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EUROPEAN CENTRAL BANK
BANKING SUPERVISION

ECB Annual Report on supervisory activities

2015

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Foreword of Mario Draghi, President of the ECB



Back in 2012, when it was decided to establish a single supervisory mechanism in the euro area, many a critic claimed that either it was impossible, or that it would take forever. And yet, we already celebrated the first anniversary of the Single Supervisory Mechanism (SSM) and look back on a very successful first year of European banking supervision.

Nevertheless, the SSM was neither the start, nor the end of the suite of institutional reforms that we must undertake to restore in Europe the stability that is the premise for a return to sustainable growth. But it was a crucial step and, in many ways, it was the key to going further.

In the early years of the euro, we lived under the illusion that we had established a full-fledged monetary union. However, as the vast majority of money is issued by private banks, there can only be a single currency if there is a single banking system. For a currency to be truly single, it has to be truly fungible, independent of its form and independent of its location. That requires stronger common governance of the banking sector in countries that share a currency.

The creation of the SSM was in part a response to that need. A single supervisor, applying homogenous methodologies, internalises mutual trust. And this not only provides greater protection for citizens, but also brings substantial benefits to member countries. Their financial institutions can fully exploit economies of scale within the Single Market.

This being said, banking union was conceived with three pillars: a single supervisory mechanism, a single resolution mechanism, and a uniform deposit insurance scheme. For a currency to be truly single, we need all three. Supervision had to come first because it was an essential precondition for the other pillars of banking union. At the beginning of 2016, the Single Resolution Mechanism (SRM) was set up as the second pillar. To complete our banking union we have to build the third pillar: uniform deposit insurance. Only then will we have constructed a stable building.

The banking union is not an objective per se, but an essential step in building a single European market for banking and financial services. Integrated and well-functioning banking and capital markets are vital conditions for a stable and successful euro and help to promote growth and employment, in the interest of all European citizens.

Foreword of Danièle Nouy, Chair of the Supervisory Board



When the first Annual Report was published in March 2015, the Single Supervisory Mechanism (SSM) was not even half a year old; it had a promising future but hardly any history. With this second issue of the Annual Report, we can look back on one-and-a-half years of European banking supervision¹; the SSM still has a promising future, but it also has an encouraging past.

Over the course of 2015, we made good progress in promoting the objectives of European banking supervision. We contributed to the safety and soundness of credit institutions and to the stability of the financial system. We also promoted the unity and integrity of the internal market based on equal treatment of credit institutions. The SSM fostered harmonisation, it followed an intrusive approach to banking supervision, and it intensified cooperation with European institutions and other supervisors, as well as communication. We have certainly not yet reached our objective of truly European banking supervision, but we have come much closer.

Fostering integration and harmonisation – past successes and future challenges

In 2015, European banking supervision took a great step towards harmonised and unbiased supervision by conducting a **euro area-wide Supervisory Review and Evaluation Process (SREP)** according to a common methodology. For the first time, all significant institutions in the euro area were assessed against a common yardstick. Quantitative and qualitative elements were combined through a constrained expert judgement approach, which ensured consistency, avoided supervisory forbearance and accounted for institutions' specificities. The common methodology greatly benefited from the previous experience and best practices of the national competent authorities (NCAs). Overall, and with a view to the coming years, the experience of the first harmonised SREP has been very encouraging.

Nevertheless, enhanced harmonisation of supervisory practices within the SSM cannot happen without a further harmonisation of the rules. The European regulatory framework – the CRR/CRD IV – offers more than 160 provisions where some discretion remains for supervisors or national governments to decide on the concrete implementation of the relevant European norms. Some of these “**options and national discretions**” (ONDs) cater for specific national features. Many of them, however, are the mere reflection of unquestioned traditions, pure national interest

¹ According to stylistic conventions used in English-language texts produced by the ECB, the Single Supervisory Mechanism (SSM) should generally be referred to as “European banking supervision”; the term “Single Supervisory Mechanism” may, however, still be used as a descriptor of how supervision is carried out (rather than by whom) and may also be retained in legal texts and narrative describing the banking supervision tasks and set-up.

and regulatory capture. They have material effects on the level of prudence of the framework and on the comparability of capital ratios. They also add an additional layer of complexity as well as a source of regulatory arbitrage.

In order to address this issue we set up a High-Level Group which identified about 120 ONDs which can be exercised by the ECB and where harmonisation is possible. These ONDs cover a wide range of topics such as the treatment of deferred tax assets, large-exposure intragroup exemptions and intragroup liquidity waivers. We have agreed on a single implementation of these national options and discretions for the entire euro area, aligning it with global standards or, if there is no such standard, adopting the most conservative approach. This gave rise to a regulation and a guide which were subject to public consultation and adopted by the ECB. The regulation will enter into force in October 2016. This is a major step towards a harmonised regulatory framework for the euro area.

Still, the regulatory framework remains fragmented to a certain degree. With regard to CRD IV, for example, Member States have interpreted several provisions differently. National legislation varies from strict word-for-word transpositions of European legislation to national gold-plating. And in some countries national legislators are increasing fragmentation even further by converting non-binding supervisory practices into binding legal acts.

It is the prerogative of national law-makers to transpose EU directives. Nevertheless, a fragmented regulatory framework is at odds with the overarching objectives of the banking union. At the same time, dealing with a wide array of different national legislations is far from ideal for the single European supervisor. Consequently, we actively encourage further **harmonisation of the regulatory framework** for the banking sector. As long as regulation remains fragmented, the convergence of supervisory practices cannot ensure a fully level playing field. In this regard, the SSM actively contributes to the work of the European Banking Authority (EBA) in establishing the single rulebook and the single supervisory handbook at the EU level.

The banking sector and supervisory activities in 2015

The starting point for our supervisory work in 2015 was provided by the results of the 2014 comprehensive assessment. This was enhanced by an analysis of the macroeconomic environment and an extensive analysis of the key risks for the banking sector. Based on that foundation, the Supervisory Board defined five priorities which guided our supervisory activities in 2015. These priorities were:

- business models and profitability drivers;
- governance and risk appetite;
- capital adequacy;
- credit risk;
- cyber risk and data integrity.

Throughout 2015, the Joint Supervisory Teams (JSTs) engaged in discussions with banks' senior management to clearly articulate the SSM's supervisory expectations and challenge the viability of **business models and profitability drivers**. Horizontal analyses on peer groups, taking into consideration specificities of different business models, were conducted by an expert group with strong involvement of NCAs.

On the issue of **governance and risk appetite**, an extensive thematic review was launched in March 2015 which fed into the SREP. The review was concluded in January 2016 with the issuance of follow-up letters for the institutions. As part of the supervisory cycle, the performance of the thematic review also allowed JSTs to identify follow-up supervisory actions for 2016 as well as areas for future on-site inspections. A report on the best practices identified during the thematic review will be published later in the year.

In 2015, **capital adequacy** was a priority which we addressed on an ongoing basis. The results of the comprehensive assessment gave the JSTs a good starting point for their follow-up. The work on ONDs represented a leap towards a more harmonised definition of banks' regulatory capital across the SSM. Another area of focus was the preparation of a targeted review of banks' internal models to make sure that they deliver the adequate risk-weighted assets (RWA) intensity. The objective is to ensure their compliance with regulatory standards and to foster their consistency across institutions. Over the course of 2015, a first stocktake has been conducted and a proposal for a targeted review of internal models over the coming years has been devised.

With regard to **credit risk**, a thematic review on leveraged finance was initiated in 2015. The objectives of the review were to obtain a better understanding of leveraged finance activities in supervised institutions, to assess the key drivers and dynamics of this market as well as to identify best practices. The review also aimed at enabling benchmarking of institutions with regard to leveraged finance. In addition, the Supervisory Board established a temporary task force to develop and implement a consistent supervisory approach towards supervised institutions with high levels of non-performing loans.

Regarding **cyber risk and data integrity**, a thematic review on IT cyber security was started in early 2015 with the objective of capturing the cyber risk profiles of the significant institutions and conducting a benchmarking exercise on the data gathered from banks. Initial results were used to identify banks where on-site inspections were to be carried out in 2015 and 2016. The Supervisory Board also approved an operating and communication model for cybercrime incidents and the setting-up of a cybercrime incident database. To support work in these areas, an expert group with involvement of NCAs was launched.

The European banking sector at the beginning of 2016

In the first quarter of 2016, the European banking sector experienced a deterioration of the global financial environment. Nevertheless, the European banking sector of today is very different from that of the past. First and foremost, the banks have

improved the quality and quantity of the capital they hold. Since 2012 the CET1 ratio of significant institutions in the euro area has risen, on average, from 9% to around 13%. These institutions are well prepared to meet the fully phased-in regulatory capital requirements that will be in effect from 2019 onwards. And with regard to supervisory capital requirements, European banking supervision has clearly stated the levels of Pillar 2 capital it expects the banks to hold in steady state. All things being equal, supervisory requirements will not be increased further.

Altogether, the European banking sector is much better prepared to cope with unexpected headwinds than just a few years ago. In addition, the significant institutions further increased their profits in 2015. Consequently, they were able to pursue appropriate distribution policies, while still meeting regulatory and supervisory capital requirements. This is also true with regard to distributions on Additional Tier 1 capital instruments.

However, there is still a subset of European banks that show elevated levels of non-performing loans. These loans were identified during the 2014 comprehensive assessment, using a harmonised definition for the first time ever. And equally important, these non-performing loans have been reasonably well provisioned for. We are therefore in a reasonably comfortable position to promote further progress in bringing down the levels of non-performing loans over the next few years in an orderly manner.

Finally, there has been a breakthrough concerning the structure of the banking system. With the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Board (SRB), we now have in place a resolution regime that allows for the orderly failure of banks. This regime ensures that the costs of resolution are no longer borne by taxpayers but by the shareholders and creditors of banks. Nevertheless, while the BRRD appropriately increases market discipline, the increase in spreads observed in the first quarter of 2016 does not appear justified in light of the much higher capital levels that banks hold.

Supervisory priorities for 2016

In 2016 business models and profitability drivers of banks will continue to be a major focus of activity for European banking supervision. Both are being challenged by the prolonged period of low interest rates and the high level of asset impairments. Further important elements of risks, whose importance varies across countries, include credit risk and heightened levels of non-performing loans as mentioned above, a reversal of the search for yield, conduct and governance risk, sovereign risk, geopolitical risk, growing vulnerabilities in emerging economies, as well as, once again, IT and cybercrime risk. Banks also need to prepare for new regulatory capital requirements.

These risks and challenges served as a point of departure for defining our supervisory priorities for 2016. As many of the key risks and challenges have not significantly changed since 2015, there is an overlap between our supervisory priorities for this year and last year. In addition, some priorities for 2015 were, from

the beginning, conceived over a time horizon of more than one year. Against this background, the SSM has adopted five **supervisory priorities** for 2016, which were made public at the beginning of 2016, namely:

- business model and profitability risk;
- credit risk;
- capital adequacy;
- risk governance and data quality;
- liquidity.

Business model and profitability risk remains a key priority in 2016. Building on the analyses performed in 2015, a thematic review has been started on bank's profitability drivers at the firm level and across business models. In this context, an area of supervisory focus will be to examine whether profitability is achieved, among other things, through a weakening of credit underwriting standards, greater reliance on short-term funding, or an increase in risk exposures.

Credit risk also remains a key priority. The deterioration in the credit quality of loans to corporates and households and in credit underwriting standards, as well as the persistently high level of non-performing loans, are a source of concern in a number of euro area countries, particularly those hard hit by the crisis. In addition to following up on the work started in 2015, ECB Banking Supervision will also investigate excessive risk concentrations in certain areas such as real estate. A strongly related issue is the implementation of the new accounting standard "IFRS 9 – Financial Instruments", which has a bearing on the measurement of credit impairments as well as the valuation of financial instruments. A relevant thematic review will be launched shortly.

Another priority for 2016 is **capital adequacy**. Of particular relevance in this regard are the consistency and quality of banks' Internal Capital Adequacy Assessment Processes (ICAAP) including their internal stress testing capabilities, and the conduct of supervisory stress tests such as the EU-wide stress test coordinated by the European Banking Authority. Further pivotal elements of supervision in 2016 are the follow-up on the quality and composition of banks' capital (also in relation to ONDs) as well as the examination of banks' preparedness for new regulatory standards such as the minimum requirement for own funds and eligible liabilities (MREL) and total loss-absorbing capacity (TLAC). The targeted review of banks' internal models and their RWA intensity will be another top priority in 2016 and subsequent years.

Banks' **risk governance and data quality** also remain a priority in 2016 against the backdrop of low profitability and a potential search-for-yield, paired with cheap and ample funding. Moreover, the financial crisis clearly showed that banks' governing boards often lacked the information they needed to make good business decisions. A priority now for the SSM is to clearly communicate supervisory expectations vis-à-vis banks in that respect. Furthermore, a thematic review will assess compliance with

the Basel Committee on Banking Supervision's (BCBS) principles for effective risk data aggregation and risk reporting. This review will also reinforce the follow-up actions to the SSM's 2015 thematic review of risk governance and risk appetite. Finally, ensuring data quality and security requires state-of-the-art IT infrastructure. IT risks will therefore be part of the analysis.

Finally, liquidity was added as a new supervisory priority in 2016. The experience of the 2015 SREP has shown that many banks do not yet fully meet supervisory expectations regarding sound management of liquidity risks. Consequently, the SREP methodology on liquidity risk is being developed further. This includes dissecting the robustness of the bank's liquidity coverage ratio and understanding the reliability of the bank's liquidity risk management and risk appetite as expressed through the Internal Liquidity Adequacy Assessment Process (ILAAP) or a comparable framework.

In many ways these priorities are valid for both the significant banks, which are directly supervised by the ECB, and less significant institutions, which are directly supervised by the NCAs and indirectly by the ECB. A consistent approach is ensured across the whole of the SSM in close coordination with the NCAs and in accordance with the principle of proportionality.

Consolidating the SSM model of supervision

The supervisory priorities for 2015 and 2016 emphasise the forward-looking nature of the SSM's approach to banking supervision. Our main objective is to address potential issues in a timely manner. Based on increased opportunities for benchmarking and peer comparison, we also promote **multiple perspectives on risk**. We aim to develop a deep understanding of the risk factors, risk appetite and business model of each institution, with due regard to the diversity of bank's business models within Europe. This is an obvious strength of a European banking supervisor.

