



Yale SCHOOL OF MANAGEMENT
Program on Financial Stability

EliScholar – A Digital Platform for Scholarly Publishing at Yale

YPFS Resource Library

3-14-2014

Single Supervisory Mechanism Quarterly Report

European Central Bank (ECB)

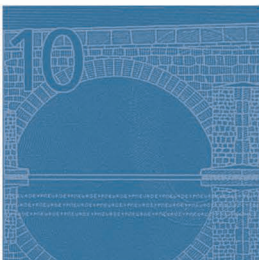
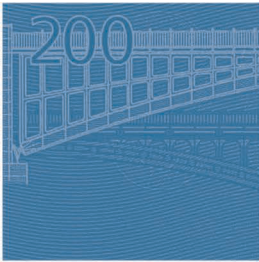
<https://elischolar.library.yale.edu/ypfs-documents/218>

This resource is brought to you for free and open access by the Yale Program on Financial Stability and [EliScholar](#), a digital platform for scholarly publishing provided by Yale University Library. For more information, please contact ypfs@yale.edu.



EUROPEAN CENTRAL BANK

EUROSYSTEM



SSM QUARTERLY REPORT

Progress in the operational implementation of the Single Supervisory Mechanism Regulation

2014 / 3

© European Central Bank, 2014

Address Kaiserstrasse 29, 60311 Frankfurt am Main, Germany
Postal address Postfach 16 03 19, 60066 Frankfurt am Main, Germany
Telephone +49 69 1344 0
Internet <http://www.ecb.europa.eu>

All rights reserved. Reproduction for educational and non-commercial purposes is permitted provided that the source is acknowledged.

ISBN 978-92-899-1212-9 (online)
ISSN 2315-3652 (online)
EU Catalogue No QB-BM-14-003-EN-N (online)

KEY MESSAGES

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

The key messages of this Quarterly Report are the following:

- **The ECB will assume the tasks conferred on it by the SSM Regulation within three months, on 4 November 2014.** Considerable progress has been made thus far in ensuring the ECB's preparedness to carry out such tasks, as set out in this report. Nonetheless, several challenges remain to be addressed over the next three months.
- **The SSM governance is fully operational.** The Supervisory Board and its Steering Committee held five meetings during the period under review. The Supervisory Board has already prepared complete draft decisions, which were adopted under the non-objection procedure in line with the SSM Regulation. In particular, the preparation and adoption of more than 100 decisions determining the significance of supervised institutions proceeded smoothly. Following a selection procedure that began with a call for expressions of interest on 1 May 2014, the Governing Council will appoint five members and two alternates to the Administrative Board of Review in early August. The ECB Regulation on the establishment of the Mediation Panel was formally adopted in June, and steps have been taken for the appointment of its members by the Member States.
- **The Supervisory Board largely finalised the process of determining which credit institutions in the euro area should be deemed "significant" and therefore subject to direct supervision by the ECB.** The process was carried out in close cooperation with the NCAs in line with the criteria set out in the SSM Regulation and the SSM Framework Regulation. Around 120 credit institutions or groups were determined as significant, most of which are already undergoing the comprehensive assessment. These institutions and groups were notified of a draft decision on significance, on which they could provide comments, in line with the due process set out in the SSM Regulation and the SSM Framework Regulation. Despite fulfilling the significance criteria, a small number of institutions were determined as less significant, as the Supervisory Board found that "particular circumstances"² existed that justified that classification. The final decisions are being notified to the credit institutions and the final lists of significant and less significant banks will be published on the ECB's website before 4 September 2014. The overall process – assessment of the credit institutions, preparation and adoption of

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

² As defined in Article 70 of the SSM Framework Regulation.

the decisions and their notification in all relevant official languages to more than 120 institutions and groups – involved considerable analytical, legal and logistical challenges, which were addressed by the ECB’s SSM structures in close cooperation with the NCAs. This represented a first major operational test for the ECB, the Supervisory Board and the SSM structures.

- The establishment of Joint Supervisory Teams (JSTs), which will be the main operational structure for the conduct of supervision by the SSM, has reached certain milestones. The SSM will establish a JST for each significant institution or group, leading to the establishment of 117 JSTs³. Almost all JST coordinators for the 117 JSTs have been selected and will have joined the ECB by the end of the summer. By September, the target number of ECB staff needed for the JSTs to be operational (around 200) will have been met, in line with the SSM planning assumptions. Besides adequate staffing, the setting-up of operational JSTs requires the development of infrastructures, training and effective organisational arrangements for both ECB and NCA staff participating in the JSTs. To this end, the ECB and the NCAs have held a significant number of high-level and staff meetings. Preparations for the JSTs in this period also focused on (i) the transition of supervisory responsibilities to the SSM, (ii) the follow-up to the results of the comprehensive assessment, and (iii) any supervisory responses following the disclosure of the results (planned to take place before 4 November).
- **Significant progress has been made in the conduct of the comprehensive assessment.** The major work blocks of the asset quality review (AQR), one of two components of the comprehensive assessment along with the stress test, will be concluded in August. The ECB held a range of outreach meetings and events for the institutions and groups subject to the comprehensive assessment, as well as for national project management teams and third parties, such as auditors. The ECB is now finalising the methodology for the join-up of the AQR and the stress test, which will be published in the first half of August. On 17 July 2014, the ECB released the templates for the disclosure of the bank-level results of the comprehensive assessment, together with additional information on methodological issues.
- **The SSM Supervisory Manual and the public Guide to the SSM’s approach to banking supervision are being finalised.** The Supervisory Manual is an internal document for SSM staff which describes the processes and methodology for the supervision of credit institutions, as well as the procedures for cooperation within the SSM and with authorities outside the SSM. It has been further refined, in particular in relation to the methodology for the SSM Supervisory Review and Evaluation Process

