwhile DG III of indirect supervision. DGIV will be responsible for horizontal tasks.

At the core of the supervisory activities are the Joint Supervisory Teams (JST) which comprise staff from both the ECB and NCAs of the countries in which credit institutions, banking subsidiaries or the significant cross border branches of a given banking group are established. The composition of the JST will depend on the nature and complexity, among other things, of the supervised institution. The JST will be led by an ECB coordinator who will be responsible for the implementation of the Supervisory Examination Program (SEP) meanwhile NCA sub-coordinators will support the JST coordinator and will define thematic or geographic areas of supervision. In addition, for certain specific tasks, the JST may require additional support from experts, normally coming from the DGIV.

The supervisory cycle includes different steps that cover from the definition of the supervisory policies up to the quality assurance of the supervisory decisions as Graph 2 shows. At the core of the on-going supervision remain the Supervisory Review and Evaluation Process (SREP) which benefits from the NCAs previous experience but will be developed and enhanced by the JSTs and ECB horizontal divisions. The SSM SREP will comprise three core elements: i) risk assessment which evaluates risks levels and risks controls of financial institutions; ii) a review of the ICAAP (Internal Capital Adequacy Assessment Process) and ILAAP (Internal Liquidity Adequacy Assessment Process) and iii) a capital and liquidity quantification methodology.

Graph 2

The supervisory cycle and the supervisory review and evaluation process (SREP)



Source: ECB (2014)

Conduct of supervision in the SSM [2]

The supervision implemented by the SSM will try to achieve an integrated approach meaning that all key processes will be the same for all the institutions independent on their condition as “significant” or “less significant”.

The guidelines describe several processes or procedures, among others:

- Authorisations, acquisitions of qualifying holdings and withdrawals of authorisations will be a responsibility of the ECB but the initiative may start at the NCA level.
- Supervisory planning whose main outcome will be the Supervisory Examination Programs (SEP). This planning will be done in two steps. First, at the financial system level (strategic) and, second, at individual level (operational). These plans will cover the majority of the supervisory actions to be taken in a year.
- On-site inspections [3]. These supervisory actions will not be carried out by the JST directly. In fact JST cannot lead on-site inspection groups. These inspections could be done even by external experts.
- Assessment of a consistent application of the common methodological framework is a must. As such, a quality assurance will be pursued.

Assessment

This publication is a step in the right direction to increase transparency of the supervisor. Even if the public version of these guidelines is just an abstract of the non-public version, it gives a good idea of how supervision will be implemented by the SSM. In this regard, it is worth mentioning the remarkable role of the NCA in the supervisory process and the SREP framework at the core of the supervision.

Notes

1. A financial institution will be significant when: i) total assets >€30bn or exceeds 20% of national GDP unless total assets are below than €5bn; ii) it is one of the three most significant credit institutions established in a Member State; iii) it is recipient of direct assistance from the ESM; iv) total value of assets exceeds €5bn and the ratio of its cross border assets/liabilities in more than one participating Member State to its total assets/liabilities is above 20%. The SSM may declare an institution significant even when these requirements are not fulfilled.
2. The Guide covers a specific point related to supervision for less significant institutions as well
3. Other processes included in the Guide are: procedures for applications, requests and notifications, right of establishment and approval, on-going supervision of internal models and suitability of members of management bodies