What has been achieved so far is mainly thanks to the dedication and hard work of our teams. In 2016, we will continue to develop an **SSM team spirit** within the ECB and the NCAs. Such a team spirit is essential given that all the highly skilled people contributing to the SSM are employed by different authorities, located in different countries and engaged in a unique form of integrated cooperation. In line with the general request of EU legislators, we will continue to develop human resources policies on training, performance feedback and intra-SSM mobility in order to promote a common supervisory culture and a truly integrated supervisory mechanism.

Much work still lies ahead for the SSM in implementing best practices for independent, intrusive and forward-looking supervision that ensures a level playing field for banks in the euro area. As we gain experience and grow closer together, we will approach this objective at an increasing pace.

1 Organisational set-up: ECB Banking Supervision

During the first year of operations, the organisational set-up of ECB Banking Supervision² proved very well suited to support the work of the Single Supervisory Mechanism (SSM). Nevertheless, given the magnitude of the project and the shortness of the preparation phase, it would have been surprising if there had not been anything to improve. Consequently, steps have been taken to further enhance the organisational framework, and further steps will be taken in due course.

Given the high volume of decisions required within the SSM, a number of measures have been introduced to streamline the decision-making process. It also became clear over the first year of operations that a number of key tasks have higher than anticipated resource needs. Therefore, over the next two years, additional staff will be hired.

In order to ensure good governance, the Ethics Framework for all ECB staff was revised to reflect new tasks in banking supervision and entered into force on 1 January 2015. Simultaneously, a Compliance and Governance Office was established to advise staff and support the implementation of the framework. The separation of monetary policy and supervisory tasks at the decision-making level was also ensured throughout 2015, and no intervention by the Mediation Panel was necessary. The availability of high-quality data for supervisory purposes, as well as information management systems covering the whole SSM, was improved further.

1.1 Discharging of accountability requirements

This Annual Report has been prepared as one of the ECB Banking Supervision's main accountability channels in accordance with the SSM Regulation. The Regulation provides that the conferral of supervisory tasks on the ECB should be balanced by appropriate transparency and accountability requirements. Maintaining and fostering the [accountability framework](#) – established on the basis of the Interinstitutional Agreement between the European Parliament and the ECB and the Memorandum of Understanding between the EU Council and the ECB – continued to be among the ECB's priorities in 2015.

With regard to the European Parliament, in 2015, the Chair of the Supervisory Board spoke before the Parliament's Committee on Economic and Monetary Affairs for the presentation of the 2014 ECB Annual Report on supervisory activities (31 March), two ordinary public hearings (25 June and 19 October), and two ad hoc exchanges of views (25 June and 19 October). Among the key issues discussed were the

² According to stylistic conventions used in English-language texts produced by the ECB, the term "ECB Banking Supervision" denotes the ECB's supervisory arm.

“options and national discretions” in the CRR/CRD IV as well as the Supervisory Review and Evaluation Process (SREP). In the course of 2015, the ECB published on its website 26 replies to questions from MEPs on supervisory matters. The letters explained the legal framework as well as the ECB’s policies on a broad range of supervisory topics, such as the 2014 comprehensive assessment, the ECB’s supervisory actions, the proportionality of supervisory decisions and specific risks for supervised banks.

Moreover, in line with the Interinstitutional Agreement, the ECB transmitted the records of proceedings of its Supervisory Board meetings to the European Parliament.

With regard to the EU Council, in 2015, the Chair of the Supervisory Board attended two meetings of the Eurogroup in banking union composition: on 24 April the Chair presented the 2014 ECB Annual Report on supervisory activities, and on 7 December Ms Nouy attended an exchange of views on topics including the implementation of the supervisory framework, the harmonisation of the options and national discretions in the CRR/CRD IV and the 2015 comprehensive assessment.

As part of the reporting requirements under the SSM Regulation, representatives of the ECB involved in banking supervision had exchanges of views with national parliaments.

1.2 Decision-making

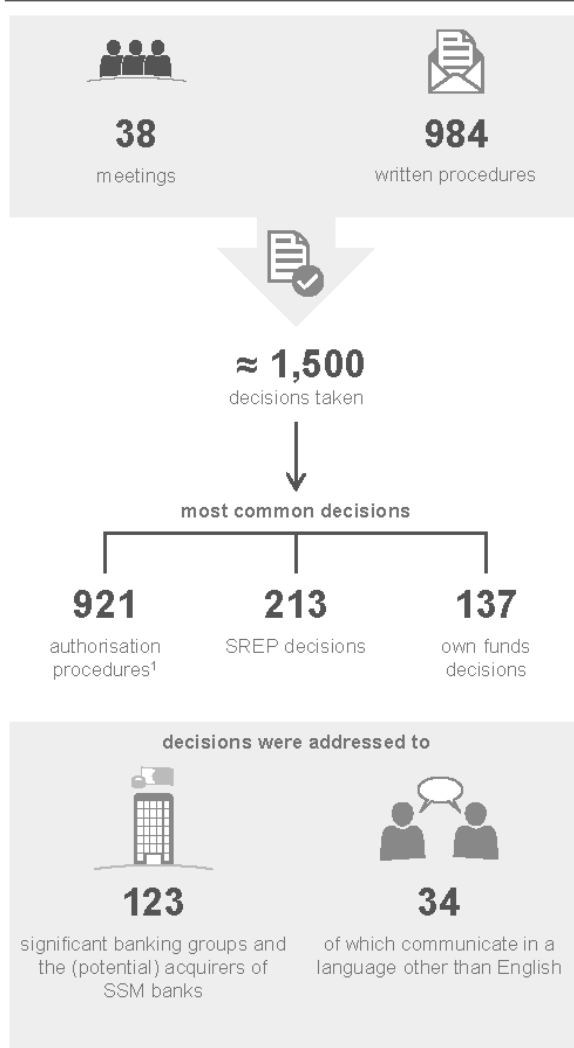
1.2.1 Supervisory Board and Steering Committee

2015 was the first full operational year of the SSM. A total of 38 meetings of the Supervisory Board took place, 22 of which were held in Frankfurt am Main and 16 were held via teleconference. In these meetings, the Supervisory Board discussed a wide variety of issues regarding both individual supervised banks and more general issues, such as the development of policy notes and common methodologies. In addition to meetings and teleconferences, the Supervisory Board can decide by written procedure³. In 2015, a majority of decisions were taken this way, in particular fit and proper decisions.

The ECB adopted a large number of decisions regarding individual banks (see Figure 1). This requires an efficient governance of the decision-making process. The individual draft decisions need to be submitted to the Supervisory Board for approval and thereafter to the Governing Council, for final adoption under the non-objection procedure. Furthermore, not all supervised banks have agreed to receive formal

³ Under Article 6.7 of the Supervisory Board’s Rules of Procedure, decisions may also take place by written procedure, unless at least three members of the Supervisory Board having a voting right object. In such case, the item is put on the agenda of the subsequent Supervisory Board meeting. A written procedure requires normally not less than five working days for consideration by the Supervisory Board.

Figure 1
Key figures on the activities of the Supervisory Board



Notes: The numbers in this figure relate to individual supervisory decisions addressed to supervised entities or their potential acquirers. In addition, the Supervisory Board took decisions on a number of horizontal issues (e.g. common methodologies) and institutional issues.

1) The 921 decisions on authorisation procedures cover more than 2,000 individual procedures (see Section 3.1.2).

ECB decisions in English: for 34 banks the decisions were transmitted in another EU official language.

Although ECB Banking Supervision is based on EU law, in particular the CRR/CRD IV, Member States have transposed CRD IV into national legislation in diverse ways. This poses another operational challenge for decision-making, since expertise on each of the 19 different national legislative frameworks is necessary also at the central level. And the regulatory framework is still being fragmented even further, as some countries are converting non-binding supervisory practices into binding legal acts. In addition, national transpositions of CRD IV and national regulatory requirements that go beyond the European norms have, in specific cases, led to a debate about the ECB's exact supervisory powers. In a number of cases, this has led the ECB to exercise supervision through instructions to national competent authorities (NCAs).

In 2015 a number of steps were taken to streamline the decision-making process. In order to manage the high volume of proposed decisions, possibilities for delegation will be further explored.

In addition to the bank-specific decisions, the Supervisory Board decided on several horizontal issues, most notably the application of common methodologies and frameworks in specific areas of its supervision. In three cases, the Supervisory Board mandated temporary structures (two high-level groups and a task force), consisting of senior managers from the ECB and the NCAs, to carry out preparatory work, respectively, on (i) the exercise of options and discretions in EU law; (ii) the SREP methodology; and (iii) a consistent supervisory approach towards supervised institutions with high levels of non-performing loans.

Supervisory Board



First row (front row, from left to right)
Alexander Demarco, Jouni Timonen, Cyril Roux, António Varela

Second row (from left to right)
Andreas Dombret, Fabio Panetta, Julie Dickson, Luc Coene, Danièle Nouy, Sabine Lautenschläger, Anneli Tuominen, Stanislava Zdravec Capriolo, Jan Sijbrand

Third row (from left to right)
Mathias Dewatripont, Vladimír Dvořáček, Robert Ophèle, Ignazio Angeloni, Karol Gabarretta, Yiángos Demetriou, Claude Simon, Fernando Restoy Lozano, Zoja Razmusa

Fourth row (from left to right)
Raimund Röseler, Andreas Ittner, Andres Kurgpõld (alternate for Mr Kessler), Helmut Ettl, Ingrida Šimonytė, Norbert Goffinet, Ilias Plaskovitis

Chair	Danièle Nouy	Cyprus	Yiángos Demetriou (Central Bank of Cyprus)
Vice-Chair	Sabine Lautenschläger	Latvia	Kristaps Zakulis (Finanšu un kapitāla tirgus komisija) (until 28 January 2016) Pēters Putniņš (Finanšu un kapitāla tirgus komisija) (since 15 February 2016) Zoja Razmusa (Latvijas Banka)
ECB representatives	Ignazio Angeloni Luc Coene (since 11 March 2015) Julie Dickson Sirrka Hämäläinen	Lithuania	Ingrida Šimonytė (Lietuvos bankas)
Belgium	Mathias Dewatripont (Nationale Bank van België/Banque Nationale de Belgique)	Luxembourg	Claude Simon (Commission de Surveillance du Secteur Financier) Norbert Goffinet (Banque centrale du Luxembourg)
Germany	Elke König (Bundesanstalt für Finanzdienstleistungsaufsicht) (until 28 February 2015) Felix Hufeld (Bundesanstalt für Finanzdienstleistungsaufsicht) (since 1 March 2015) Andreas Dombret (Deutsche Bundesbank)	Malta	Karol Gabarretta (Malta Financial Services Authority) Alexander Demarco (Bank Centrali ta' Malta/Central Bank of Malta)
Estonia	Kiivar Kessler (Finantsinspeksioon) Madis Müller (Eesti Pank)	Netherlands	Jan Sijbrand (De Nederlandsche Bank)
Ireland	Cyril Roux (Central Bank of Ireland/Banc Ceannais na hÉireann)	Austria	Helmut Ettl (Finanzmarktaufsicht) Andreas Ittner (Oesterreichische Nationalbank)
Greece	Vassiliki Zakka (Bank of Greece) (until 31 July 2015) Ilias Plaskovitis (Bank of Greece) (since 31 July 2015)	Portugal	António Varela (Banco de Portugal) (until 7 March 2016)
Spain	Fernando Restoy Lozano (Banco de España)	Slovenia	Stanislava Zdravec Capriolo (Banka Slovenije)
France	Robert Ophèle (Banque de France)	Slovakia	Vladimír Dvořáček (Národná banka Slovenska)
Italy	Fabio Panetta (Banca d'Italia)	Finland	Anneli Tuominen (Finanssivalvonta) Kimmo Virolainen (Suomen Pankki – Finlands Bank) (until 1 January 2016) Jouni Timonen (Suomen Pankki – Finlands Bank) (since 1 January 2016)

The Steering Committee, which includes eight members of the Supervisory Board, supports its activities and prepares its meetings, held 22 meetings in 2015: 19 meetings were held in Frankfurt am Main, 3 meetings via teleconference⁴. In April, the first rotation of the five NCA members, who are appointed for a one-year term, took place.

1.2.2 Activities of the Administrative Board of Review

In 2015 **eight requests** for an administrative review of ECB supervisory decisions were filed with the Administrative Board of Review⁵. The Administrative Board adopted six opinions: two proposing to maintain the initial decision and four proposing to amend it or to improve the reasoning. The other two requests were withdrawn by the applicants.

Procedure and scope of the Administrative Board's reviews

From a procedural point of view, the organisation of an **oral hearing** of the applicant(s), which is a possibility under the Administrative Board's Operating Rules⁶, has proven to be an important element of the review process. It gives the applicants, who are often represented by their senior management, the opportunity to be heard by the Administrative Board of Review and the ECB the opportunity to present its views.

In the two cases where a request for review was withdrawn before the Administrative Board issued an opinion, the Board, including its Secretariat, contributed to the **resolution of issues** to the satisfaction of both the applicant(s) and the ECB, by playing a mediation role between the ECB and the applicant(s).

As stated in Article 24.1 and Recital 64 of the SSM Regulation, the scope of the Administrative Board's review should pertain to the procedural and substantive conformity of ECB decisions with the SSM Regulation while respecting the **margin of discretion left to the ECB**. Where the ECB has exercised this discretion, the Board's review has been limited, in accordance with the case-law of the Court of Justice of the European Union, to establishing whether the contested decision was impaired by a manifest error or misuse of powers and whether or not it clearly exceeded the bounds of the ECB's discretion. The Board has also verified whether the relevant procedural rules were complied with and whether the facts on which the disputed decisions were based were accurately stated.

⁴ See Article 26(10) of the SSM Regulation.

⁵ The Administrative Board of Review is composed of five members: Jean-Paul Redouin (Chair), Concetta Brescia Morra (Vice-Chair), F. Javier Aristegui Yáñez, André Camilleri and Edgar Meister, and two alternates: René Smits and Kaarlo Jännäri (until 6 November 2015)/Ivan Šramko (since 3 February 2016).

⁶ Decision of the European Central Bank of 14 April 2014 concerning the establishment of an Administrative Board of Review and its Operating Rules (ECB/2014/16).

Topics under review and issues of relevance

The Administrative Board of Review dealt with the following main topics in the course of the examination of the decisions under its review: scope of the consolidated supervision (e.g. the powers of the ECB vis-à-vis the holding company as parent of a banking group; the status of joint ventures in banking groups); and corporate governance rules, in particular regarding the separation between supervisory and management functions within the credit institutions.

In dealing with these topics, the Administrative Board has observed a **lack of harmonisation in the implementation of European law at national level** in areas such as bank consolidation or fit and proper requirements. In examining the requests for review, the Board noted that, in allowing a broad range of interpretation among the credit institutions, these differences make it challenging to review ECB decisions in a consistent manner.