³ The number of 117 JSTs does not correspond exactly to the around 120 significant institutions because some significant institutions are part of the same group (e.g. some of the institutions determined as significant by virtue of being the third largest institution in a Member State).

(SREP). The approval process by the Supervisory Board is taking place section by section, taking into account that the manual is a living document that will continue to be updated regularly. Before 4 November, the ECB will publish the Guide to the SSM's approach to banking supervision, clarifying the features, tasks and processes of the SSM. The Guide complements the SSM Regulation and the SSM Framework Regulation and will be made available in all official euro area languages.

- **The draft ECB Regulation on supervisory fees was submitted for a public consultation.** In line with the SSM Regulation, the public consultation on the arrangements for the collection of fees levied on a credit institution or branch, including underlying calculations, was launched on 27 May 2014, with a deadline for submitting comments of 11 July. By the closing date, the ECB had received 31 sets of comments, which are now being assessed.
- **The staffing of the SSM is proceeding apace.** The recruitment of management and professionals for the ECB's supervisory function is moving towards finalisation; the recruitment has been organised in a top-down fashion. The large number of applications received (more than 15,700 for the positions advertised so far) confirms that there is considerable interest in the SSM positions. It is important to keep up the current momentum while respecting a clear commitment not to compromise on quality.
- The **preparatory work** is also well advanced in many other areas, such as IT infrastructure, HR, premises, internal and external communication, logistical organisation, as well as legal and statistical services.

1 INTRODUCTION

The SSM Regulation⁴ requires the European Central Bank (ECB), as from 3 November 2013, to send quarterly reports to the European Parliament, the EU Council and the European Commission on progress in the operational implementation of the SSM Regulation.

Under the accountability arrangements with the European Parliament⁵ and the EU Council⁶, these reports should cover, among other things:

- internal preparation, organisation and planning of work;

⁴ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

⁵ Interinstitutional Agreement between the European Parliament and the European Central Bank on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the Single Supervisory Mechanism (OJ L 320, 30.11.2013, p. 1).

⁶ Memorandum of Understanding between the Council of the European Union and the European Central Bank on the cooperation on procedures related to the Single Supervisory Mechanism, which entered into force on 12 December 2013.

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

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

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

2 ESTABLISHMENT OF THE SSM GOVERNANCE STRUCTURES

2.1 SUPERVISORY BOARD AND STEERING COMMITTEE

The Supervisory Board and its Steering Committee held five meetings during the period under review. Besides formal meetings, there were many informal exchanges between the members of the Supervisory Board as part of the visits of the Chair and Vice-Chair to the Member States. In particular, further to the commitment to visit the supervisory authorities of all participating Member States by the end of 2014, given at the selection procedure hearing before the European Parliament in November 2013, the Chair has so far met with the boards and staff of 14 supervisory authorities across the euro area.

In accordance with the Rules of Procedure of the Supervisory Board, representatives of the European Commission and the European Banking Authority (EBA) were invited to some of the Supervisory Board meetings in order to ensure an optimal interplay with the Single Market on a number of issues. (Note that the Chair also represents the ECB on the EBA's Board of Supervisors.)

The Supervisory Board has already prepared complete draft decisions, which were adopted by the ECB's Governing Council under the non-objection procedure in line with the SSM Regulation. In particular, the preparation and adoption of more than 100 decisions determining the significance of supervised institutions proceeded smoothly (see Section 3).

2.2 ADMINISTRATIVE BOARD OF REVIEW

The SSM Regulation requires the ECB to establish an Administrative Board of Review for the purposes of carrying out an internal administrative review of the decisions taken by the ECB in the exercise of the powers conferred on it by the SSM Regulation. Such internal administrative reviews will cover the procedural and substantive conformity of such ECB decisions with the SSM Regulation. The Administrative Board of Review is to be composed of five individuals of high repute acting as members and two alternates who meet the eligibility criteria set out in the SSM Regulation.

