



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

ECB-RESTRICTED

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Microprudential Supervision II

Progresses in the field of Supervision and SREP within the SSM

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Overview

1 SSM: governance and structure

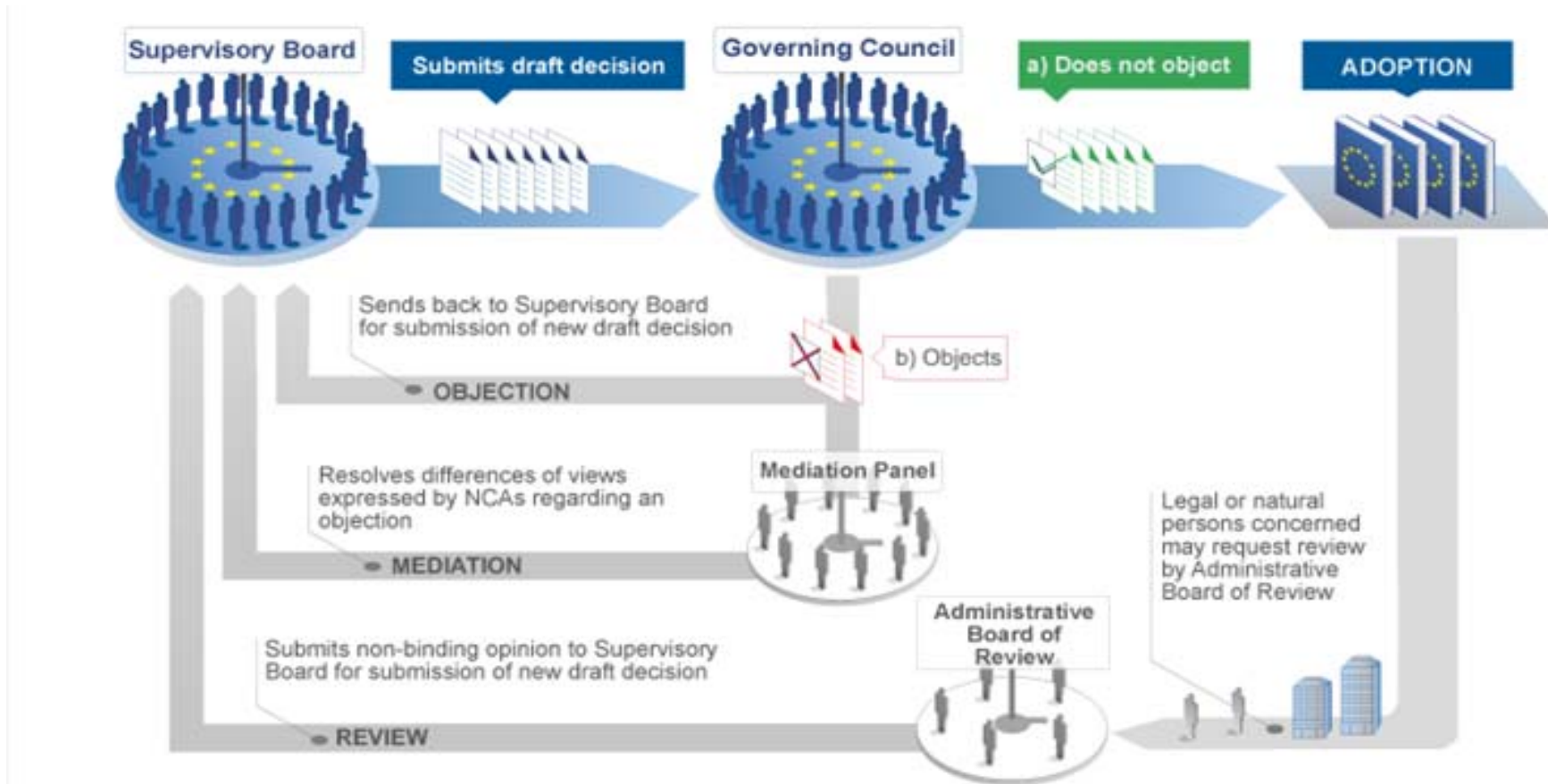
2 Supervisory Priorities in 2015

3 SREP:
3.1 Legal basis