Finally, the Administrative Board of Review had the opportunity to underline the **importance of good internal governance** of credit institutions, particularly as regards the responsibility of the management body in building a first line of control within the credit institution.

1.3 ECB Banking Supervision staffing

1.3.1 Staffing in 2015

The recruitment process for ECB Banking Supervision was carried out successfully. A critical mass of new employees was recruited in time to go live in November 2014. By the end of 2014 approximately 85% of them had been recruited out of the 1,073.5 full-time equivalents (FTEs)⁷ approved for 2015, with 769 approved positions for the five ECB business areas dealing with banking supervision and 304.5 FTEs for the related shared services⁸. In the course of 2015 the recruitment of the remaining positions continued, with approximately 96% of the approved positions filled by the end of the year. In addition to the above FTEs, which refer to permanent or fixed-term contracts, ECB Banking Supervision relied on 40.5 FTEs on short-term contracts.⁹

Chart 1 illustrates the breakdown of the approved headcount positions for the five ECB business areas dealing with banking supervision as at 31 December 2015.

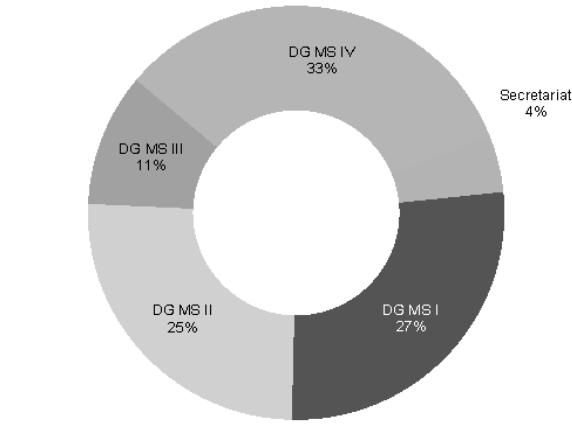
⁷ Of these, 984.5 FTEs are permanent positions and 89 FTEs are limited positions.

⁸ ECB business areas, such as IT, human resources, budget, legal, statistics, communications and administration, which provide services to ECB Banking Supervision in the same way as they do for other ECB tasks.

⁹ Short-term contracts can run up to 12 months and cannot be extended beyond the one-year duration. Such contracts typically aim to provide the ECB with the flexibility to respond to urgent and short-term needs.

Chart 1

Approved headcount positions for ECB Banking Supervision as at 31 December 2015 – FTE-breakdown



Since the launch of recruitment for ECB Banking Supervision in 2013, there have been a total of 113 recruitment campaigns, which have generated more than 25,000 individual applications.

The recruitment campaign was organised in a transparent, competitive and top-down fashion in order to allow managers to recruit their own teams. The selection was tailored to recruiting employees with the highest level of ability, efficiency and integrity. In the very demanding recruitment process, all candidates had to demonstrate not only the required sound technical competencies, but also their behavioural competencies and managerial skills, as appropriate. A variety of tools and techniques were used to assess the skills and competences required for the open positions, including online testing, written exercises, presentations and structured interviews.

The recruitment process aims at ensuring a mix of nationalities, age, gender and backgrounds. Of the colleagues recruited, 38% were female and 62% were male. The new staff have brought with them a variety of professional experience, with the majority coming from a central banking/supervisory environment.

Regarding gender diversity, the distribution is the following as shown in Table 1:

Table 1
Gender diversity in ECB Banking Supervision

% of female staff/total staff	38%
% of female staff in non-managerial positions/total non-managerial positions	40%
% of female staff in managerial positions/total managerial positions	31%

1.3.2 Review of resources for ECB Banking Supervision (decisions taken in 2015 for implementation in 2016)

The original headcount for ECB Banking Supervision was estimated in 2013 on the basis of best efforts and assumptions. At that stage, however, the organisation was still in its start-up phase and only limited direct operational experience was available. As the ECB increased its understanding of the banks it supervises with nearly a year of supervisory experience, it became clear that more resources than anticipated were required for a number of key tasks.

For example, it was necessary to reinforce the staffing related to the direct supervision of significant banks, most notably for the small and medium-sized significant banks and banking groups to ensure an adequate minimum engagement level in the Supervisory Examination Programme (SEP), also in the light of the

banks' risk profiles. Moreover, for all directly supervised banks, irrespective of their size, but taking into account qualitative criteria, resources are required, among other things, for (i) methodology upgrades, (ii) on-site inspections, and (iii) the review of internal models.

In September 2015, the ECB's Governing Council decided to increase the relevant headcount over the next two years. For 2016, positions in the supervision-related business areas will increase by 160 (permanent and limited) FTEs¹⁰. Regarding the (most likely substantially smaller) increase in 2017, further reflections will be undertaken and a decision will be made in the course of this year.

The 2016 recruitment phase has already started with the first vacancy notices being published in October 2015 in order to fill the new headcount as early as possible. The recruitment campaigns are organised in a transparent, competitive, and top-down manner, starting with managerial and adviser positions. The selection of candidates aims at recruiting employees with the highest level of ability, efficiency and integrity. In line with the ECB's standard recruitment procedure, all candidates will have to demonstrate not only the required sound technical competencies, but also their behavioural competencies and managerial skills, as appropriate.

1.3.3 Other initiatives concerning staffing

The ECB has amended its traineeship rules to allow young graduates to perform a part of their traineeship in up to two NCAs in addition to their stay at the ECB. The mobility of trainees across institutions within the SSM offers pan-European work experience to young graduates, thereby contributing to a common European banking supervision culture and creating a pool of young talents for the whole system. The first SSM traineeship programme was launched in 2015 with the aim of fostering collaboration within the SSM. In April 2016, 38 trainees, who were selected out of approximately 1,000 applications, will commence their assignments.

1.4 Implementation of the Code of Conduct

Under Article 19(3) of the SSM Regulation, the ECB was required to establish and publish a Code of Conduct for ECB staff and management involved in banking supervision. On 1 January 2015 the ECB's revised Ethics Framework entered into force and a Compliance and Governance Office was established to implement it and advise all ECB staff on ethical issues.

Throughout 2015, more than 1,300 requests were received from all ECB staff members by the Compliance and Governance Office relating to a wide range of topics (including private financial transactions, gifts and hospitality, external

¹⁰ The number is composed of 125 permanent positions and 35 limited positions. The ratio of limited positions to permanent ones for the new roles is 24%, far higher than the 8% ratio for the existing approved headcount. Additional resources were approved for the shared services, namely 43 positions (of which 29 permanent and 14 limited).

activities). The Compliance and Governance Office identified a limited number of instances of non-compliance with the revised Ethics Framework, one-third of which related to staff and management involved in banking supervision. None of those instances – mainly relating to (perceived) conflicts of interest – involved any intentional misconduct by ECB Banking Supervision staff.

Of those members of staff and management involved in banking supervision who resigned from their post in the course of 2015, one case triggered a cooling-off period in line with the revised Ethics Framework.

With a view to ensuring high ethics standards among the constituent components of the SSM, the ECB's Governing Council adopted a [Guideline](#) in March 2015 setting out the common principles of an Ethics Framework for both the ECB and NCAs. A dedicated task force supports the Governing Council in implementing these principles for an adequate corporate and ethics culture across the SSM.

A high-level Ethics Committee, which was also established in 2015 to advise members of the bodies involved in the ECB's decision-making processes, issued SSM-related advice on two occasions; in both cases the matter concerned activities undertaken in a personal capacity.

1.5 Application of the separation principle between monetary policy and supervisory tasks

In the course of 2015, application of the separation principle between monetary policy and supervisory tasks mainly affected the exchange of information between different policy areas¹¹. In line with [Decision ECB/2014/39 on the implementation of separation between the monetary policy and supervision functions of the ECB](#), exchange of information was subject to a need-to-know requirement, i.e. each policy area had to demonstrate that the information requested was necessary to achieve its policy objectives. The majority of cases did not relate to individual banks' data and access to confidential information was granted directly by the ECB policy function owning the information; intervention by the Executive Board to solve possible conflicts of interest was not necessary.

Under [Decision ECB/2014/39](#), the involvement of the Executive Board was nonetheless required in a few instances to allow the sharing of non-anonymised FINREP and COREP data¹², and other raw data. Such exchanges of information mainly concerned credit institutions located in programme countries. Access to the data was granted temporarily to ensure that the need-to-know requirement was fulfilled at all relevant points in time.

¹¹ Decision ECB/2014/39 also contains provisions relating to organisational aspects.

¹² FINREP (FINancial REPorting) and COREP (COMmon REPorting) form part of the EBA's Implementing Technical Standards (ITS). FINREP deals with the collection of financial information from banking institutions; it represents a standardised format of their annual accounts (balance sheet, profit and loss and detailed annexes). COREP deals with the collection, also in a standardised format, of information relative to the Pillar 1 calculation, i.e. details on own funds, deductions and capital requirements (credit, market and operational risk) as well as large exposures.

Separation at the decision-making level did not raise concerns and no intervention by the Mediation Panel¹³ was required.

1.6 Data reporting framework and information management

1.6.1 Developments within the data reporting framework

Data quality and firm-wide risk data aggregation as well as risk reporting capabilities are an essential precondition for sound, risk-based decision-making in banks. Together, they determine the quality of risk governance. Against this backdrop and in line with the SSM's supervisory priorities for 2015, data quality scores and metrics were developed. They help the SSM to implement the principles for effective risk data aggregation and risk reporting set by the Basel Committee on Banking Supervision.

To accommodate the need for timely, high-quality and granular data, the SSM relies on a "sequential approach", with NCAs being the first port of call for data collection and data quality control. The experience made throughout 2015 revealed that harmonised procedures throughout the SSM jurisdictions are a prerequisite for high-quality data and a vital first layer of quality control. Consequently, the ECB and the NCAs have initiated work to increase harmonisation in the sequential approach.

In addition, a second layer of **quality control** has been established within the ECB. These controls assist in the application of the same data quality standards across all supervised institutions. The controls also provide supervisors with clear indications on the level of data quality controls and processes performed by the reporting institutions themselves, as required by the CRD IV.

In that context, the connectivity of the **Supervisory Banking data system (SUBA)** was extended to improve communication with NCAs. To fill the data gaps not covered by regular reporting, the Agile Collection Environment project and the Stress Test Accounts Reporting (STAR) project were launched. They will serve to meet future data requirements filed by the ECB for the fulfilment of both its macro- and microprudential functions. To further strike a balance between the availability of complete, consistent and regular reporting and the avoidance of an undue reporting burden, additional requirements effectively implement the principle of proportionality and will be communicated with reasonable advance notice.

ECB Regulation on reporting of supervisory financial information

The **ECB Regulation on reporting of supervisory financial information (ECB/2015/13)** was adopted on 17 March 2015. In accordance with the SSM Regulation, the draft regulation had been submitted for public consultation in 2014. The regulation

¹³ Established by virtue of Regulation ECB/2014/26 with a view to ensuring the separation between monetary policy and supervisory tasks, as required under Article 25(5) of the SSM Regulation.

permanently and in a harmonised fashion closes some of the data gaps in supervisory reporting. In particular, it extends the harmonised regular reporting of financial information to the consolidated reports of banks under national accounting frameworks, as well as reports on an individual basis, for example for supervised entities that are not groups.

The Regulation respects the principle of **proportionality** by distinguishing between different groups of reporters depending on whether they are significant or less significant, reporting on a consolidated or individual basis and whether their total assets are above or below a materiality threshold of €3 billion.

The Regulation does not affect the **accounting standards** applied by supervised groups and entities in their consolidated or annual accounts, nor does it change the accounting standards applied to supervisory reporting.

The Regulation uses templates designed by the EBA that form part of Commission Implementing Regulation (EU) No 680/2014. In particular, there are dedicated national GAAP reporting templates that harmonise the reporting of entities under these accounting standards while respecting their differences vis-à-vis IFRS. In addition, the ECB is collaborating with the NCAs to provide national GAAP banks with further guidance to facilitate their reporting.

1.6.2 Developments in information management

The activities of the SSM rely on the availability of IT tools to support supervisors located both at the ECB and NCAs in their day-to-day work. The systems that were implemented before the SSM's official start on 4 November 2014 played a key role in supporting its first supervisory cycle. Of particular note in this context is the **IMAS system (Information Management for SSM)**, which has become a crucial element in supporting central SSM processes and ensuring a harmonised supervisory approach across all euro area countries.

Over the course of 2015, IMAS has been enhanced significantly. In particular, it has been embedded in a supervisory portal acting as a single point of entry to all information resources and IT tools used within the SSM.

2 Supervisory contribution to financial stability

In 2015, with the highest risks for banks across the euro area relating to business models and profitability drivers, the profitability of euro area banks improved, largely driven by more stable macroeconomic conditions and low costs of funding. However, part of the improvement was also due to one-off gains. Moreover, for a large number of banks in the euro area, profitability still remained below the estimated cost of equity.

Greece again took centre stage after political uncertainty led to severe liquidity constraints for Greek banks. While the banks' liquidity position was ensured through emergency liquidity assistance (ELA), their solvency position also deteriorated over the course of 2015. In order to limit the impact of the crisis, a number of supervisory measures were taken, including the conduct of a comprehensive assessment for the four significant institutions in Greece. The capital shortfalls arising from the asset quality review (AQR) and baseline scenario were covered by private investors, while, in some cases, additional state aid was needed to cover the capital needs arising from the adverse scenario.

In 2015, great steps were taken towards harmonising European banking supervision by applying a harmonised methodology for the Supervisory Review and Evaluation Process (SREP). For the first time ever, all significant institutions in the euro area were assessed against a common yardstick. The harmonised SREP will certainly play a major role in making banks more resilient. The ECB also contributed to the establishment of a crisis management framework for banking union. That framework is based on the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM). It will ensure that potential bank failures are handled smoothly and crises prevented to the extent possible.

Regarding macroprudential policy, 2015 was also the first full year in which the ECB performed its competencies in that field. Nevertheless, given the current stage in the financial cycle, the ECB's Governing Council saw no need in 2015 to adopt broad-based countercyclical macroprudential measures.

2.1 Credit institutions: main risks and general performance in 2015

2.1.1 Main risks in 2015

For 2015, among the main risks faced by the euro area banking sector, **business model sustainability and low profitability** was ranked the highest¹⁴. The relevance of the other identified risks varied across euro area countries. This section provides an overview of some of the main risks in 2015, which for the most part remain relevant in 2016.