On 1 May 2014, the ECB published a call for expressions of interest in the Official Journal of the EU. The initial deadline then had to be extended from 22 May to 2 June 2014, due to the lack of a sufficient number of applications. The candidates were assessed against the eligibility and selection criteria given in the call for expressions of interest, taking gender and geographical diversity into account. The selection committee proposed five members and two alternates to the ECB's Executive Board. After consulting the Supervisory Board on the potential nominees, the Executive Board submitted the nominations of the members and alternates to the Governing Council. In view of the notification period of one month before the respective Governing Council meeting,⁷ the decision on the appointment of the Administrative Board of Review members and alternates is currently scheduled for early August 2014.

2.3 MEDIATION PANEL

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

On 2 June 2014, the Governing Council formally adopted an ECB Regulation concerning the establishment of the Mediation Panel and its Rules of Procedure, which entered into force on 20 June 2014. The Vice-Chair of the Supervisory Board, who is not a member of the panel, will act as Chair of the Mediation Panel.

In order to proceed with the establishment of the Mediation Panel, and taking into account the requirement in the aforementioned ECB Regulation that the Chair “shall facilitate the achievement of a balance between Governing Council and Supervisory Board Members”, the

⁷ Decision ECB/2014/16 of 14 April 2014 concerning the establishment of an Administrative Board of Review and its Operating Rules (OJ L 175, 14.6.2014, p. 47).

Chair of the Mediation Panel is currently taking steps to assist Member States in the appointment of their member.

3 DECISIONS ON THE LIST OF SIGNIFICANT INSTITUTIONS

The SSM Framework Regulation states that the ECB is to determine which of the credit institutions across the euro area should be deemed significant. By 4 September 2014, the individual credit institutions must be notified of their status, after having had the opportunity to exercise their right to be heard. In addition, the ECB is to publish a list of significant institutions, as well as a list of less significant institutions, on its website.

In order to complete this process, the Supervisory Board initiated the assessment of significance in March this year, by gathering and analysing the necessary information in close cooperation with the NCAs concerned. On the basis of this analysis, the Supervisory Board decided on the proposed list of significant credit institutions in May and sent out notification letters to all the institutions concerned, inviting them to submit comments to the ECB; the ECB also published a preliminary draft list on its website.

After assessing and considering the comments of the institutions that have been deemed significant, the Supervisory Board will decide on the full list of significant credit institutions. The overall process – assessment of the credit institutions, preparation and adoption of the decisions and their notification in all relevant official languages to more than 120 institutions and groups – involved considerable analytical, legal and logistical challenges, which were addressed by the ECB's SSM structures in close cooperation with the NCAs. The ECB will publish the final lists of significant and less significant supervised entities on the ECB's website before 4 September 2014. According to the SSM Framework Regulation, the ECB must at least annually review the status of a supervised entity as significant or less significant.

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

- a size (total assets exceeding €30 billion);
- b importance for the economy of the EU or any participating Member State (in particular, total assets exceeding €5 billion and 20% of GDP of a Member State);
- c significance of cross-border activities (in particular, if the ratio of its cross-border assets or liabilities to its total assets or liabilities, respectively, is above 20%);

- d a request for, or the receipt of, direct public financial assistance from the European Stability Mechanism (ESM);
- e one of the three most significant credit institutions in a participating Member State.

As a result of this assessment, currently 120 credit institutions or groups can be considered as significant. The relevant criteria for significance applied to these institutions are shown below.

Criteria for significance	Number of credit institutions/groups
Size	97
Importance for the economy	13
Cross-border activities	3
One of the three most significant credit institutions in a participating Member State	7

All of these institutions are already undergoing the comprehensive assessment, except four, three of which are considered significant on the basis of the cross-border activities criterion, which had not been taken into account when defining the scope of the comprehensive assessment. These relatively small credit institutions will be subject to the comprehensive assessment after 4 November 2014. The fourth case is a branch of a non-SSM banking group and therefore falls beyond the scope of this exercise.

Conversely, a total of 11 institutions covered by the comprehensive assessment have been qualified as less significant, mainly due to updated information regarding their size (also taking into account that, for the purposes of the comprehensive assessment, a buffer range of 10% below the formal size threshold is applied so as to capture all potentially significant institutions).

When assessing the significance of the institutions, particular circumstances may exist that justify the classification of a supervised entity as less significant, even though, formally, the criteria for classification as significant are fulfilled. The SSM Framework Regulation establishes that particular circumstances exist “where there are specific and factual circumstances that make the classification of a supervised entity as significant inappropriate, taking into account the objectives and principles of the SSM Regulation and, in particular, the need to ensure the consistent application of high supervisory standards”. The ECB, jointly with the relevant NCAs, has identified three such cases where institutions have been classified as less significant, although they comply with the formal significance criteria. For two of these cases, the decision was based on the need to preserve the integrated supervision currently exercised by

the NCAs. The third case involved an institution that, although one of the three most significant in a Member State, is too small to come under the ECB's direct supervision.

The ongoing comprehensive assessment will be completed for all banks within its scope, regardless of the banks' current proposed classification.

4 ESTABLISHMENT OF THE SUPERVISORY FUNCTION AT THE ECB

4.1 STAFFING

The recruitment of management and professionals for the ECB's supervisory function is progressing well. More than 15,700 applications have been received for the positions advertised so far, showing that there is a considerable interest in the SSM positions, both from staff from NCAs and from the private sector.