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3.3 SREP 2015 calendar
3.4 Methodology

4 Thematic review on Governance

1. SSM: governance and structure (1/3)

Decision taking based on non-objection procedure



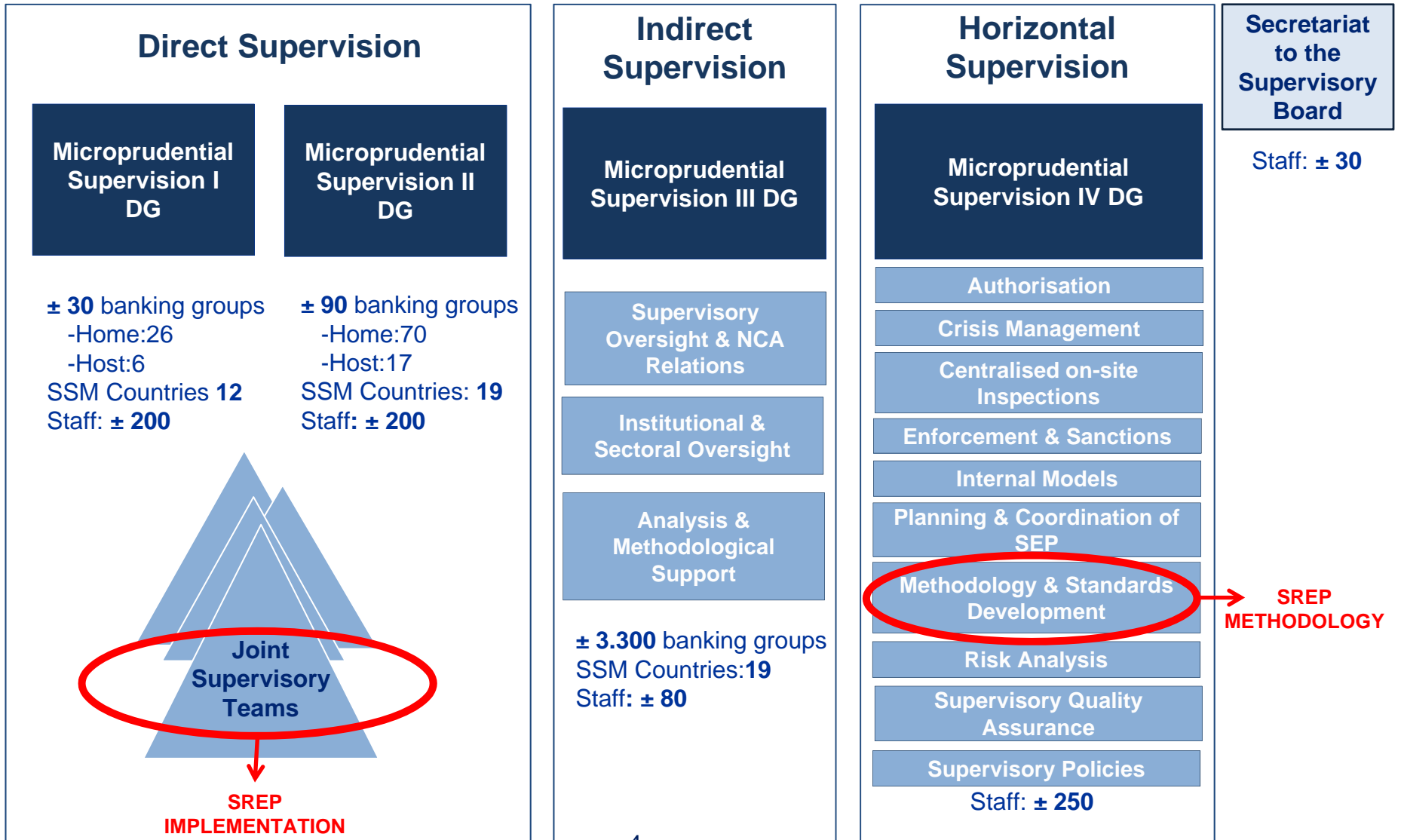
The **Supervisory Board** takes draft decisions which are submitted to the **Governing Council**



Within a defined period of time (10 working days) the decision is **adopted** if **non-objection** by the Governing Council