In 2015, both business models and the profitability of banks were challenged, in particular by a high level of impaired assets and the protracted period of low interest rates. Profits continued to be under pressure, with the average return on equity remaining below the cost of capital. Low profitability may impact the medium-term sustainability of some banks' business models, and hinder their capability to generate capital and access financial markets. The profitability of the banking sector was hampered by a number of challenges. The most important factor is the low nominal growth and low interest rate environment, which affects traditional banking activities (such as retail lending) relying on maturity transformation. Moreover, the stock of legacy problem assets is also a drag on profitability.

Credit risks were not a cause for concern in all euro area countries, but remain an issue for most of the countries that have been hit hard by the financial crisis. Credit risks include the deterioration of credit quality of loans to SMEs, corporates or households and the deterioration of credit standards.

The current environment of historically low risk premia and investors searching for yield harbours a potential for an abrupt reversal of global risk premia. This can affect banks in several ways. First, their security holdings might need to be revalued, leading to losses particularly for the assets measured at fair value. Second, lower asset prices may lead to higher collateral requirements, affecting banks with a large proportion of secured funding. Third, for banks that rely heavily on wholesale funding, higher risk premia are likely to translate into higher funding costs. Finally, for banks with significant capital market activities, higher volatility could hamper profitability. One indicator for compressed risk premia is the risk-adjusted yields on sovereign bonds. These have been decreasing since 2006, implying that investors accept lower returns for the same level of risk. Other signs of investors accepting lower returns were an observed flattening of the yield curve and narrowing credit default swap (CDS) spreads between high-yield and investment grade bonds.

Conduct and governance risks – also with regard to moral and ethical standards – have also been highlighted as being among the most important risks. Several euro area banks have been prosecuted and fined in recent years for violations of rules, laws and standards, with consequences for their profits and reputation. Other

¹⁴ ECB Banking Supervision assesses the key risks to which credit institutions are exposed in close collaboration with the NCAs, leveraging on the input from the Joint Supervisory Teams (JSTs), the other functions of the ECB, and the European Systemic Risk Board (ESRB).

litigation cases are still pending and may create uncertainties with respect to future costs for the banks involved. Prominent cases of misconduct are related, inter alia, to mis-selling, market manipulation, money-laundering, tax fraud and violations of U.S. sanctions.

Geopolitical tensions in Russia and Ukraine as well as growing vulnerabilities in China and emerging market economies posed risks – not only through direct exposures of banks, but also through contagion effects. Direct exposures are limited to a few significant institutions, while second-round effects from financial or macroeconomic linkages could harm the euro area banking system as a whole.

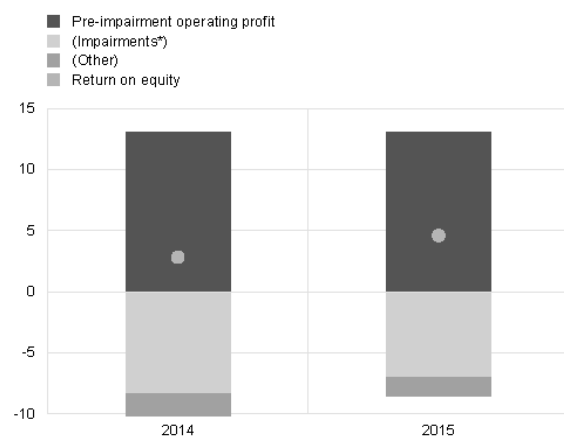
Cost-cutting programmes as well as increased reliance on IT solutions and their increasing complexity affect the soundness of banks' IT systems and expose them to **cybercrime**. The ensuing risks could lead to operational losses, reputational damage and business disruption. Indirectly, poor IT systems could have a detrimental effect on the quality of management reporting and hamper flexibility in adapting to new requirements. Another issue is that **data quality** for internal and external reporting might be insufficient, in turn leading to a misperception of risks inherent in the institutions' operations.

2.1.2 General performance of significant banks in 2015

Chart 2

Decreasing impairment still one of the main drivers in the improvement of significant banks' profitability in 2015

(All items are weighted averages displayed as a percentage of equity)



* Q3 2015 data annualised
Source: FINREP framework (101 significant institutions reporting IFRS data at the highest level of consolidation).

Over the course of 2015, the profitability of significant banks improved, albeit from very low levels: preliminary figures show that, on aggregate, the return on equity of a representative sample of 101 institutions stood at 4.6% at the end of 2015, up from 2.8% a year earlier (see Chart 2), but well below cost-of-equity benchmarks (8% according to recent estimates, see the [ECB's Financial Stability Review](#) of November 2015).

The improvement was largely due to the stabilisation of macroeconomic conditions, which reduced credit losses: impairments on loans and other financial assets decreased from 7.7% of aggregate equity in 2014 to 5.9% in 2015. While the improvement was felt across the entire euro area, the level of credit losses remained very heterogeneous among jurisdictions. At the same time, impairments of non-financial assets, such as goodwill, increased from 0.7% to 1.0% of aggregate equity between 2014 and 2015, as banks continued efforts to align pre-crisis valuations to current market conditions.

Table 2
Significant banks in the euro area

	Total assets (in € billions)	Risk-weighted assets (in € billions)	CET1 capital (in € billions)	CET1 ratio (in percentages)	Cost-income ratio (in percentages)
SSM SIs	21,573	8,046	1,027	12.77	61.50
SSM G-SIBs	11,247	3,980	474	11.92	63.88
All EU G-SIBs	17,669				
Worldwide G-SIBs	41,929				

Notes: All figures as at end-September 2015; G-SIBs stands for global systemically important banks (for the SSM area: BNP Paribas, Deutsche Bank, BBVA, Groupe BPCE, Groupe Cr dit Agricole, ING Bank, Santander, Soci t  G n rale and Unicredit Group).

Net interest income, the main source of revenues for significant banks, proved rather resilient in 2015 despite the low-interest rate environment: on aggregate, lower costs of funding fully offset the negative impact of low rates on interest income. Interest income itself was partly supported by a moderate growth in the stock of loans to households and corporates (+2.6%), concentrated in the largest institutions. Similarly, fee income grew in absolute terms, on account of asset management and private banking activities.

Costs grew in line with revenues: the average cost-to-income ratio remained stable at 63.3%.

Finally, part of the improvement in banks' profitability was due to mark-to-market profits and capital gains on the disposal of bond portfolios, one-off gains which might not be repeated in the coming quarters.

2.2 Involvement in crisis management

2.2.1 Involvement in the Greek crisis, including the comprehensive assessment of its significant institutions

As from early December 2014, political uncertainty in Greece led to severe liquidity constraints for its banks, resulting from: (i) significant deposit outflows; (ii) short-term wholesale funding (secured and unsecured) not being rolled over; (iii) increasing liquidity needs of foreign subsidiaries and branches; and (iv) high exposures to public sector borrowers, which were deemed less sustainable given the circumstances. As a result, Greek banks significantly increased their recourse to ELA in the first half of 2015, which only stabilised at the end of June 2015 following the bank holiday and the implementation of capital controls.

The solvency position of the four Greek significant institutions also deteriorated over the course of 2015, in particular during the second quarter, when a significant amount of provisions was allocated in anticipation of the outcome of the comprehensive assessment.

Comprehensive assessment of the four Greek significant institutions

Against this backdrop, a comprehensive assessment of the four Greek significant institutions was carried out by the ECB in order to provide a forward-looking assessment of their capital needs. This comprehensive assessment was requested from the ECB in its supervisory function following a Memorandum of Understanding signed on 19 August 2015 by the European Stability Mechanism, the Hellenic Republic and the Bank of Greece. It consisted of an AQR and a stress test and was carried out between early July and the end of October 2015.

The **AQR** was a point-in-time assessment of the accuracy of the carrying value of banks' assets as of 30 June 2015 and provided a starting point for the stress test. The AQR required Greek banks to reach a minimum Common Equity Tier 1 (CET1) ratio of 9.5%. The **stress test** provided a forward-looking examination of the resilience of banks' solvency to two hypothetical scenarios: under the baseline scenario, banks were required to maintain a minimum CET1 ratio of 9.5%; under the adverse scenario, they were required to maintain a minimum CET1 ratio of 8%.

Regarding the methodology applied, the AQR was based on uniform and harmonised definitions which respected current accounting and prudential regulations. It was also in line with the AQR methodology applied in the euro area-wide comprehensive assessment of 2014. In some areas, the ECB's methodology involved additional assumptions to better reflect the market conditions, for example as regards impairment triggers, the calculation of individual specific provisions and collateral valuations. The stress test was undertaken centrally, based on data templates and loan tapes provided by the banks. The projections were produced by the ECB. Supervisory dialogue meetings took place with each of the four banks, where preliminary results of the comprehensive assessment were shared and discussed.

Table 3
Outcome of the comprehensive assessment of four Greek significant institutions

	CET1 ratio starting point pre-AQR	CET1 ratio starting point post-AQR	CET1 ratio baseline scenario ¹	CET1 ratio adverse scenario	Max. capital shortfall (adverse scenario)	
					(in basis points)	(in € billions)
Alpha Bank	12.7%	9.6%	9.6%	2.1%	590	2.74
Eurobank	13.7%	8.6%	8.7%	1.3%	670	2.12
National Bank of Greece	11.6%	8.1%	7.3%	-0.2%	822	4.60
Piraeus Bank	10.8%	5.5%	5.2%	-2.3%	1 035	4.93
<i>Aggregate</i>	12.1%	7.9%	7.6%	0.1%		14.40

¹) The CET ratios shown for the baseline and adverse scenarios are the ratios as of December 2017 and, for the baseline scenario, do not necessarily reflect the lowest ratios over the 2.5 year horizon of the stress test.

The final results were used as the basis for the **recapitalisation process** at end-2015, which included a complete coverage of the shortfalls identified in the comprehensive assessment. The outcome of the 2015 comprehensive assessment, released at the end of October, showed an aggregated capital shortfall for the four Greek significant institutions of €4.4 billion in the stress test's baseline scenario

(threshold of 9.5% CET1) and €14.4 billion in the adverse scenario (threshold of 8.0% CET1).

In order to satisfy the capital needs identified in the comprehensive assessment, banks were requested to present a capital plan to the ECB explaining how they would cover the identified capital shortfalls. The measures proposed in the plans had to be implemented by 11 December 2015. Two institutions were able to raise sufficient capital from private investors to cover their total shortfall, while the other two institutions received additional state aid under the precautionary recapitalisation framework described in Directive 2014/59/EU, which establishes a framework for the recovery and resolution of credit institutions and investment firms. This public support was aimed at covering the capital needs arising from the adverse scenario of the stress test; the needs arising from the AQR and/or the baseline scenario of the stress test had already been covered by the private sector.

Close monitoring of the Greek banking system and supervisory actions to limit the impact of the crisis

In addition to the comprehensive assessment, the supervisory work in 2015 continued to focus on three complementary activities:

1. close monitoring of the main risks within the Greek banking system;
2. ongoing exchange of information and reporting to the stakeholders involved in issues regarding the Greek banks;
3. actions to limit the impact of the crisis.

In 2015 the supervisory activity continued to be very intense, requiring close monitoring by the JSTs (composed of staff from the ECB and the Bank of Greece) in cooperation with the ECB's Crisis Management Division. For the monitoring of less significant institutions, the ECB's Directorate General Microprudential Supervision III also worked closely with the Bank of Greece, which conducted a comprehensive assessment of these banks.

In order to facilitate the exchange of information and smooth cooperation, ECB Banking Supervision fostered close contacts with all relevant stakeholders: the Greek authorities, including the Bank of Greece and the Hellenic Financial Stabilisation Fund, the European Banking Authority (EBA) as well as host supervisors (from the United Kingdom, Bulgaria, the former Yugoslav Republic of Macedonia, Romania, Serbia and Turkey).

Over the course of 2015, several supervisory actions were put in place to deal with the difficult situation affecting the Greek banking sector and limit the impact of the crisis. These actions included: decisions to safeguard the liquidity position of the four significant institutions, for example restricting some investments and businesses as well as efforts to ensure that contagion did not spread to the foreign entities of Greek

banks, paying particular attention to the liquidity of their subsidiaries and branches abroad.

2.2.2 Contributing to the new EU crisis management framework

In 2015, ECB Banking Supervision contributed to the establishment of the EU crisis management framework, based on the BRRD and the Single Resolution Mechanism Regulation.

The EU crisis management framework creates a duty for supervisory and resolution authorities to cooperate. On the one hand, the ECB as a competent authority should cooperate closely with the **Single Resolution Board (SRB)** in recovery planning, the implementation of early intervention measures and the assessment of banks that are failing or likely to fail. On the other hand, the SRB is required to cooperate with the ECB in resolution planning and the assessment of a bank's resolvability, as well as in the implementation of resolution measures.

Close cooperation was initiated with the SRB, which was established in January 2015 and, as of 1 January 2016, has taken over its resolution tasks for entities and groups under the direct supervision of the ECB and other cross-border groups in the banking union. In this respect, the ECB has a permanent observer status in the executive and plenary sessions of the SRB meetings. Similarly, the ECB started to invite the Chair of the SRB, Elke König, to participate as an observer in the meetings of the Supervisory Board of the ECB for discussions on issues of relevance to the SRB. Furthermore, a [Memorandum of Understanding between the ECB and the SRB](#) was signed at the end of the 2015 (see also Section 4.1.1).

As part of the EU crisis prevention framework, every institution has to draw up and maintain a recovery plan outlining the measures to be taken by the institution in order to restore its financial position in case of a considerable deterioration. During 2015, significant institutions started submitting their **recovery plans** to ECB Banking Supervision for a complete assessment. The ECB assesses whether the plans are comprehensive and could credibly restore an institution's viability in a timely manner, in periods of stress.

If the financial situation of an institution is deteriorating and early intervention measures are considered, information exchanges between the relevant JST, the ECB's Crisis Management Division and the SRB will intensify. If no supervisory or private measures can restore a bank's soundness, a decision can be taken to declare the institution as "failing or likely to fail". For significant institutions, this decision is taken by the ECB, after consulting the SRB. The European Commission and other external stakeholders, such as the host supervisory and resolution authorities, the relevant deposit guarantee scheme(s) or the competent ministries, will be informed. After an institution has been determined as "failing or likely to fail", the ECB will coordinate closely with the SRB on necessary follow-up actions, such as the authorisation of a bridge bank and the withdrawal of the licence of the "old" institution.

Within the context of crisis management, the SSM participated in 2015 in cross-border institution-specific fora such as Crisis Management Groups, while it also contributed to policy work undertaken by international fora such as the Financial Stability Board (FSB) to mitigate "too-big-to-fail" problems and enhance banks' soundness and financial stability.