Up to mid-July, a total of 118 managers and advisers had been recruited. Around 280 professional staff were selected for the business areas responsible for the significant banks; they are expected to take up their positions in the second half of 2014. This represents a major milestone in SSM staffing and will facilitate the timely establishment of the Joint Supervisory Teams (JSTs). Additional, dedicated recruitment campaigns have been launched to fill the remaining required positions. The recruitment campaigns for the remaining around 260 professionals for positions relating to the less significant banks as well as for horizontal and specialised functions are expected to be largely finalised by the end of 2014. Meanwhile, professional experts seconded from NCAs are supporting the preparatory work in these areas. Many of these colleagues are expected to apply and, given their experience, are likely to be successful in the ongoing campaigns for the permanent or fixed-term SSM positions, thereby ensuring continuity. This expectation is supported by the results of campaigns completed thus far. Overall, by early July more than 550 colleagues had been recruited (on a permanent, fixed-term or short-term basis) for the five SSM business areas.

Despite the good progress made in recruitment, it is important to keep up the current momentum, particularly in terms of processing applications and completing the selection procedures. To mitigate the related risks regarding the quality and speed of the recruitment process, the ECB is making use of a number of pre-assessment tools (e.g. screening of CVs, online testing, remote written tests, and technical pre-selection interviews), which can be deployed flexibly, depending on the number of applications.

An additional risk may be some longer-than-foreseen notice periods, meaning that teams may not be completed as quickly as envisaged (in particular, as a number of releasing institutions are now heavily involved in the comprehensive assessment). Moreover, some positions were re-advertised as it had proven difficult to immediately find candidates with the appropriate profile. In view of the smaller number of positions concerned, the vacancy notices could be fine-tuned to enhance the likelihood of finding a suitable candidate the second time around. In any event, there is a clear commitment not to compromise on quality.

4.2 JOINT SUPERVISORY TEAMS

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

The ECB is making good progress in staffing the JSTs and carrying out the necessary preparatory work. The recruitment for the middle management of Directorates General Micro-Prudential Supervision I and II (DGs MS I and II) has been finalised; almost all coordinators for the 117 JSTs⁸ (30 in DG MS I and 87 in DG MS II, with some coordinators covering more than one JST for the smaller significant institutions) have been selected and will have joined the ECB by the end of the summer. A targeted campaign will be launched to fill the remaining open positions.

The designation of JST coordinators from among the Heads of Division and Heads of Section of DG MS I took place in early June; the designation of JST coordinators for DG MS II took place very recently, as the recruitment campaign for advisers (who form an important pool from which to draw JST coordinators in DG MS II) has only been finalised over the past few weeks. Not all of the designated JST coordinators, particularly those recruited in the most recent campaigns, are at the ECB yet, but most will have taken up their positions by September as envisaged.

Most of the JST national sub-coordinators were appointed by the NCAs in June; these appointments are temporary in some cases, however, pending the final organisational adaptation to the SSM. The NCAs have updated the number of staff assigned to the JSTs and will provide specific names by the end of August.

⁸ The number of 117 JSTs does not correspond exactly to the around 120 significant institutions because some significant institutions are part of the same group, (e.g. some of the institutions determined as significant by virtue of being the third largest institution in a Member State).

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

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

In recent months, a series of meetings has been held with various stakeholders to advance the transition of supervisory responsibilities to the SSM.

Besides the visits by the Chair to the boards and staff of a number of NCAs, high-level meetings have been held with NCAs from 13 SSM Member States, attended by NCA heads and senior executives as well as ECB Directors General and Deputy Directors General. The meetings covered the general structure and objectives of the SSM, the organisation and supervisory approach of each NCA and, finally, the NCAs' plans for adapting their supervisory framework to the SSM. Further high-level meetings with the remaining NCAs will take place in the near future.

A large number of JST kick-off meetings with the home NCAs of significant institutions have already taken place. For the remaining significant institutions, NCA kick-off meetings have been scheduled, or will be scheduled in the near future, in line with the arrival of JST coordinators. The main objectives of the JST kick-off meetings are, among other things, to enable the ECB and NCA staff to get to know each other and to agree on a working plan and the modalities for information exchange.

The kick-off meetings also serve to complement the information received from NCAs regarding the supervisory history and risk profile of authorised credit institutions in their respective Member States in line with the SSM Regulation. The information was consolidated within supervisory dossiers and has been analysed in recent months within DGs MS I and II. During the kick-off meetings, the ECB and NCA staff discussed the information in the files provided by the NCAs and the ECB was given an overview of recent events and developments. Both the high-level and the JST kick-off meetings included introductory meetings with the senior management of the respective banks. A systematic coverage of banks' senior management by JSTs, including a presentation of the future supervisory structure, responsibilities and contact persons for decision-making processes will be completed over the transition phase.