1. SSM: governance and structure (2/3)

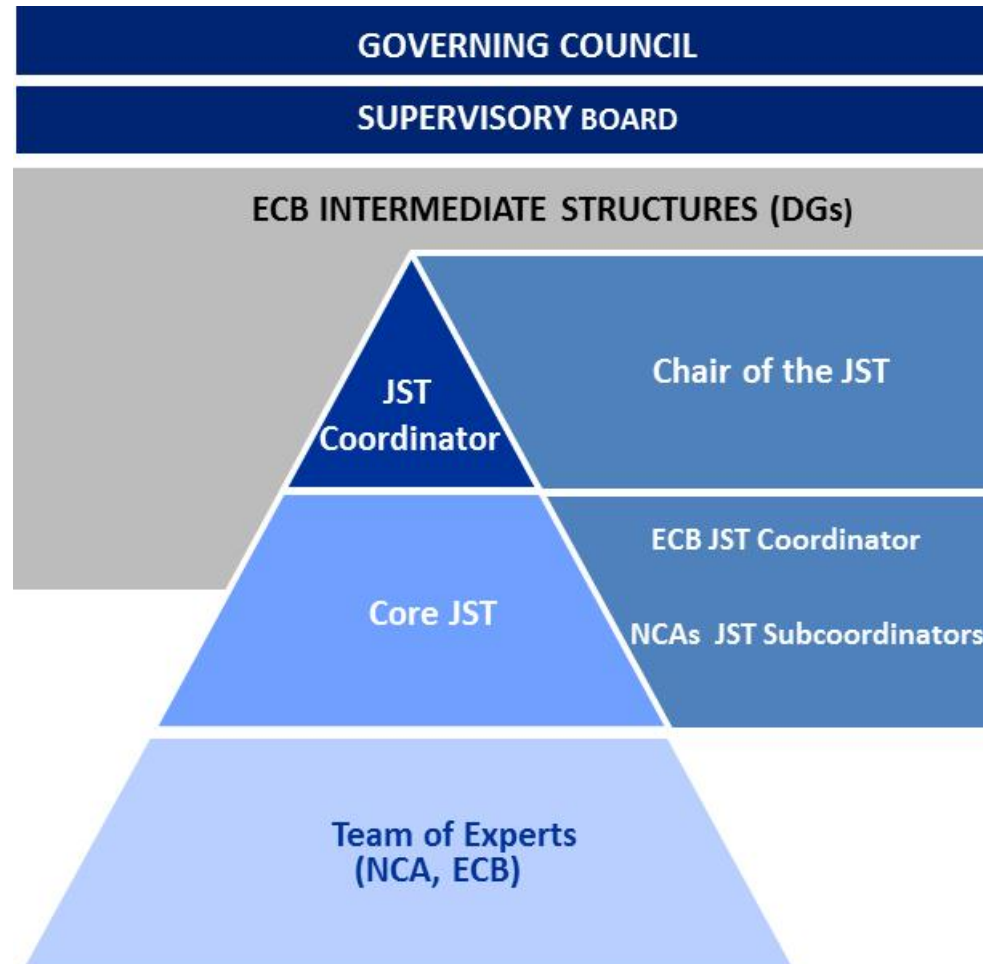
SSM organized in four Directorates General and a Secretariat to the SB



1. SSM: governance and structure (3/3)

Direct Supervision of **Significant Institutions** (DG MSI&II): **Joint Supervisory Teams**

- One JST per **Significant Institution**.
- JSTs composed of staff from **ECB** and **NCA**.
- Responsible for:
 - **Ongoing supervision** of the Significant banking groups.
 - Performing the annual **Supervisory Examination programme**.
 - Implementation of the **decisions** taken by the Supervisory Board/ Governing Council.
- **Size** and **composition** of JSTs depend on the specific characteristics of each Institution.



2. Supervisory Priorities in 2015

Supervisory Priorities for Significant institutions

Challenge business models' viability

- Assess the sustainability of banks business models and assess profitability drivers
- Monitor aggressive “search-for-yield” strategies, loosening of credit standards and lax pricing strategies

Assess governance and risk appetite

- Assess the quality of the risk governance process, risk appetite statements vs everyday risk management (thematic analysis)
- Assess the quality of risk reports and the rigor of banks' internal stress tests

Follow up capital plans (from CA)

- Follow-up capital plans from CA and banks under restructuring programs
- Analyse the allocation of capital and liquidity across group entities (thematic analysis)
- Review quality of capital and national discretions

Monitor NPEs and impairments following CA

- Follow-up findings from the Comprehensive Assessment
- Specific focus on corporate loans with a high leverage, sovereign exposures and specific portfolios (thematic analysis)

Assess cyber risk and data integrity

- Identify loopholes in IT systems and risk management, following-up on the weaknesses identified through the CA
- Assess Cyber security and data integrity (thematic analysis)