2.3 The "regular" comprehensive assessments

2.3.1 Follow-up to the 2014 exercise, including implementation of capital plans

Prior to assuming supervisory responsibilities, the ECB is required to carry out a comprehensive assessment of the relevant bank, which consists of an AQR and a stress test. The stress test examines the resilience of the bank's solvency to two hypothetical scenarios: a baseline and an adverse scenario.

In 2014 the ECB carried out a comprehensive assessment of 130 banks to prepare for assuming banking supervision responsibilities in November 2014. The results of this major exercise were published in October 2014 (for follow-up measures, see the 2014 Annual Report on supervisory activities). In April 2015 the ECB estimated that of the aggregate adjustments to asset carrying values identified by the AQR for the significant institutions (€42 billion), about two-thirds were recorded in the banks' 2014 financial statements; the remaining third was treated as prudential requirements. In addition, in the first nine months of 2015, the banks directly supervised by the ECB implemented over 75% of the actions required to remedy the qualitative findings. In some cases it was necessary to initiate medium- and long-term projects; progress on these projects is closely monitored within the SSM.

In combining the AQR and the stress test, 25 banks with a total capital shortfall of €24.6 billion were identified. Of these, 12 banks had already taken capital measures before the results of the comprehensive assessment were published. Therefore, only 13 banks remained which were required to take additional capital measures in order to close a shortfall of €9.5 billion. All the banks with capital shortfalls were in principle required to submit a capital plan to the ECB explaining how they would cover the shortfall. Any shortfall resulting from the AQR or the stress test's baseline scenario had to be covered within six months; shortfalls resulting from the stress test's adverse scenario had to be covered within nine months.

For the remaining 13 banks, some of the capital plans included measures that were implemented immediately for one of the following three reasons:

1. there was no or practically no capital shortfall under the dynamic balance sheet assumption¹⁵;
2. the bank was in resolution¹⁶;

¹⁵ This was the case for Eurobank and the National Bank of Greece and was already mentioned in the "Aggregate Report on the Comprehensive Assessment", page 10.

3. the bank had applied measures to sufficiently improve structural profitability to cover the capital shortfall¹⁷.

The remaining capital plans were reviewed by the Supervisory Board and subsequently implemented by the banks. Measures undertaken by the banks included divestments, the raising of fresh capital, restructuring, and improvements in risk management.

Altogether, the combined follow-up of the 2014 comprehensive assessment has met its stated objectives of strengthening banks' balance sheets, improving transparency and building confidence.

This is supported by a substantial decline in CDS spreads in the period from October 2014 to July 2015 for those 25 banks that failed the 2014 comprehensive assessment.¹⁸

2.3.2 2015 comprehensive assessment of new significant institutions

As comprehensive assessment by the ECB is a requirement for all banks that become or are likely to become subject to direct ECB supervision, nine banks which did not participate in the 2014 exercise underwent a similar assessment in 2015. Direct ECB supervision of five of these banks had already commenced in November 2014 with the start of the SSM¹⁹, whereas for the remaining four it started in January 2016.

The 2015 exercise was based on the methodologies applied in 2014 and also consisted of an AQR and a stress test. The threshold ratios for identifying capital shortfalls were the same as in 2014: a CET1 ratio of 8% for the AQR and the stress test's baseline scenario, and a CET1 ratio of 5.5% for the stress test's adverse scenario.

The **AQR** resulted in aggregate adjustments to asset carrying values of €453 million across the participating banks, largely stemming from the identification of additional non-performing exposures and the resulting increase in provision levels. The AQR results served as a starting point for the **stress test**, which projected the evolution of

¹⁶ This was the case for Dexia and was already mentioned in the "Aggregate Report on the Comprehensive Assessment", page 10.

¹⁷ This was the case for Nova Ljubljanska Banka and Nova Kreditna Banka Maribor. The pre-provision profit in both banks indicated the ability of the banks to restructure their cost base.

¹⁸ See S. Steffen, "Capital shortfalls in SSM banks: How much progress has been made?", paper provided at the request of the European Parliament's Committee on Economic and Monetary Affairs, October 2015.

¹⁹ Sberbank Europe AG, VTB Bank (Austria) AG and Banque Degroof S.A. were not included in the 2014 exercise because at the time when the list of banks to be subjected to it was determined, the criterion based on which they would eventually become significant (significance of cross-border assets and liabilities) was not yet fully defined in the legal framework. Unicredit Slovenia was not included because it was not yet classified as the third largest credit institution in Slovenia at that time. Novo Banco SA did not yet exist as an entity at the start of the 2014 comprehensive assessment, since it was only created in 2014 as a result of the resolution measures taken in respect of Banco Espírito Santo.

banks' capital positions over three years (2015-17). Under the adverse scenario²⁰ the participating banks faced a weighted average decline of 6.1 percentage points in their CET1 ratios.

Table 4
Banks participating in the 2015 comprehensive assessment

Bank name	Country	Start of direct supervision
Sberbank Europe AG	Austria	4 November 2014
VTB Bank (Austria) AG	Austria	4 November 2014
Banque Degroof S.A.	Belgium	4 November 2014
Kuntarahoitus Oyj (Municipality Finance plc)	Finland	1 January 2016
Agence Française de Développement	France	1 January 2016
J.P. Morgan Bank Luxembourg S.A.	Luxembourg	1 January 2016
Medfin Holding Limited	Malta	1 January 2016
Novo Banco SA	Portugal	4 November 2014
Unicredit Slovenia	Slovenia	4 November 2014

No bank fell below the threshold ratio of 8% CET1 after the AQR. However, combining the effects of the AQR and the stress test resulted in five banks falling below the threshold ratio of 5.5% CET1 in the adverse scenario. The aggregate **capital shortfall** was €1.74 billion. Part of that had already been covered by capital increases and other eligible measures the banks had undertaken since January 2015.

As in the 2014 exercise, the banks are required to cover the remaining shortfalls within nine months after the publication of the comprehensive assessment results on 14 November 2015. To this end, they had to submit **capital plans** within two weeks after publication, detailing the measures they planned to undertake or had already undertaken. The implementation and monitoring of these measures is aligned with the annual SREP carried out by the JSTs in charge of supervising the banks concerned. Required remediation actions are not limited to closing capital shortfalls, but also relate to qualitative findings of the AQR, such as weaknesses in banks' systems and processes.

2.4 Implementing the SSM model of supervision

2.4.1 Implementation of the SSM SREP methodology

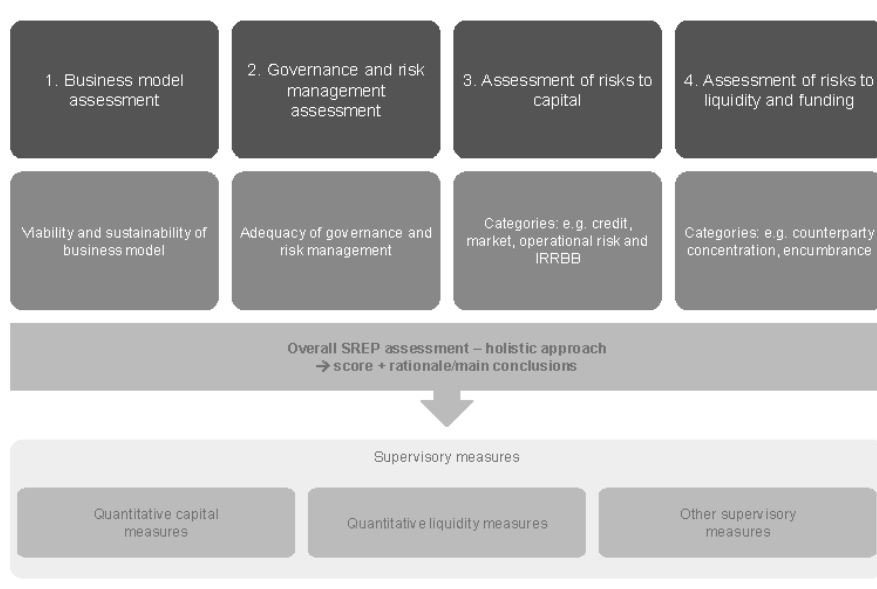
The JSTs – composed of ECB and NCA staff – are the cornerstone in the implementation of the SSM model of supervision. As the operational units responsible for the direct supervision of the significant institutions, they carry out the day-to-day, ongoing supervisory activity. Together with the outcome of the thematic

²⁰ The adverse scenario captured a set of macro-financial risks including an increase in global bond yields, a further deterioration of credit quality in vulnerable countries, stalling policy reforms and a lack of necessary bank balance sheet repair to maintain affordable market funding.

reviews, on-site inspections and the work on internal models, this provides key input for the Supervisory Review and Evaluation Process (SREP).

In 2015, the SSM for the first time ever carried out the SREP based on a common methodology for the then 123 largest banking groups in the euro area. The objective of the SREP is to promote a resilient banking system that is able to finance the euro area's real economy soundly and sustainably. Previous financial crises were in part triggered by over-exuberant, undercapitalised banking systems, which stopped lending at the outset of the crisis in order to deleverage, thereby hampering sustainable economic growth. Altogether, the long-term benefits of a properly capitalised banking system by far outweigh any short-term costs for the banks involved.

Figure 2
SSM SREP methodology



The SSM methodology illustrated in Figure 2 was developed by the ECB in close cooperation with the 19 national supervisors. It is in line with EU legislation and EBA guidelines²¹ and draws on best practices within the SSM and as recommended by international bodies. An *SSM SREP Methodology Booklet* was published on 19 February 2016.

The development and implementation of the new unified methodology in such a short time frame required huge efforts within the SSM in terms of coordination, analysis, calibration, field-testing and training.

²¹ Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) (EBA/GL/2014/13), EBA, 19 December 2014.

Largely on the basis of key input from the JSTs, the 2015 SREP assessed the following four main elements:

- **business models** – a review of institutions' business model viability and profit sustainability;
- **governance and risk management** – a review of institutions' operational and organisational structure and their overall risk management framework;
- **risks to capital** – an assessment of capital-related risks and risk controls, of the need for setting additional capital requirements and of capital adequacy;
- **risks to liquidity and funding** – an analysis of the institutions' liquidity and funding position, the relevant risk controls and the need for additional liquidity buffers.

Each element was assessed using a building block approach with a bottom-up evaluation of risks disaggregated into categories and sub-categories. In the assessments, various perspectives were taken, such as focusing on the current situation and taking a more forward-looking approach.

Quantitative and qualitative elements were combined through constrained expert judgement. This approach ensures consistency overall while also taking into account institutions' specificities. Extensive peer comparisons and transversal analyses were also possible for the first time on a wide scale.

Altogether, the harmonised SREP allowed for a holistic assessment of institutions' situations and viability, taking a forward-looking perspective and applying proportionality. Assessing all institutions in a consistent manner contributed to further integrating the Single Market for banking. As a result of the 2015 SREP, capital levels and liquidity requirements of banks directly supervised by the ECB have been set according to their risk profiles. Additional supervisory measures have been applied where deemed necessary.

Average Pillar 2 capital requirements²² for banks were increased by 30 basis points from 2015 to 2016. Part of these 30 basis points can be attributed to the euro area's position in the economic cycle, which requires maintaining, and in some cases, strengthening the capital in the banking system. Many banks are still recovering from the financial crisis and continue to face risks and headwinds.

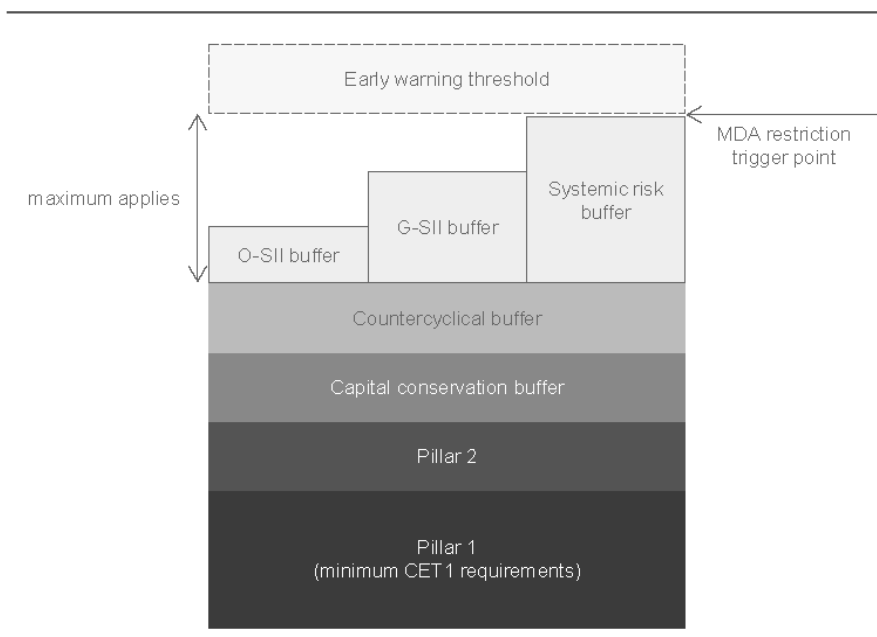
An additional 20 basis points of capital requirements are the effect of the phase-in of the systemic buffers. These buffers are motivated by a key lesson of the crisis that is reflected in EU legislation: the need to contain the system-wide externalities that emanate, in particular, from global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs) and that affect the entire financial system and eventually the euro area's real economy. In order to contain these effects and in accordance with the relevant EBA Guideline, systemic buffers

²² Pillar 2 capital requirements are the requirements which are imposed by the competent supervisory authority – on top of the minimum capital requirements – based on the results of the SREP.

(whether for G-SIBs or D-SIBs, or the systemic risk buffer) are added to the Pillar 2 requirements. These systemic buffers will continue to be phased in as expected until 2019.

With regard to the application of the maximum distributable amount (MDA) framework, the SSM approach refers to the Opinion published by the EBA on 18 December 2015. This approach might nonetheless be revisited in response to future regulatory developments at the European and international levels, or to the application of the EBA guidelines, in order to ensure consistency and harmonisation in the Single Market.

Figure 3
Breakdown of capital requirements



The level of capital requirements was checked carefully for the significant banks, especially taking into account fully-loaded Common Equity Tier 1 (CET1) requirements. In the case of G-SIBs, the calibration of the phase-in and fully-loaded capital requirements reflect a number of considerations, including the need to promote a consistent framework across the institutions supervised by the ECB, the systemic impact of G-SIBs and D-SIBs, and a broad comparison with G-SIBs of other jurisdictions.