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

timeline for the joint decisions on capital and liquidity and to enable NCAs to coordinate the preparatory work for these decisions in good time.

DGs MS I and II are also preparing JSTs for the implementation of the results of the comprehensive assessment and any supervisory responses that may ensue (see Section 8).

A number of challenges will have to be addressed to make the JSTs fully operational well in advance of November 2014. On top of risks relating to the SSM staffing in general (including delays in colleagues effectively joining the ECB and the need to fill certain gaps in special skill areas, etc.), the JSTs will face the challenge of a number of key tasks over the coming months, including:

- deepening outreach to the NCAs and banks;
- acquiring the skills to help assess the results of the comprehensive assessment;
- preparing to assume leadership of colleges;
- building the necessary infrastructure to manage the day-to-day tasks of the JSTs (in close collaboration with DG MS IV, which handles horizontal and specialised services).

4.3 SEPARATION OF THE FUNCTIONAL AREAS

The SSM Regulation specifies aspects of the separation principle such as:

- i separation of objectives;
- ii separation of tasks;
- iii organisational separation;
- iv procedural separation at the level of the Governing Council.

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

In addition to the measures already taken in the areas of organisational and procedural separation to implement the requirements under the SSM Regulation, work is ongoing on the sharing of information between the supervisory and monetary policy functions. Appropriate information exchanges and the related governance structures are currently being set up. This work is expected to result in a proposal for a legal act specifying the exchange of information between the two policy areas. These rules will be organised in full and strict compliance with

relevant laws and regulations⁹ and the general obligations of professional secrecy as laid down in the Statute of the ESCB.

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

Under the SSM Regulation, the ECB's Governing Council is to establish and publish a Code of Conduct for the ECB staff and management involved in banking supervision. The ECB has prepared draft rules of ethical conduct as part of a general review of the Ethics Framework that applies to all ECB staff. These new rules will take account of the requirements laid down in the SSM Regulation and the Interinstitutional Agreement. A proposal was submitted to the Supervisory Board and staff representatives in mid-June for their consideration by the end of July and September, respectively. The proposal will be submitted to the ECB's Executive Board and Governing Council in the course of October. In line with the Interinstitutional Agreement, the ECB will inform the European Parliament about the main elements of the envisaged Code of Conduct before it is adopted. It is expected that the review of the Ethics Framework will be completed before the ECB fully assumes its supervisory responsibilities in November 2014.

4.5 CODE OF CONDUCT FOR THE MEMBERS OF THE SUPERVISORY BOARD

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

5 LEGAL FRAMEWORK

5.1 PUBLIC CONSULTATION ON THE DRAFT ECB REGULATION ON SUPERVISORY FEES

Under Article 30(2) of the SSM Regulation, the amount of the fee levied on a credit institution or branch is to be calculated in accordance with arrangements established, and published in advance, by the ECB. Before establishing those arrangements, the ECB is required to conduct

⁹ For example, the Capital Requirements Directive, Council Regulation (EC) No 2533/98 on the collection of statistical information by the ECB, and legal acts governing data protection and banking secrecy.

open public consultations and to analyse the potential related costs and benefits, and to publish the results of both. In addition, under Article 4(3) of the SSM Regulation, the ECB must conduct public consultations on ECB regulations adopted for the purposes of carrying out the tasks conferred upon it by the SSM Regulation.

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

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

5.2 FOLLOW-UP TO ECB DECISION ON CLOSE COOPERATION

Under the SSM Regulation, Member States whose currency is not the euro may participate in the SSM under a regime of close cooperation. Whereas Article 7 of the SSM Regulation sets out the main conditions for the establishment of close cooperation between the ECB and the competent authorities of a requesting Member State, the procedural aspects – for example, timing and content of a request to enter into close cooperation, its assessment by the ECB and the eventual adoption of an ECB decision – have been laid down in Decision ECB/2014/5¹⁰.

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

¹⁰ Decision ECB/2014/5 of 31 January 2014 on the close cooperation with the national competent authorities of participating Member States whose currency is not the euro (OJ L 198, 5.7.2014, p. 7)

5.3 ECB RECOMMENDATION TO AMEND COUNCIL REGULATION (EC) NO 2532/98

Recommendation ECB/2014/19 for a Council Regulation amending Regulation (EC) No 2532/98 concerning the powers of the European Central Bank to impose sanctions, which had been adopted on 16 April 2014, was published in the Official Journal of the EU on 14 May 2014¹¹. The purpose of the amendments is to establish a coherent regime for the ECB's imposition of administrative fines relating to the performance of its supervisory tasks.

6 SUPERVISORY MODEL

6.1 FINALISATION OF THE SUPERVISORY MANUAL

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

The main amendments to the Supervisory Manual focus on the following areas:

- composition and staffing of the JSTs;
- supervisory processes;
- roles and responsibilities within the ECB;
- methodology for on-site inspections;
- methodology and process for the SSM Supervisory Review and Evaluation Process (SREP).