3.1. SREP: legal basis

Legal Background: **Applicable Regulatory Framework**

- **Basel Committee Core Principles**
 - ✓ General principles
 - ✓ Risk category specific principles
- EU Capital Requirements Directive (**CRD IV**)
- EU Capital Requirements Regulation (**CRR**)
- **EU Commission ITS and RTS**
- **EBA guidelines and recommendations**
 - ✓ SSM Methodology in line with the recent EBA *Guideline on common procedures and methodologies for SREP (EBA/GL/2014/13) - 19 December 2014*
- **Existing national regulations and guidelines**

3.2. SREP: principles and challenges (1/2)

SSM implementation relies on the **main principles**:

1. **Consistency** of SREP assessments and decisions

- ✓ Harmonized methodology for individual supervision and horizontal analyses
- ✓ Across the euro area

2. **Quality**

- ✓ Forward looking, risk-based and judgment-based supervision
- ✓ Grounded in strong quantitative analysis
- ✓ Multiple perspectives on risks

3. **Timeliness**

- ✓ Clear plan and common calendar for all banks
- ✓ Address potential problems in a timely manner

4. **Continuous improvement process**

- ✓ Keep track with evolving banking activities
- ✓ Continue leveraging on best practices from other supervisors

3.2. SREP: principles and challenges (2/2)

Main challenges:

- Various combinations of **supervisory judgment** and **rules**
- Various combinations of **quantitative indicators** vs. **qualitative information**
- Various **interpretation** of nature of **Pillar 2 decisions**
- Various **expectations by banks** in each jurisdiction
- Various use of **bank's ICAAP** and **ILAAP** across countries

3.3. SREP: 2015 calendar

1. Preparation

- Start College setting
- Collection of supervisory reporting and ICAAP /ILAAP related information

2. Evaluation

- Assessment
- College meetings on group/entity assessments
- Horizontal analyses

3. Decision

- Supervisory Dialogue
- SB approval of draft SREP decisions
- Right to be heard
- Governing Council approval of final SREP decisions