The SSM aims to build a coherent framework that is the most appropriate to its specific context. The banking landscape under the SSM's responsibility varies; compared with other jurisdictions, the SSM covers a much larger set of diverse institutions in different countries with still partly heterogeneous legal systems. The SSM methodology will therefore continue to evolve whenever necessary:

- to reflect developments in the applicable regulatory framework, such as prudential regulation, EBA recommendations or guidelines and Basel Committee Core Principles;
- to incorporate best practices, improvements and further sophistication.

Through direct communication to banks, ECB Banking Supervision is providing the explanations and supervisory certainty that banks need in order to perform their capital planning.

In particular, in 2015, the ECB adopted two recommendations on **dividends distributions** policies in relation to the financial years 2014 and 2015 (respectively ECB/2015/2 and ECB/2015/49) and sent a **letter to banks' CEOs on variable remuneration policies**. These documents set out the SSM's expectations regarding distributions or payouts by institutions in a way that is compatible with a linear path towards the required fully-loaded ratios.

All things being equal, the Pillar 2 requirements set out in the SREP 2015 decisions also provide an indication for the future; in particular, the capital conservation buffer will be phased-in by 2019, with the Pillar 2 requirements being reduced in equal fashion²³. Banks can also plan for the phase-in of the CRR/CRD IV, i.e. the deductions from CET1 capital and the phase-in of the systemic risk buffers. While the final developments on Basel III are not entirely known, it has already been acknowledged that they are not geared to significantly raising capital in the system, but to improving the simplicity, comparability and transparency of capital across banks.

2.4.2 Work on other methodologies

Work on internal models

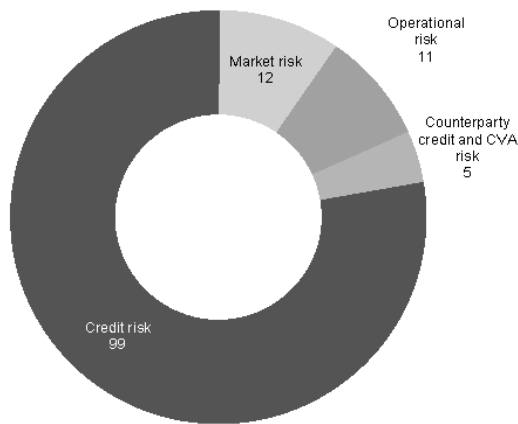
At the end of 2015, 73 significant institutions were using at least one internal model for the purpose of calculating of Pillar 1 own funds requirements.

After devising an SSM-wide approval process and a framework for conducting investigations of internal models, 137 internal model investigations were approved by the Governing Council for the year 2015 under this new regime.

A unified framework for ongoing model monitoring was created. This framework has been fully integrated into the minimum engagement level of supervision and applied in the 2016 SEP. It facilitated the participation of the significant institutions in the EBA and BCBS benchmarking exercises. A network was set up to define the process for the harmonised collection of backtesting data for significant institutions with market risk models. On this basis, an analysis of horizontal and bank-specific data is performed and used in ongoing model monitoring.

²³ The SREP decisions take into account the differences among the SSM countries in terms of phasing in the capital conservation buffer, with a view to promoting a level playing field for all SSM banks.

Chart 3
Internal model investigations 2015 per risk type



To promote a uniformly compliant implementation of Pillar I models as well as the harmonisation of supervisory practices within the SSM, work was initiated on a proposal for a **targeted review of internal models (TRIM)**. To this end, a network of senior model experts from NCAs and the ECB has been established to steer the process. TRIM foresees on-site investigations of selected credit, market and counterparty credit risk models from 2017 to 2018 (or to 2019, if the project is extended for credit risk), while 2016 will be devoted to the required horizontal analyses that will define the harmonisation goal of the project.

Other major work over the course of 2015 on **supervisory methodologies for internal models** included the still ongoing elaboration of internal model validation guidance, and of guidance on the materiality

assessment of extensions and changes to counterparty credit risk models.

Work on on-site methodologies

Several drafting teams composed of ECB and NCAs experts were set up to work on a number of risk types and develop further the on-site methodologies. Methodological papers dedicated respectively to business model and profitability and to ILAAP were finalised over the course of 2015. Other specialised teams are currently working on topics such as credit risk, counterparty credit risk, custody business, accounting, market risk and IT risk. A public charter setting out the conditions and modalities of on-site inspections is also in preparation.

2.4.3 On-site supervision

First cycle of on-site inspections

The first cycle of on-site inspections was part of the overall 2015 SEP planning that was approved in December 2014. In July 2015, a mid-year planning update was approved, which included additional on-site inspections to be conducted in the second half of the year. In total, 250 on-site inspections were approved for the year 2015.

Table 5
On-site inspections: breakdown per risk

Main risk categories covered	Total	Profitability	Capital	Credit	Governance	IRRBB	Liquidity	Market risk	Operational risk
Total number of inspections	250	6	20	62	55	9	29	13	56

Table 6On-site inspections: breakdown per cluster of banks²⁴

Cluster	Total	1	2	3	4	5
Number of significant institutions	118	7	7	28	27	49
Total number of inspections	250	42	35	69	54	50

On-site inspections are planned and staffed in close cooperation with the NCAs, which provide most of the heads of mission and team members. As of October 2015, the NCAs had provided 906 inspectors, which accounted for 95% of the on-site resources. The remaining 5% was provided by the ECB's dedicated Centralised On-site Inspections Division; these inspectors also led 26 of the missions planned in 2015.

With the objective of promoting on-site inspections conducted by mixed teams, the Supervisory Board approved in May 2015 the implementation of a secondment model regime for NCA inspectors.

To ensure close collaboration with the NCAs on all topics relating to on-site inspections, a total of 8 network meetings were organised in 2015, on top of the 21 dedicated bilateral meetings that took place with 16 NCAs. Furthermore, a number of seminars and workshops for heads of mission were organised with the objective of facilitating networking among the SSM community.

Ongoing monitoring activities

In order to ensure a homogeneous application of the on-site inspection methodology, the ECB's Centralised On-Site Inspection Division carries out a number of monitoring activities during the whole inspection life cycle:

- reviewing the pre-inspection note during the preparatory phase of missions;
- supporting the on-site team during the investigation phase;
- performing quality assurance on all inspection reports submitted by heads of mission.

All activities are performed through a dialogue-based process in order to support the development of mutual understanding and a common approach with the NCAs.

In 2015, to harmonise the work of the on-site inspections teams, the ECB proposed a number of guidelines and templates for inspection reports.

²⁴ The banking groups directly supervised by the ECB are broken down into five clusters with cluster 1 hosting the largest and cluster 5 the smallest. The number of significant institutions mentioned (118) does not include the significant institutions that are subsidiaries of a larger institution in the SSM (e.g. Deutsche Bank AG and Deutsche Bank Malta Ltd are counted as one in the table).

2.4.4 Thematic reviews on risk governance and risk appetite, IT and cyber security risks, and leveraged finance

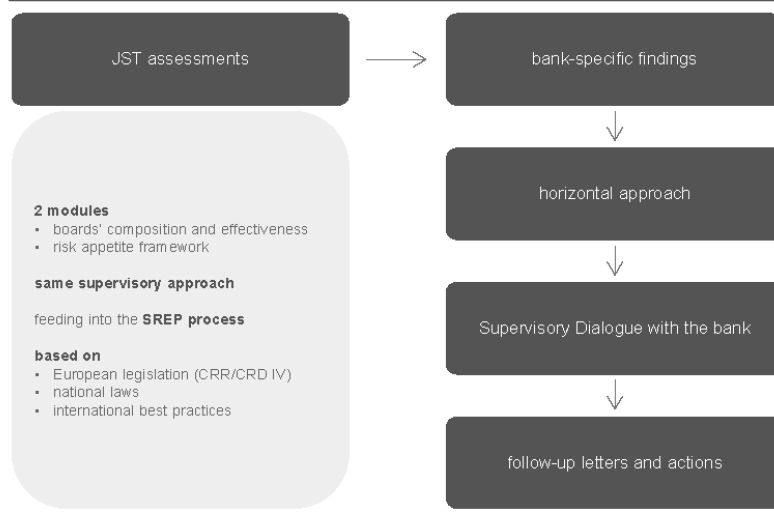
2.4.4.1 Risk governance and risk appetite

Scope, methodology and objectives

Given the overall impact of corporate governance on the institutions' risk profile and business sustainability, the Supervisory Board approved the launch of a thematic review on risk governance and appetite at the SSM level in 2015. Feeding into the SREP, 113 JSTs²⁵ performed deep and granular assessments of (i) banks' management bodies in charge of supervisory and management functions; and (ii) banks' risk appetite frameworks. A proportionate approach was developed, taking into account the size and complexity of individual institutions. Relevant supervisory tools included meetings with key function holders, the assessment of board documentation and minutes, and attendance as observers to board meetings. Conclusions of on-site inspections related to these issues were also taken into account.

Figure 4

Deep assessment for 113 significant institutions following the same approach



With the aim of fostering consistency at the highest standards, the assessment followed a two-layer approach:

1. assessing compliance with national and European legislation;

²⁵ From the total number of significant institutions, those in a winding-down process or with very specific business models were excluded.

2. assessing consistency with best international practices.

The review acknowledged the differences in national legal frameworks, and the fact that effective governance structures are possible in any corporate model. Finally, with the objective of enhancing the engagement with the boards, JSTs discussed their findings with the institutions in supervisory dialogue meetings that took place in October and November 2015.

Outcome

The thematic review enabled the JSTs to strengthen their knowledge and fine-tune their assessment of the governance structure of the institutions they supervise. In addition, the horizontal approach fostered discussion among experts from the ECB and the NCAs, at the levels of both the JSTs and the horizontal functions.

The horizontal approach has allowed the identification of:

1. **aggregated conclusions:** the thematic review revealed that, even if compliant with their national law, significant institutions are still far from consistent with international best practices. The main areas of attention are the countervailing capacity of the boards, the inclusion of risk perspective in the boards' discussions and the interplay between risk appetite frameworks and strategy.
2. **good practices observed:** the thematic review has allowed the identification of best practices in the operational implementation of international standards. These will feed into an SSM report on the best practices identified that will be published later in the year.
3. **consistent recommendations:** the thematic review was action-oriented and led to concrete recommendations to the institutions in order to improve their governance and risk appetite frameworks. The horizontal approach ensured consistency in the recommendations so that similar findings would lead to similar recommendations.

As part of their supervisory activities for 2016, JSTs will follow up on the implementation of the actions included in the individual follow-up letters sent to banks. A number of JSTs will put in practice an enhanced monitoring of those aspects identified as main areas of attention.

2.4.4.2 Thematic review on IT and cyber security risks

Scope, methodology and objectives

IT and cyber security risk was identified as one of the key risks for the euro area banking system (see Section 2.1.1). In order to enhance understanding of these risks, an SSM Expert Group on IT Risk was established, consisting of experts from

NCAs and the ECB and a thematic review on cyber security risk was launched with the following goals:

1. define a specific and common SSM framework for the analysis of cyber security risks;
2. perform individual assessments of cyber security risk profiles and controls on a selected sample of 12 significant institutions (on-site review);
3. develop a horizontal approach to have a first insight on the cyber security risk exposures and controls of significant institutions and benchmark practices across peers where possible (off-site review).

For the off-site review, the ECB used the NIST²⁶ Framework for Improving Critical Infrastructure Cybersecurity as a basis. The NIST Framework was refined and integrated by the ECB in order to set up a customised tool for analysis, named "Cybercrime risk questionnaire", which was distributed to 110 significant institutions. The information gathered was then analysed for each bank and horizontally across banks.

Outcome

The thematic review led to a number of conclusions along different dimensions:

1. **ongoing supervision and risk analysis:** structured information on the cyber security risk profile of significant institutions was gathered on the euro area level for the first time in a consistent way, enabling JSTs to follow up with individual banks. These higher risks should be mitigated with above average controls;
2. **on-site supervision:** 12 on-site examinations were triggered by the thematic review, leading to specific firm-level recommendations;
3. **methodology:** the gathered information provided input for the further development of the SSM on-site methodology on cyber security risks.

In addition to the above conclusions, a parallel workstream of activities was launched to set up a specific operational and communication procedure that should be followed by significant institutions in case of cyber-attacks. This procedure will be implemented in 2016 as a pilot scheme with a limited number of institutions.

²⁶ National Institute of Standards and Technology – the Framework (12 February 2014) is available at <http://www.nist.gov/cyberframework/upload/cybersecurity-framework-021214-final.pdf>

2.4.4.3 Thematic review on leveraged finance

Scope, methodology and objectives

The prolonged period of very low interest rates and the ensuing search for yield strategies have warranted a specific monitoring of credit quality. The Supervisory Board therefore decided in 2015 to carry out a thematic review on leveraged finance. The review encompassed leveraged loans, high-yield bonds and collateralised loan obligations, all of which benefit significantly from the favourable financing conditions.

Three key objectives were defined:

1. inform JSTs on current developments at the SSM level and at the individual institution level;
2. identify outliers in terms of risk appetite and management, as well as system-wide vulnerabilities;
3. advise on an appropriate set of remediation actions across the sample.

In order to ensure a consistent analysis, a comprehensive survey was drafted and distributed to 37 banks engaged in leveraged finance. The objectives of the survey were to capture the evolution of leveraged finance exposure, the size of the underwriting pipeline, potential exposure concentrations and overall credit quality.

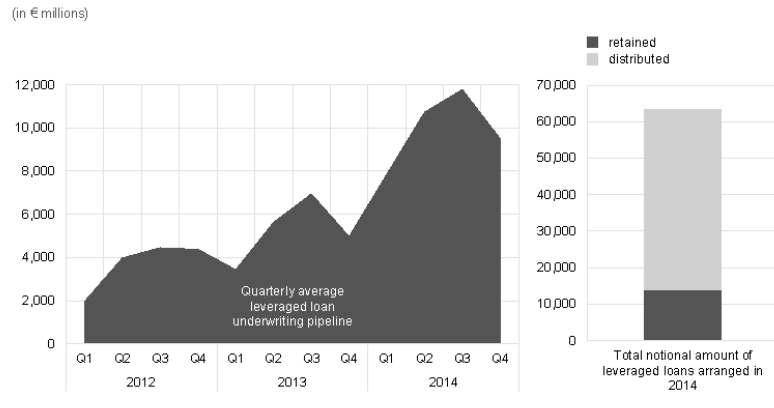
Outcome

The leveraged finance market has globally experienced a strong recovery since the crisis and is characterised by fierce competition. The borrower-friendly conditions have translated into a weakening of deal structures (increased leverage levels, import of covenant-lite structures into European markets), and in many cases they have led to greater lenience in banks' credit policies.