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

The updated version of the Supervisory Manual will support the planning of the 2015 activities. The Supervisory Manual is expected to be a living document that is updated to reflect new market developments and supervisory practices.

¹¹ OJ C 144, 14.5.2014, p. 2.

6.2 PREPARATION OF A PUBLIC GUIDE TO SSM SUPERVISORY PRACTICES

The SSM is subject to publication requirements in order to ensure that there is an adequate level of information about its supervisory model available to both the public and supervised entities. In particular, the Interinstitutional Agreement provides for publication on the ECB's website of a guide to supervisory practices.

In this context, the ECB is finalising a user-friendly document entitled "*Guide to the Single Supervisory Mechanism's approach to banking supervision*", which will explain the overall functioning of the SSM. More specifically, the Guide will give an overview of the main supervisory processes and methodologies applied to significant and less significant credit institutions. For example, it will describe the work of the JSTs and set out how SSM business areas are to interact in developing the supervisory cycle.

The Guide will complement both the SSM Regulation and the SSM Framework Regulation and will be made available in all official euro area languages. It has not been developed to establish any legal requirements and, therefore, will not create any legal obligations, neither for the credit institutions, nor for the SSM.

As mentioned in previous issues of the Quarterly Report, the ECB plans to publish the Guide before the ECB fully assumes supervisory responsibilities on 4 November 2014. Early publication will help the supervised entities to better understand the key supervisory processes of the SSM and, where relevant, to adjust their own internal procedures.

7 PREPARATION OF OTHER RELEVANT STRANDS OF WORK

7.1 SUPERVISORY DATA REPORTING FRAMEWORK

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

This exercise was launched at the beginning of March and is now nearing completion. The purpose of the exercise is to continue to refine the preparatory work for the centralised risk assessment system (RAS) and to further improve its methodologies. Besides the development of the RAS, data also play an important role in the development of the model infrastructure for future horizontal risk analyses.

The content of the data collection was closely coordinated with NCAs; in order to accommodate their needs as well as those of banks, the original deadline was extended by two weeks (from mid-May to the end of May 2014).

Another important ongoing task is the design of the reporting framework for non-harmonised data categories, i.e. those that are not defined by the EBA Implementing Technical Standards (in particular, data that are required for assessing interest rate risk) and the preparation of the relevant legal acts for reporting requirements.

Significant progress has been made in implementing the Supervisory Banking data system (SUBA) required for the collection, storage, quality analysis/enhancement and dissemination of supervisory data and metadata. The user requirements have been prioritised so that the first wave of supervisory data can be collected from the significant institutions as of 31 July 2014. The SUBA data system will be further developed to enhance its reporting capabilities and improve the quality of the data collected. From 2015, the ECB will also collect data using the templates of the EBA Implementing Technical Standards for the less significant institutions. Over time, the SUBA data system will gradually accommodate other supervisory data needs.

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

7.2 INFORMATION TECHNOLOGY

The establishment of the SSM, the implementation of its operational model and business processes require extensive IT developments and support, the most important being:

- *Shared IT services:*
 - The temporary site for SSM staff has been integrated into the ECB’s IT network.
 - Some non-central bank NCAs are outside the ESCB/Eurosystem IT infrastructure (“CoreNet”) and are currently establishing connectivity to the corresponding NCBs (AT, LU, LV and MT). Two NCAs (DE and AT) have expressed a preference for a direct connectivity link. However, this will only be possible after the roll-out of the new version of the CoreNet infrastructure, which is planned for the first quarter of 2015.
 - A new requirement has been registered for exchanging confidential e-mails and documents between significant institutions and the ECB. Given the time

constraints, the most feasible solution would be to use the “Transport Layer Security (TLS)” protocol. A proposal for implementing this protocol has been drawn up.

- ***Collaboration, workflow and information management:*** The IT project for managing contact data and handling enquiries is currently being implemented, with first functionalities going live in July 2014. In anticipation of the expected load increase due to SSM, assessments of the IT shared services and the capacity of the document management system are under way.
- ***Enterprise resource planning:*** Work on the IT requirements for the fee collection and the SSM budget, organisational structure and reporting is in progress and will be completed in the second half of 2014.
- ***Data collection, data quality management and analytics:*** The first functionalities of the SUBA data system have been developed and deployed. The key objective of the project is to enable the ECB to receive specific supervisory data from all SSM countries based on XBRL format, in line with the EBA’s Implementing Technical Standards framework. Following the user requirements for SUBA, the messaging service from SSM NCAs via the ECB to the EBA have been designed, realised and tested. The service is expected to go live in the fourth quarter of 2014. Furthermore, the XBRL processor and the platform for data validation and analysis have been developed using commercial software products. The first release of SUBA went live in July 2014. Additional iterations and releases are planned before the end of 2014.
- ***Information Management System (IMAS):*** IMAS will provide the basis for ensuring harmonised processes and consistency in the supervision of credit institutions. Especially in the initial phase of the SSM, it will be a crucial element in ensuring the application of the common methodology and standards by all JSTs. The software development is on track within the tight project schedule and the project team is now focusing on preparing the testing and training environment for JST members and users in the SSM’s horizontal services. In this regard, the availability of JST members from NCAs will be a crucial element for the successful roll-out of IMAS to the SSM by 4 November 2014.