2015

Q 1

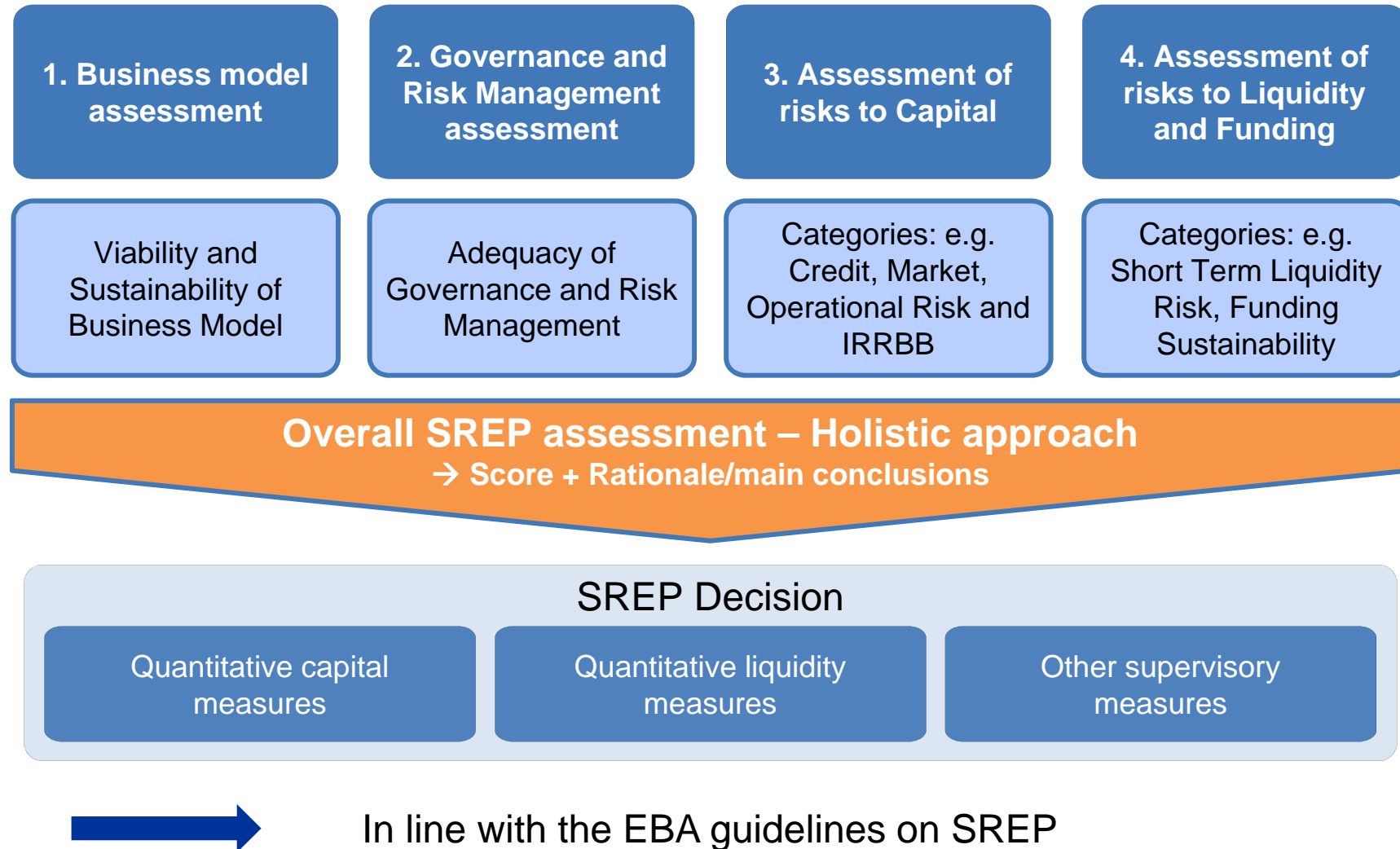
Q 2

Q 3

Q 4

3.3. SREP: methodology (1/8)

Common framework:



3.3. SREP: methodology (2/8)

Key features:

- The ECB has created a **common SREP approach** initially covering **all significant institutions** in the SSM.
- **Building block** approach
- Balance between:
 - ✓ Quantitative + qualitative information
 - ✓ Past data + forward-looking elements
- Combination of **anchor points** and **flexibility** (“constrained judgment”):
 - ✓ Automatic calculations
 - ✓ Anchor rating and benchmarks: minimum consistency and comparability
 - ✓ Expert judgment: account for specificities and non-quantifiable information

3.3. SREP: methodology (3/8)

4 elements and 3 blocks: all 4 SREP elements follow a common logic

Three phases in on going risk assessment

Phase 1: Data gathering

Phase 2: Automated score of Risk Level / formal compliance checking of Risk Control

Phase 3: Assessment



Risk Level (RL) vs. Risk Control (RC)

	1. Business model	2. Internal Governance and RM	3. Assessment of Capital risks	4. Assessment of Liquidity risks
RL	✓	n/a	✓	✓
RC	n/a	✓	✓	✓

n/a: non applicable

The supervisory intensity and intrusiveness are defined by JSTs in accordance with the proportionality principle, in order to reflect the bank's size and risk profile.

3.3. SREP: methodology (4/8)

4 elements and 3 blocks: JSTs assess **capital** from 3 different perspectives

1. Block 1: Supervisory perspective

- ✓ Credit, Market, Operational and IRRBB risks

2. Block 2: Bank's perspective

- ✓ Assessment of ICAAP reliability
- ✓ Supervisory proxies in line with EBA's Guidelines

3. Block 3: Forward looking perspective

- ✓ Assessment of bank's internal Stress Tests
- ✓ Supervisory Stress Test

Supervisory proxies in EBA Guidelines on common SREP

335. Competent authorities should develop and apply **risk-specific supervisory benchmarks** as a means **to challenge ICAAP** calculations for those material risks, or elements of such risks, that are not covered by Regulation (EU) 575/2013, or to further support the determination of risk-by-risk additional own funds requirement where ICAAP calculations for those material risks, or elements of such risks, are deemed unreliable or are unavailable.

336. The supervisory benchmarks should be developed **to provide a prudent, consistent** (calibrated to equivalent holding periods/risk horizons and confidence levels as required by Regulation (EU) 575/2013), **transparent** and **comparable measure** with which to calculate and compare the potential own funds requirements of institutions by risk type (excluding risks covered by Regulation (EU) 575/2013).

337. Given the variety of different business models operated by institutions, the outcome of the supervisory benchmarks may not be appropriate in every instance for every institution. Competent authorities should address this by using the **most appropriate benchmark** where alternatives are available, and by **applying judgment** to the outcome of the benchmark to account for business-model-specific considerations.

338. When competent authorities take supervisory benchmarks into consideration for the determination of additional own funds requirements, as part of the dialogue, they should **explain to the institution the rationale and general underlying principles** behind the benchmarks.