Both the appetite to underwrite a transaction and the propensity to retain parts of the exposure have grown across the main banks supervised within the SSM. This development justifies closer supervisory scrutiny in monitoring syndication risk and the fundamental credit quality of exposures. Finally, some areas for improvement in banks' monitoring practices have been identified.

Chart 4

Top 13 SSM banks engaged in leveraged lending – underwriting activity and share of arranged deals intended for distribution or retention



In order to address these concerns – summarised in individual bank reports and a single aggregated report – the following actions have been taken:

- **supervisory letters** were sent to a selected number of banks to remediate the shortcomings identified;
- a dedicated **dashboard** is being developed for the regular monitoring of banks' exposures;
- **guidance** is currently being drafted in order to clearly communicate the SSM's expectations regarding leveraged finance.

2.4.5 Indirect supervision of less significant institutions and supervisory oversight

The framework for indirect supervision of less significant institutions encompasses a range of ongoing processes for day-to-day cooperation between the ECB and the NCAs, as well as project-based initiatives mostly concerning the development of joint supervisory standards and methodologies.

Ongoing processes in indirect supervision and supervisory oversight

Day-to-day cooperation between the ECB and the NCAs on the supervision of less significant institutions is organised through dedicated ongoing processes. These processes enable an efficient exchange of information, which allows the ECB's Directorate General Microprudential Supervision III (DG MS III) to fulfil its oversight

role and provide support and input to the NCAs who perform the direct supervision of less significant institutions.

Via a dedicated notification framework, the ECB received and assessed in 2015 a total of 54 ex ante notifications from NCAs on material supervisory procedures and on draft decisions relating to high-priority less significant institutions²⁷ covering a wide range of supervisory issues (e.g. capital, liquidity and governance). The notifications often triggered follow-up work in the course of which the ECB and the relevant NCAs jointly discussed and assessed the most appropriate course of action. In a similar vein, the ECB participated in the assessment of common procedures (granting/withdrawal of authorisations and qualifying holding procedures) related to the less significant institutions.

The specialised country desks within DG MS III were in continuous dialogue with the NCAs on developments at the level of sectors and individual institutions, in particular those institutions classified as high-priority. A particular focus was put on monitoring crisis-related measures concerning a number of institutions facing a significant deterioration of their financial situation.

The above-mentioned functions were supported by efforts to further harmonise NCAs' supervisory assessment methodologies. Furthermore, a variety of analyses on banks and sectors were conducted in order to identify risks and vulnerabilities. The results of these analyses were regularly summarised in dedicated risk reports, which were then shared with supervisors across the SSM.

Development of joint supervisory standards, analyses and common methodologies related to less significant institutions and other project-based initiatives

Ensuring the consistent application of high supervisory standards across the SSM is the primary goal of indirect supervision and supervisory oversight. The key tools for the supervision of less significant institutions are joint supervisory standards and common methodologies, developed together with the NCAs. Joint standards are intended to be fully in line with existing EBA requirements.

Joint supervisory standards developed in 2015

One of the joint standards developed in 2015 relates to the supervisory planning process, through which NCAs prioritise, plan and monitor the execution of key on-site and off-site supervisory activities for less significant institutions. The joint standard aims to ensure that this process is conducted consistently across the SSM.

Ensuring consistency is also particularly relevant in the context of recovery planning, taking into account the provisions of the Bank Recovery and Resolution

²⁷ The prioritisation framework for less significant institutions is described later in this section.

Directive (BRRD) which grants competent authorities the discretion to apply simplified obligations for recovery planning to non-systemic institutions under certain conditions. A significant number of less significant institutions are expected to fall within the scope of simplified obligations. Work was therefore initiated focusing on three key dimensions:

1. the assessment of the eligibility of institutions for simplified obligations and for waivers;
2. minimum common content for recovery plans under simplified obligations;
3. the assessment of recovery plans.

Savings banks and cooperative banks represent a significant part of the SSM banking system. In some Member States, institutions from these sectors have established **institutional protection schemes (IPS)**, which constitute mutual support arrangements aimed at ensuring their liquidity and solvency. The Capital Requirements Regulation (CRR) enables the competent authorities to grant preferential treatment to IPS member institutions on certain aspects, such as a 0% risk weight for exposures to other IPS members. In several cases, both significant and less significant institutions have entered into one IPS.

To ensure a consistent treatment of IPS members across the SSM, in 2015, the ECB in cooperation with the NCAs worked on developing a joint approach towards the supervisory assessment of IPS. This included the definition of joint assessment criteria regarding the compliance with CRR conditions, as well as a process to ensure coordination between ECB and NCAs when both significant and less significant institutions are involved in the same IPS.

Analysis and methodologies

The principle of proportionality is of fundamental importance for the indirect supervision of less significant institutions (LSIs) given the very large number of LSIs (over 3,100²⁸ as of 30 December 2015) and their diversity in terms of size and business models. Therefore, ongoing processes (e.g. the notification framework and country desk interaction described above) and the development of joint standards and methodologies draw on a **prioritisation framework**. That framework classifies less significant institutions into low, medium and high priority based on their intrinsic riskiness and their potential impact on the domestic financial system. The classification allows for aligning the level of supervisory oversight and the intensity of supervisory activities accordingly. The methodology underlying the framework was further refined in 2015 and is being applied for the 2016 supervisory cycle.

Another important strand of ongoing work relates to the development of a common methodology for the **risk assessment systems (RAS)** of less significant institutions.

²⁸ Counted at the consolidated level.

The RAS constitutes a key element of the SREP carried out by the NCAs. The overarching objective of the project is to foster convergence in conducting the SREP for less significant institutions, providing the NCAs with a common framework to adjust and fine-tune their methodology and, eventually, to perform the SREP where risks can be assessed in a consistent manner across the euro area, without losing sight of the specific context in which individual institutions operate. Given the general objective of ensuring the functioning of the SSM as a single integrated system, the RAS methodology for less significant institutions will be based on that used for significant institutions. It will, however, be adapted to ensure proportionality and account for differences between significant and less significant institutions with respect to the availability of supervisory data, as well as specific features of national accounting frameworks (national GAAP) in some Member States.

The RAS methodology project was initiated in 2015, focusing in particular on business model analysis, the assessment of internal governance, and the assessment of risks to capital and risks to liquidity and funding. This work will be continued during 2016 with a focus on capital and liquidity quantification and the trial of the new proposed methodology.

Supervisory support

Supervisory support projects are temporary initiatives aimed at covering specific needs for additional resources and/or expertise that may arise during NCAs' ongoing direct supervision of less significant institutions. Experts from the ECB, and potentially from other NCAs, are deployed for a temporary period to work alongside NCA staff on a given project. In 2015, for instance, experts from the ECB's DG MS III worked together with NCA staff on an on-site mission at a less significant institution. The supervisory support programme was successfully tested in 2015 and will be expanded in 2016.

Box

Indirect supervision – need for convergence towards consistent high supervisory standards across the SSM

The ECB is entrusted with maintaining oversight to ensure the consistent application of high supervisory standards in line with EU requirements while taking account of the principle of proportionality.

As part of its oversight tasks relating to the supervision of less significant institutions (LSIs), and in order to survey the existing situation at the start of the SSM, the ECB conducted a stock-take on key topics relating to NCAs' supervision of LSIs in 2014. This included NCAs' responsibilities and organisation, their staff resources for LSI supervision, the conduct of off-site and on-site activities (including supervisory decisions and actions taken) as well as the risk assessment methodologies and other supervisory practices.

While 2014 was a unique year for banking supervision in the euro area (in view of the setting-up of the SSM, and the conduct of the comprehensive assessment) and so cannot be considered as a

wholly consistent baseline, this initial assessment of supervisory practices before the launch of the SSM confirms the importance of reaching a common terminology and deeper understanding of supervisory practices, and of developing consistent approaches. Significant variations were reported in areas such as:

- the staff resources per supervised LSI;
- the number of supervisory decisions related to LSIs taken by NCAs (indicating differences between NCAs decision-making approaches);
- the average durations of on-site inspections at LSIs;
- the frequency and type of regular interaction with LSIs;
- different risk assessment methodologies (e.g. in terms of frequency, scoring scale or aggregation methodology).

Some of these variances relate to temporary factors, to differences in terminology or to the different nature of the LSI sectors across the SSM, while others reveal more fundamental differences in the conduct of supervision at the start of the SSM.

The findings of this stock-take support the ECB's efforts, already ongoing in 2015, to meet the overall objective of the SSM to apply consistent and high supervisory standards. In 2016, work will continue with NCAs on the areas in which a need for convergence has been highlighted, for example in developing the common risk assessment system for LSIs, as well as exploring wider aspects of the Supervisory Review and Evaluation Process, and preparing joint supervisory standards on topics such as on-site inspections. More generally, work is progressing on a compendium of joint supervisory standards and legal instruments to deliver consistency in the main areas of NCAs' supervision of LSIs.

2.4.6 Macroprudential tasks

2015 was also the first full year in which the ECB performed its competencies in the field of macroprudential policy, as set out in Article 5 of the SSM Regulation. Within this defined frame of macroprudential policy, the ECB has two mandates:

1. It may apply higher requirements for relevant capital buffers than those applied by the national authorities. It may also apply more stringent measures aimed at addressing systemic or macroprudential risks, subject to the procedures set out in relevant EU law. For example, the ECB may apply higher requirements for banks related to: countercyclical capital buffers; systemic risk buffers; capital surcharges on systemically important institutions; risk weights on real estate and intra-financial sector exposures; limits on large exposures; and additional disclosure requirements.
2. National authorities have to notify the ECB when they intend to implement or change a macroprudential measure included in the CRR or CRD IV. The ECB

then assesses the planned measures and can object to them. National authorities consider the ECB's comments before making their final decision. A similar notification obligation towards the NCAs applies if the ECB decides to apply higher requirements.

The ECB's Governing Council is ultimately responsible for taking macroprudential decisions by endorsing, objecting to or amending proposals of decisions made by the Supervisory Board. The Governing Council can also, acting on its own initiative, request the Supervisory Board to submit a proposal to apply higher requirements for macroprudential instruments.

In 2015 the Governing Council's assessment was that there was no need to adopt broad-based countercyclical macroprudential measures, given the current stage in the financial cycle. This assessment also took account of the fact that more than 80 actions in the macroprudential field had already been taken in euro area countries to increase the resilience of the banking system and prevent the emergence of possible imbalances, particularly in the real estate sector.

In 2015 the national authorities in the 19 SSM countries notified the ECB of 48 macroprudential measures: there were 28 notifications on countercyclical capital buffers, 18 on "other systemically important institutions" and 2 on the introduction of a systemic risk buffer (see the overview of national macroprudential policy actions provided by the [European Systemic Risk Board](#)). In all countries, countercyclical capital buffers have been formally introduced, but their coefficient has been kept at zero – implying that there is no cyclical impact on capital accumulation. In almost all cases, the formal notification was preceded by an informal one in the spirit of collaboration between the ECB and the national authorities. When notified of the macroprudential decisions taken by national competent and designated authorities, the Governing Council conducted its assessment of the measures in line with Article 5(1) of the SSM Regulation, and decided not to object to the decisions by these authorities.

In order to ensure that the microprudential and macroprudential perspectives are effectively combined and that appropriate analytical elements are provided, macroprudential issues are discussed by the Governing Council and the Supervisory Board in joint sessions (Macroprudential Forum). The Macroprudential Forum met on a quarterly basis during 2015 to discuss risks facing the SSM area and individual SSM countries, as well as other topics relevant from a macroprudential perspective.

3 Authorisations, reporting of breaches, enforcement and sanctioning proceedings

Although only directly supervising significant credit institutions, the ECB is the competent authority for all euro area credit institutions for granting or withdrawing banking licences and assessing the acquisition of qualifying holdings (known collectively as “common procedures”). The ECB is also responsible for the fit and proper assessment of members of the management bodies of significant credit institutions and for passporting procedures. All in all, a substantial proportion of European banking supervision decisions relate to authorisation processes.

More than 3,000 authorisation procedures – mostly relating to fit and proper assessments with just a modest number of bank licence requests – were notified to the ECB in 2015. Great effort went into improving processes in terms of simplicity and proportionality and into developing policy guidance on a number of issues.

The ECB also fulfilled its duty to ensure effective mechanisms for reporting by any person of breaches of relevant EU law. In 2015, 79 breach reports were received, 51 of which were within the remit of the ECB’s supervisory tasks. These reports mainly concerned governance issues and the calculation of own funds and capital requirements.

3.1 Authorisations

3.1.1 Changes in the number of institutions under the direct supervision of the ECB

On 4 November 2014 the ECB began to directly supervise 120 entities, identified as significant institutions under the criteria listed in Article 6(4) of the SSM Regulation (i.e. institutions that reach certain thresholds in terms of size, importance for the economy and significance of cross-border activities; that have requested or are receiving public financial assistance; or are among the three most significant institutions in each participating Member State). All other institutions are defined as less significant. A first list of significant institutions and less significant institutions was published on 4 September 2014.

According to the SSM Framework Regulation, the classification of supervised entities and supervised groups as significant or less significant must be reviewed at least on an annual basis. For the annual assessment of significance, the ECB reviews all supervised groups that have not been subject to an ad hoc decision on significance since the previous general assessment in order to establish: (i) whether entities currently classified as significant still fulfil the respective criteria; and (ii) whether

entities currently classified as less significant now meet the criteria. The assessment also covers whether any exceptional circumstances need to be taken into account.

The annual assessment of significance conducted in 2015 brought the number of banks and banking groups directly supervised by the ECB to 129. The [updated list of supervised entities](#) was published on the ECB's banking supervision website on 30 December 2015.

Eight entities, consisting of seven credit institutions/banking groups and one branch, were newly identified as significant as of the reference date 31 December 2014:

- RCI Banque SA, the French branch of Barclays Bank plc, Credito Emiliano S.p.A., Kuntarahoitus Oyj (Municipality Finance Plc) and Agence Française de Développement exceeded the €30 billion total assets threshold.
- The total assets of J.P. Morgan Bank Luxembourg S.A. exceeded 20% of Luxembourg's GDP.
- Medifin Holding Limited and Abanka d.d. belong to the three largest credit institutions within Malta and Slovenia respectively.

Moreover, the ECB took note that Deutsche Bank (Malta) Ltd and Unicredit Banka Slovenija d.d. changed their rank in terms of size within their domestic jurisdictions. As a consequence, both entities no longer belong to the three largest credit institutions in a participating Member State and thus do not meet the significance criteria on a sub-consolidated level. However, given that both entities belong to supervised groups that have been classified as significant in another participating Member State, they continue to be supervised directly by the ECB.

The direct supervision of the above-mentioned institutions that were newly identified as significant was initiated between 1 January and 1 February 2016, based on the date of the individual decisions on significance notified to the relevant institutions.