8 COMPREHENSIVE ASSESSMENT

The comprehensive assessment is well under way and progress has been achieved on multiple fronts. The major work blocks of the asset quality review (AQR) are being concluded in August, broadly on time, taking into account the quality assurance process. Banks have submitted preliminary bottom-up stress test results to the ECB, the NCAs and the EBA; these results are

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

8.1 COMPREHENSIVE ASSESSMENT WORK BLOCKS: STATE OF PROGRESS

Overall, Phase 2 of the AQR, i.e. the actual execution, is on schedule for completion by early August 2014. Major achievements of Phase 2 include the generation and submission of bank loan tapes, the submission of credit files by the banks, and the completion of the data integrity validation, the processes, policies and accounting review, and the trading book review. In addition, the collateral valuation, credit file review, revaluation of non-derivative level 3 assets, and the level 3 derivative pricing model review are very close to completion, with quality assurance currently being performed on specific aspects that arose during the analyses of the data submissions. By 1 August, the bank inspection teams had submitted the completed templates for the overall capital adjustment based on the AQR, which incorporates the findings of all work blocks. These will be subject to quality assurance and then used in the join-up with the stress test. AQR results in separation may also result in further capital needs for banks.

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

All of the findings of the AQR will be included in the stress test. For all portfolios that have been subject to the AQR, (i) the year-end 2013 starting balance sheet and capital ratio will be adjusted to include all the AQR findings, and (ii) the parameters for forecasting total losses in the stress test will be adjusted to reflect any material differences between the banks’ own figures and AQR findings. This is a major innovation compared with previous stress tests.

Following formal approval by the EU Council on 23 July 2014 for Lithuania to join the euro area on 1 January 2015, and in order to be in line with the rest of the euro area, the Lithuanian banks likely to be considered as significant are completing a comprehensive assessment with the same project management, methodology and deadline as for the current euro area countries.

8.2 INTERACTION WITH BANKS BEFORE THE DISCLOSURE OF FINAL RESULTS

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

In September and October, a review of partial and preliminary AQR and stress test results (including elements regarding the join-up of both components) will be conducted with the banks as part of the “supervisory dialogue”. These meetings will be organised under the auspices of the ECB and will allow for discussions which are essential to have a common understanding between banks and supervisors on the key elements and main individual drivers of the outcome of the exercise, while not addressing the full final impact on banks’ capital ratios. No bank will be given certainty concerning its full overall result on this occasion.

During the second half of October, prior to publication, the results of the comprehensive assessment will need to be endorsed by the ECB.

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

8.3 DISCLOSURE OF THE COMPREHENSIVE ASSESSMENT RESULTS

The templates for disclosure of the bank-level results of the comprehensive assessment were published by the ECB on 17 July 2014. Prior to their publication, a consultation was held to give banks an opportunity to comment on the templates both in written form and in a series of physical meetings between CFOs/CROs and ECB and NCA representatives at the ECB in Frankfurt am Main.

The templates as published comprise the following sections:

- a **Main results and overview:** A summary of the comprehensive assessment results for each individual bank, showing the overall impact of the exercise on the bank’s CET1,

also split into the individual CET1 adjustments stemming from each of its key components (i.e. AQR, baseline scenario and adverse scenario of the stress test). The sheet also includes an overview of the major capital measures taken by banks between 1 January and 30 September 2014.

- b **Detailed AQR results:** Specific insights into the different findings of the AQR which are reflected in the overall CET1. The adjustments shown are split into those resulting from the work blocks dedicated to accrual accounted assets and those resulting from the fair value review. The sheet also provides disclosure on the portfolio selection underlying the exercise and the impact of the AQR findings on the key asset quality indicators.
- c **Detailed stress test results:** This part of the template will be identical to the EBA disclosure template of the stress test, with the results shown for SSM banks incorporating adjustments based on the AQR.

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

8.4 PREPARATION, ASSESSMENT AND IMPLEMENTATION OF REMEDIATION ACTIONS

Once the results are published in the second half of October 2014, banks facing a capital shortfall will be requested to submit capital plans within a period of two weeks, which will then be evaluated by the SSM. As from 4 November 2014, the JSTs will then closely track the implementation of these plans. As communicated previously, if banks face a capital shortfall arising from the AQR or the baseline stress test scenario, they will be expected to restore their capital position within six months, and in the case of the adverse stress test scenario within nine months.

The Terms of Reference on shortfalls and burden-sharing following the comprehensive assessment, as published by the ECOFIN Council and the Eurogroup on 9 July 2014, will apply. The first port of call to address capital shortfalls is private sources.