3.3. SREP: methodology (5/8)

4 elements and 3 blocks: JSTs assess **liquidity** from 3 different perspectives

1. **Block 1: Supervisory perspective**

- ✓ Short-term liquidity and funding sustainability risks

2. **Block 2: Bank's perspective**

- ✓ Assessment of ILAAP

3. **Block 3: Forward looking perspective**

- ✓ Assessment of bank's internal stressed estimates

3.3. SREP: methodology (6/8)

Overall assessment

- After the 4 elements are assessed, **JST** has a view on:
 - ✓ **Capital quantitative** proposals
 - ✓ **Liquidity quantitative** proposals
 - ✓ **Qualitative actions** proposals

- The **overall SREP assessment (holistic view)**:
 - ✓ How **all 4 elements** and **measures relate** and what is the most efficient measure to achieve the desired goal
 - ✓ Use **all available information** (peer comparison, etc....)
 - ✓ Overall SREP assessment is **synthesis** of all **4 elements** and not simple sum

- Direct **link** between **SREP assessment** and **supervisory actions**.

3.3. SREP: methodology (7/8)

SREP decision

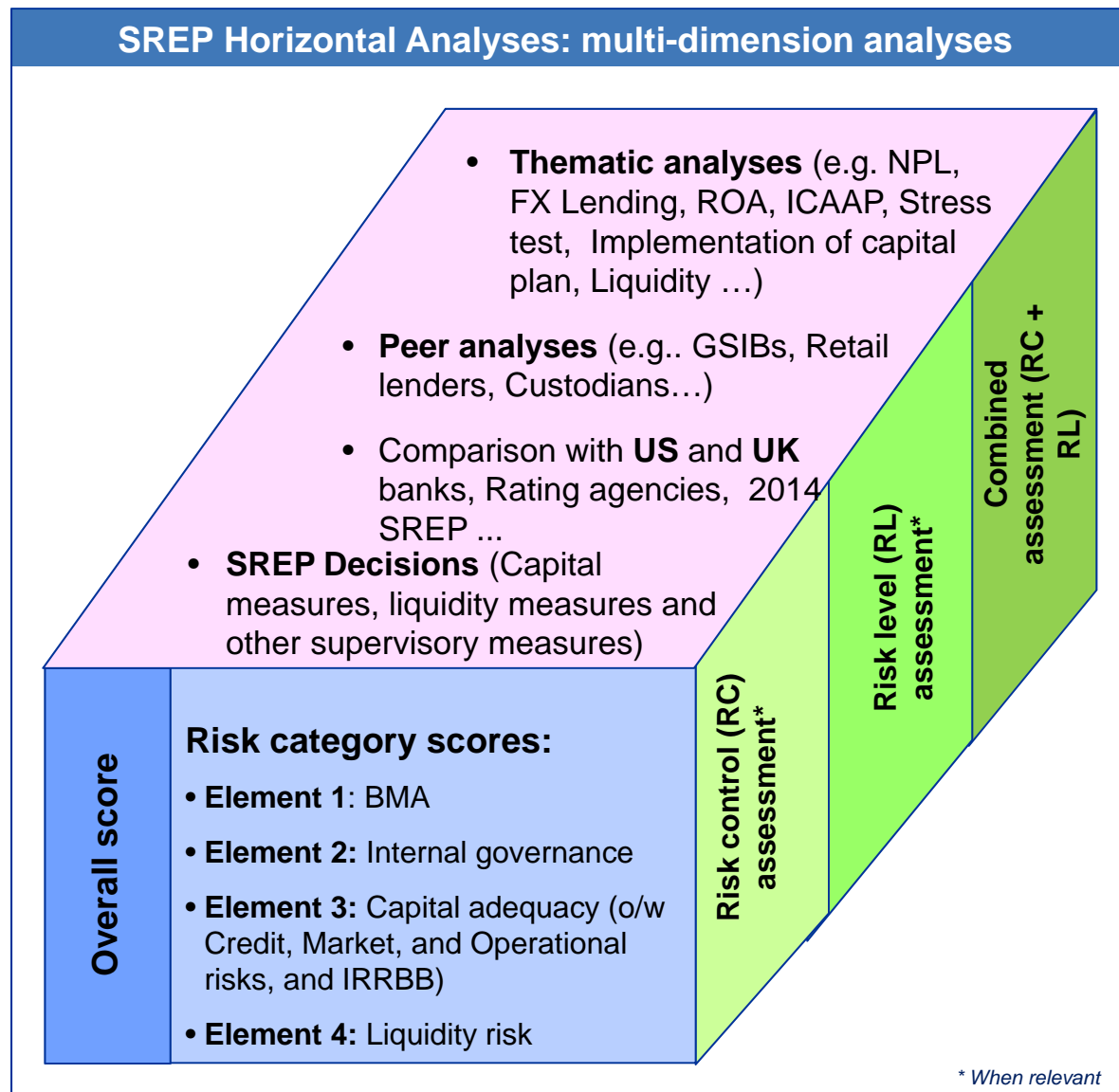
- The overall **SREP assessment measures** (holistic view):
 - ✓ **Capital quantitative** measures
 - ✓ **Liquidity quantitative** measures
 - ✓ **Other supervisory** measures (cf. article 16(2) of SSM Regulation)

- Institutions are recommended **not to disclose the SREP decisions** and the information therein, unless required by law to do so.