Nevertheless, as also mentioned in the Terms of Reference, public recapitalisations may be required in certain situations, but this should be the exception rather than the rule, and should be used only when strictly necessary to remedy a serious disturbance in the economy of a Member State and to preserve financial stability. From January 2015, the use of public funds would imply that an institution is deemed to be failing, or likely to fail, and would lead to resolution, except for precautionary public recapitalisations that meet all the conditions of the Bank

Recovery and Resolution Directive (BRRD). These precautionary recapitalisations will not trigger resolution, and will be conditional on final approval under state aid rules, including the presentation of a restructuring plan and burden-sharing, thus ensuring a level playing field.

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

Asset sales and their impact on profit and loss, risk-weighted assets and deductions from CET1 will be eligible only as extraordinary measures if they can be clearly identified as being distinct from normal business operations. Typically, large asset sales programmes of clearly separated portfolios (e.g. disposal of securitisation portfolios) and sales of subsidiaries will fall into this category. The impact of formal deleveraging or restructuring plans (as agreed with the European Commission) will be taken into account.

Reductions in risk-weighted assets as a result of Pillar 1 risk model changes and switches in Pillar 1 approaches will not be deemed eligible for addressing a capital shortfall, unless these changes had already been planned and approved by the relevant NCA before the disclosure of the comprehensive assessment results.

In their capital plans, banks will be able to propose that shortfalls arising solely from the AQR may be offset by retained earnings from 2014. With respect to capital shortfalls arising under either the baseline or the adverse scenario of the stress test, only the difference between the realised pre-provision profits from 2014 and the pre-provision profits predicted for the same year in the stress test scenarios is eligible as a mitigating measure. This is due to the fact that accounting for the full amount would imply double-counting, since earnings are already taken into account in the bank's projections for the stress test.

The JSTs will assess the feasibility, viability and credibility of all planned capital measures. If a capital plan is found to be insufficient or lacking in credibility, the ECB will decide about possible supervisory measures in line with Article 16 of the SSM Regulation. These measures will then be implemented as part of the decision emerging from the annual SREP for 2014,

which will be based on the results of the comprehensive assessment, the assessment of the capital plans and the outcome of the annual review and evaluation conducted by the NCAs.

After the submission of this decision to the banks, scheduled for December 2014, the JSTs will start to monitor the implementation of the capital plans based on a continuous dialogue with the respective bank, involving existing colleges of supervisors, wherever appropriate.

As part of this monitoring process, the JSTs will closely track the incorporation, in line with the applicable accounting frameworks, of the AQR findings in banks' forthcoming accounts. The banks will generally be expected to reflect AQR findings in the latter. The JSTs will review the conclusions of the banks and their statutory auditors in order to assess whether they are comfortable with the way the AQR results have been incorporated into the accounts and, if necessary, to consider the use of available prudential measures to complement the accounting treatment.

The overall range of supervisory measures to address weaknesses identified in the comprehensive assessment includes quantitative measures, such as capital add-ons to the minimum Pillar 1 requirements, restrictions to the distribution of dividends and specific liquidity requirements, for example limiting maturity mismatches between assets and liabilities. In addition, Pillar 2 includes a number of qualitative measures, addressing management and reporting issues, internal controls and risk management practices. The SSM will make use of the full Pillar 2 tool box as appropriate, using the whole range of instruments to address the specific situation and risk profile of each institution.

9 ACCOUNTABILITY

This section briefly presents the main elements of the discharging of accountability towards the EU Council and European Parliament during the period under review.¹²

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

With regard to the European Parliament, and in line with the relevant sections of the Interinstitutional Agreement, the ECB transmitted to Parliament's Committee on Economic and

¹² An overview of the accountability framework is presented in Section 8 of the first SSM Quarterly Report.

Monetary Affairs the draft ECB Regulation on supervisory fees on 26 May 2014, in advance of the public consultation launched on 27 May, and the legal acts already adopted by the ECB in the context of the SSM. The Committee also received the confidential records of proceedings of the Supervisory Board meetings held between end-March and June 2014.

The next regular hearing with the Chair of the Supervisory Board in Parliament's Economic Affairs Committee, one of the key channels of accountability towards the European Parliament, is scheduled to take place on 7 October 2014.

10 NEXT STEPS AND CHALLENGES

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

- the ECB internal rules on the separation of functions and exchange of information;
- the draft ECB Regulation on supervisory fees, following the public consultation;
- the review of the ECB Ethics Framework (including ethical conduct for ECB staff and management involved in banking supervision).

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

Important milestones	
Action	Time frame
Publication of list of significant banks	before 4 September 2014
Supervisory dialogue with banks on partial and preliminary AQR and stress test results	between second half of September and early October 2014
Adoption of ECB Regulation on supervisory fees	October 2014
Publication of ECB Guide to supervisory practices	before end-October 2014
ECB internal rules on separation of functions and exchange of information	before 4 November 2014
Review of the ECB Ethics Framework (including ethical conduct for ECB staff and management involved in banking supervision)	before 4 November 2014
<i>Fourth Quarterly Report to the European Parliament, EU Council and European Commission</i>	<i>early November 2014</i>
Start of supervisory activities	4 November 2014