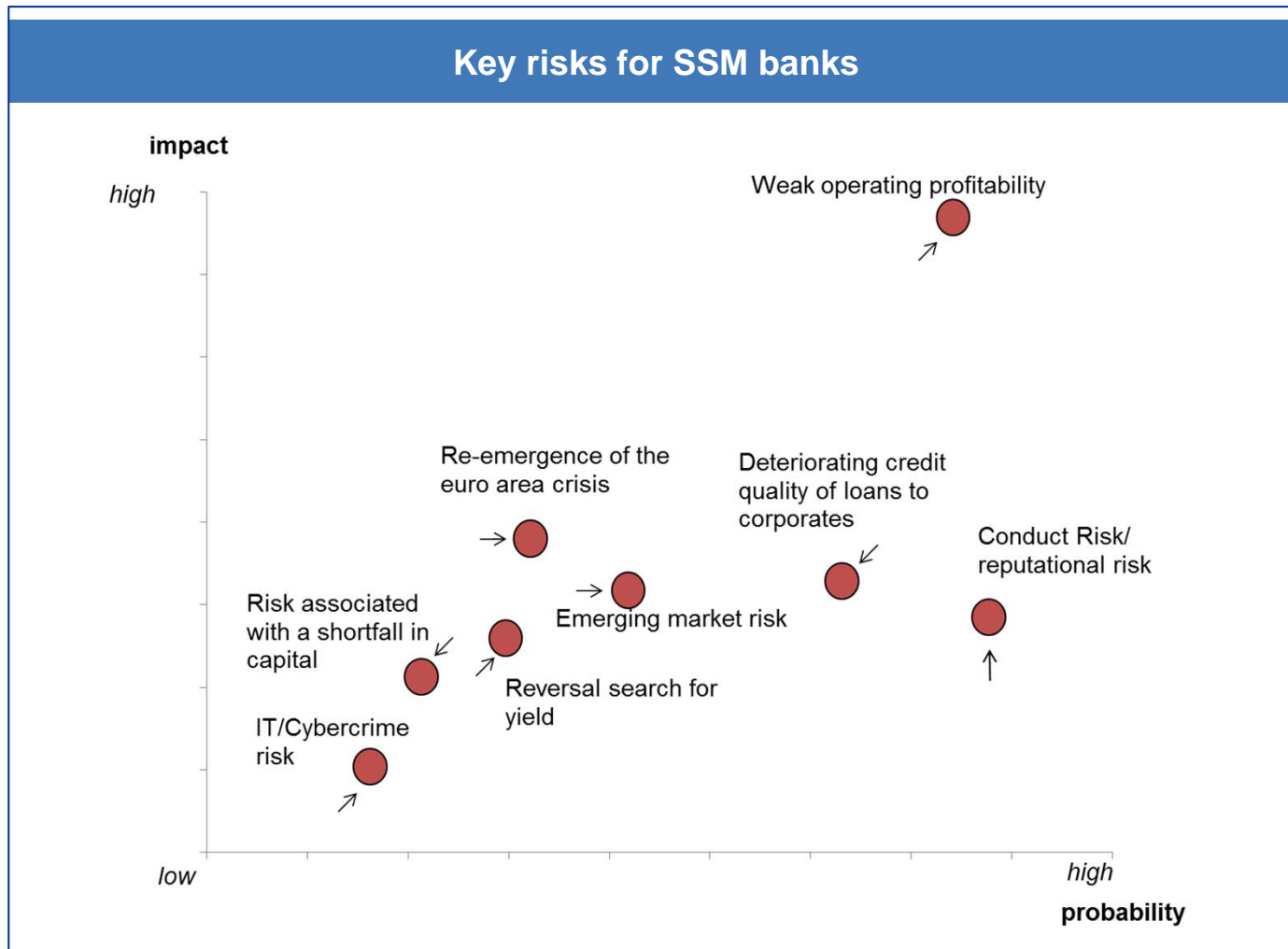
3.3. SREP: methodology (8/8)

Consistency and fair treatment

- More than **80 horizontal analyses** performed (for all Significant Institutions)
- **4 rounds of horizontal analyses** during Q2 and Q3 2015 - at each main step of the process
- **Additional perspectives for JSTs** to improve quality and consistency of assessment and decisions
- Discussion and agreement within **supervisory colleges**



3.4. SREP: SREP 2015 key risks



➔ **Weak operating profitability** remains by far the most important risk for SSM banks

4. Thematic review on Governance (1/3)

- The need to understand bank-specific **governance** features is a **strategic supervisory priority** for the SSM given their overall impact on risk-profile and business model sustainability

Supervisory Principles

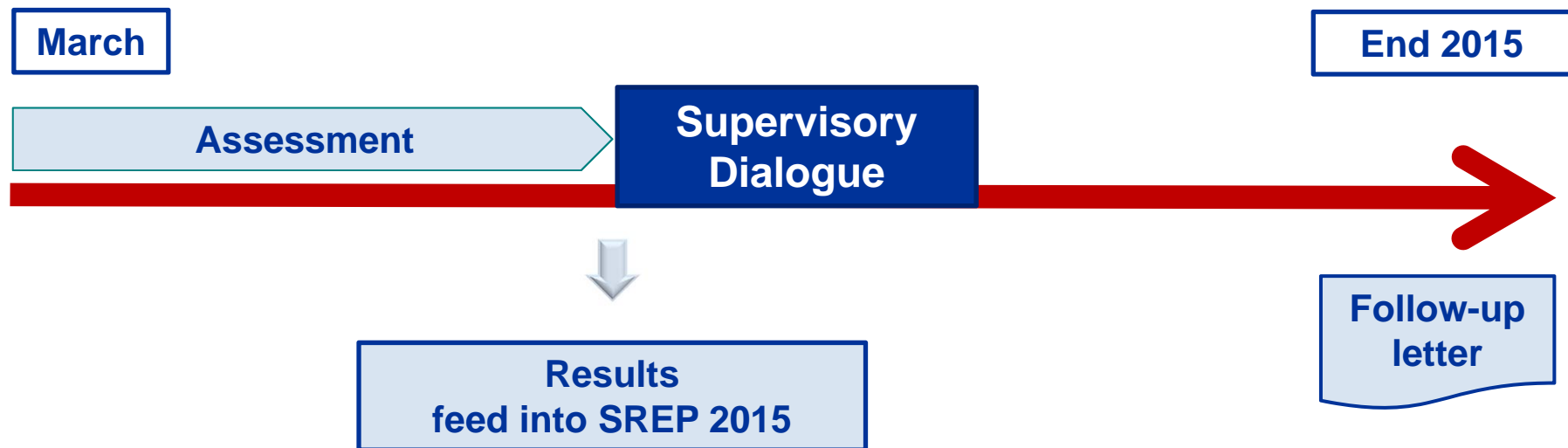
- **International best practices as guidance** (EBA, BCBS, FSB)
- **Consistency**, taking into account different national frameworks and governance structures
- **Proportionality**: supervisory intensity depends on the probability of materialization of risks and their impact.

Supervisory tools

- **On site inspection**
- **On-going supervision:**
 - Assessment of minutes, presentations to BoD and related documentation;
 - Assistance as observers to some meetings;
Meetings with key function holders

4. Thematic review on Governance (2/3)

- The “**Thematic Review on Risk governance and Appetite**” is part of the **supervisory cycle**. The result of the thematic review feeds into the **SREP** decisions and their findings lead to **follow-up actions**.



- **Corporate Governance** will remain as one of the key **priority areas** for future **SSM supervisory strategy**.
- **Interaction** with the **Board** and **Control Function Committees** will be a complementary supervisory tool for the SSM.

4. Thematic review on Governance (3/3)

Elements to be assessed

- **Management bodies in supervisory and management functions:** organisation, composition, documentation and decision-making.
- **Risk Appetite Framework:** policies, practices and implementation and governance.

Preliminary findings

- **Corporate governance is far from fully compliance with international best practices.**
- Non-compliance cases have been observed in both **GSIBs** and **smaller Sis.**
- An **effective** Corporate Governance is possible regardless of the **corporate governance model structure** → The SSM has no preference between single-tier or two-tier models.
- In case of SIs with **recent Risk Appetite Frameworks**, JSTs will follow-up with the assessment of their implementation.



Thank you for
your attention