Apart from the annual assessment, the following events led to changes in the initial number of significant institutions (120) over the course of 2015:

- With Lithuania joining the euro area on 1 January 2015, the three largest institutions in the country (SEB bankas, Swedbank and DNB bankas) were added to the list of significant institutions directly supervised by the ECB.
- Catalunya Banc, S.A. was acquired by Banco Bilbao Vizcaya Argentaria, S.A. and was therefore no longer identified as significant at the highest level of consolidation or on a stand-alone basis.
- A restructuring in the State Street Group led to the creation of a new significant supervised entity, namely State Street Europe Holdings S.a.r.l. & Co. KG, in addition to the existing State Street Bank Luxembourg S.A.

It should be noted that, in some cases, a restructuring process in the banking group led to a new institution at the highest level of the group being identified as significant, without leading to an overall increase in the number of significant institutions.

Overall, with the above-mentioned changes in the number of significant institutions, total assets under direct supervision continue to represent approximately 82% of total euro area banking assets.

Table 7
Significant and less significant institutions in the SSM

	Total assets (in € billions)	Number of entities	
		at consolidated level	at solo level
Significant institutions	21,818.10	129	1,117
Less significant institutions	4,689.10	3,167	3,443
Institutions in the SSM	26,507.20	3,296	4,560

Notes: Total assets as at 30 December 2015 with reference date 31 December 2014 (or 30 June 2015 if data available); number of less significant institutions with reference date for the group structure as at end-September 2015.

3.1.2 Common procedures (licences and qualifying holdings), fit and proper assessments and passporting procedures

High number of procedures

In 2015 around 3,400 authorisation procedures were notified by the participating NCAs to ECB Banking Supervision, including 37 licence applications, 61 licence withdrawals (including lapses), 137 acquisitions of qualifying holdings, 435 passporting procedures and 2,730 management and supervisory board appointments (i.e. fit and proper assessments dealing with the requirements for managers of good repute, knowledge, skills and experience).²⁹ All in all, a substantial proportion of European banking supervision decisions relate to authorisation processes.

In 2015 a total of approximately 2,000 authorisation procedures were approved by the Supervisory Board and the Governing Council.³⁰ In addition, approximately 650 authorisation procedures not requiring a formal ECB decision were completed, including passporting, lapsing and erroneous and withdrawn procedures.³¹

²⁹ Including a limited number of requests for additional directorships (18).

³⁰ These 2,000 authorisation procedures were incorporated in 921 ECB legal acts (see Figure 1 in Section 1.2). Some legal acts cover more than one authorisation procedure (e.g. fit and proper assessments of several members of the management bodies of the same significant institution or acquisitions of qualifying holdings in different subsidiaries resulting from a single transaction).

³¹ Erroneous and withdrawn procedures cover all procedures formally submitted by the NCAs, but which, for various reasons, closed before finalisation at the NCA's request. Reasons for withdrawal include: (i) wrong choice of procedure; (ii) withdrawal of application by the applicant; (iii) completion is within NCAs competence (i.e. negative decision on granting an authorisation); and (iv) choice of another solution (in particular, if the procedure relates to an intended resolution), etc.

Table 8Authorisation procedures notified to the ECB³²

Licensing		Withdrawal and lapses		Qualifying holdings		Fit and proper		Passporting	
2014	2015	2014	2015	2014	2015	2014	2015	2014	2015
7	37	5	61	9	137	115	2,730	34	435

Roughly half of the common procedures (i.e. granting/withdrawal of authorisations and qualifying holding procedures) notified to the ECB concern significant institutions, in most cases subsidiaries of significant institutions, confirming a trend towards the simplification of some banking groups through internal reorganisation.

The distribution of the authorisation procedures over the participating Member States was rather disparate, seeming to reflect, in part, differences in structure across national banking markets.

Altogether, a fairly modest number of requests for bank licences have been received, although comparable figures for previous years are not available. Most of the notified licence applications related to the extension of existing licences or to the restructuring of existing banks. Only a few concerned the establishment of a complete new institution. Requests for new bank authorisations relating to traditional banking tended to be limited, with applications more often submitted to pursue captive activities (automotive or technology sector). Furthermore, four bridge bank licences were granted in 2015. Many of the notified withdrawal and lapsing procedures resulted from a merger of two credit institutions within the same group, whereby the absorbed entity ceased to exist. In such cases, most Member States apply for a lapsing of the authorisation of the absorbed institution, while only a few require an explicit withdrawal decision by the ECB.

Authorisation procedures were improved ...

The processing of the authorisation procedures requires scrutiny but, most of all, in-depth cooperation between the ECB's Authorisation Division and the NCAs, the JSTs and the Secretariat of the Supervisory Board. Building on the experience gained in the course of 2015, the processes and templates used for the notification of procedures to the ECB have been further improved following the changes already introduced in 2014.

The fit and proper process has been simplified, focusing on increasing efficiency and improving timelines. With a view to proportionality, new templates were introduced which differentiate between material and non-material subsidiaries of significant institutions. NCAs now bear more responsibility for non-material subsidiaries. They will also take on more responsibility for reappointment procedures at all subsidiaries. As regards qualifying holdings, a simplified approach for internal

³² Reminder: 2014 covers only November and December. Furthermore, the cut-off date for 2014 was 15 January 2015. As a result, there is a limited overlap between the numbers of 2014 and 2015.

reorganisations has been agreed upon, while a reviewed methodology was introduced for acquisitions by specific acquirers, such as private equity funds, hedge funds and sovereign funds. Furthermore, parallel procedures affecting subsidiaries of a single group in several Member States have been coordinated, enabling the ECB to reach consistent decisions.

... but challenges remained

Despite these efforts, the timely handling of the authorisations procedures was a challenge. The large number of fit and proper assessments was particularly difficult to manage, on the one hand because all subsidiaries of significant institutions are subject to the fit and proper process and, on the other, because of the diversity of the applicable legal regimes. This, combined with capacity constraints, resulted in a gradual build-up of a backlog in fit and proper testing. Against this backdrop, certain measures, such as staff increases, were implemented in the course of 2015. These measures, along with a decline in the number of notified procedures towards the end of 2015, helped to reduce the backlog. Nonetheless, continued efforts are required to reduce it to an acceptable level.

In particular for qualifying holding assessments and, to a lesser extent, also for licensing procedures, the short deadlines under the SSM Framework Regulation for decision-taking – 15 days for qualifying holdings and 10 days for licensing – were difficult to meet. The time period between the submission of the final NCA proposal and the deadline for a decision was often very tight, putting pressure on the ECB to assess the final proposals (also taking into account the regular decision-making process). Similar pressures arose for fit and proper procedures in cases where national law provides for short timelines.³³ All too often, this resulted in shortened approval timelines at Supervisory Board level. Fostering cooperation and communication with all of the stakeholders involved over the full period between initial notification of the procedure to the NCA and the submission of the proposal to the ECB proved to be a core factor in managing time pressures and complying with legal deadlines.

Development of policy stances

In 2015 great effort also went into developing policy guidance on a number of issues. Although requirements stemming from the CRD IV are transposed into national laws, participating Member States and stakeholders have different interpretations of these provisions, potentially leading to diverging results. In order to ensure harmonisation in the application of these requirements, euro area policy stances and supervisory practices were defined. Through a dedicated network of experts, the ECB and the NCAs jointly succeeded in developing common SSM policy stances on several

³³ About 10% of fit and proper decisions (for Member States with a deadline) were not taken within the deadline specified under national law.

issues relating in particular to fit and proper assessments and to the assessment of acquisitions of qualifying holdings.

With regard to fit and proper procedures, policy stances were developed regarding, among other things:

- the assessment of pending criminal and administrative proceedings;
- sufficient time commitment to perform a management function;
- the way of counting directorships that may be held by a member of the management body;
- the disclosure and the weighing of possible conflicts of interest;
- the assessment of a management body's collective suitability.

Further policy stances were completed in early 2016, in particular with regard to interviews with candidates, the evaluation of relevant experience and the criteria for conditional approvals.

Regarding the assessment of qualifying holdings, harmonised guidance has been developed for assessing proposed acquisitions of qualifying holdings in credit institutions by acquirers characterised by a high level of complexity or a lack of transparency (*specific acquirers*), such as private equity funds, hedge funds and sovereign wealth funds. With these types of acquirers, it can be challenging to identify the ultimate beneficial owners in order to assess their reputation. Furthermore, such acquirers regularly finance the acquisition through a form of leverage, possibly having an impact on their financial soundness and stability, as well as on their long-term commitment. The policy stance developed provides guidance on these aspects.

3.2 Reporting of breaches, enforcement, and sanctioning proceedings

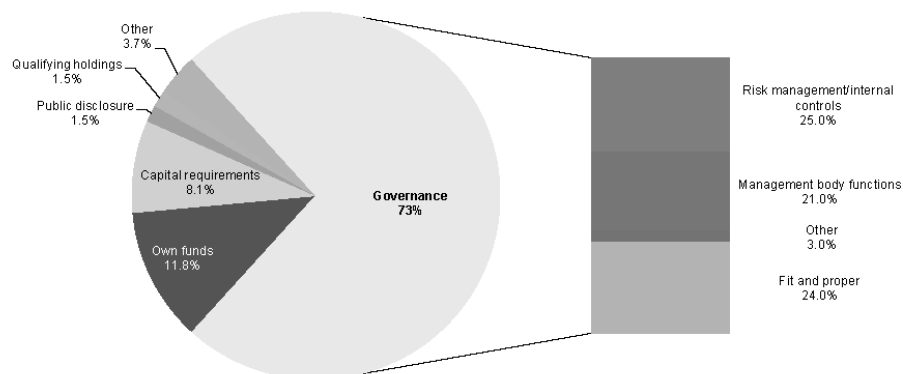
3.2.1 Experience with reporting on breaches under Article 23 of the SSM Regulation

It is the ECB's duty to ensure that effective mechanisms are put in place for reporting by any person of breaches of relevant EU law. In order to comply with that duty, the ECB set up a breach reporting mechanism (BRM) which includes a *pre-structured web platform* accessible through the ECB's banking supervision website.

In 2015, 79 breach reports were received by the ECB. Of these, 60 referred to alleged breaches of relevant EU law, 51 of which were considered to be within the remit of the ECB's supervisory tasks. A further nine breach reports fell within the remit of the NCAs' supervisory tasks. The remainder referred mainly to national issues not related to prudential requirements and, therefore, fell outside of the scope of the BRM (e.g. consumer protection). The reports falling within the remit of the

supervisory tasks of the ECB or the NCAs were forwarded to the relevant JSTs or NCAs for appropriate follow-up. Among the most common alleged breaches reported were governance issues (73%) and inadequate calculation of own funds and capital requirements (20%). The complete breakdown is shown in Chart 5. Governance-related issues referred mainly to risk management and internal controls, management body functions and fit and proper requirements. “Risk management and internal controls” comprises the mechanisms or processes that an entity needs to have in place for the adequate identification, management and reporting of the risks it is or might be exposed to. “Management body functions” refers to the extent to which the persons who effectively direct the business of an institution – or those who are empowered to set the institution's strategy, objectives and overall direction, and oversee and monitor the management decision-making – comply with their responsibilities.

Chart 5
Breakdown of alleged breaches reported by areas of infringement



Follow-up feedback received from the JSTs or the NCAs on reports submitted since November 2014 shows that the main supervisory actions taken were:

- on-site inspections (32% of the cases, which refer to six supervised entities);
- requests for an internal audit or internal investigation (17% of the cases, which refer to eight supervised entities);
- requests for documents or explanations to the entity or accused person (17% of the cases, which refer to nine supervised entities).

3.2.2 Enforcement and sanctioning

Under the SSM Regulation and the SSM Framework Regulation, the allocation of enforcement and sanctioning powers against credit institutions between the ECB and the NCAs depends on the nature of the alleged breach, the person responsible and the measure to be adopted (see [Annual Report 2014](#)).

In 2015 the ECB initiated one sanctioning proceeding in relation to suspected breaches of directly applicable EU law by a significant supervised entity. In addition, the ECB addressed two requests to NCAs to open sanctioning proceedings within the remit of their national competences.

The ECB also initiated one enforcement proceeding regarding a suspected breach of an ECB supervisory decision by a significant supervised entity.

These suspected infringements, which are under investigation, relate to governance, large exposures, capital requirements, public disclosure and reporting obligations.

After the initial stage of the SSM, during which the focus was on gaining knowledge of the prudential situation of the supervised entities, the ECB's policy stance for the next cycle can be expected to lead to an increase in the use of its enforcement and sanctioning powers.

4 The SSM as part of the European and global supervisory architecture

European and international cooperation is a key priority for ECB Banking Supervision. Consequently, the ECB entered into a number of Memoranda of Understanding (MoUs) with other European institutions such as the European Banking Authority (EBA) and the Single Resolution Board (SRB). It also joined in the existing MoUs between NCAs within the SSM and non-euro area NCAs. Furthermore, the ECB developed coordination and cooperation arrangements for relevant supervisory colleges, and it was involved in the IMF's Financial Sector Assessment Programme (FSAP) and the reviews undertaken by the EBA.

The ECB also contributed to further developing the European and international regulatory framework. Having become a member of the Basel Committee on Banking Supervision, it contributed to various regulatory initiatives. At the European level, the ECB supported the EBA's work on the single European rulebook. In 2015 another major step towards regulatory harmonisation was taken by addressing the issue of options and national discretions in CRD IV which had been a source of regulatory fragmentation.

4.1 European and international cooperation

4.1.1 Cooperation with other relevant national/EU authorities and state of play of close cooperation

The establishment of the SSM has by no means decreased the importance of "intra-EU cooperation", i.e. ensuring proper information-sharing and cooperation with other EU supervisory authorities.

The ECB has been working – and will continue to work throughout 2016 – towards the conclusion of its own MoUs with non-euro area EU NCAs, market authorities, and EU institutions.

Authorities in the European System of Financial Supervision

Cooperation with non-euro area NCAs is steadily materialising, in accordance with the European legislation and, in particular, under the conditions set by CRD IV.

The ECB has also joined in the MoUs already in place between non-euro area and euro area NCAs. Consequently, the specific provisions of these MoUs apply to the supervision of significant institutions.

In line with the SSM Regulation, the ECB has also been working on a template MoU, to be submitted to the non-euro area NCAs for negotiation, which is aimed at placing particular emphasis on the supervision of global systemically important institutions.

On 13 March 2015 the ECB concluded with the EBA and other EU banking supervisory authorities an MoU establishing a framework for an EU-wide exchange of bank-by-bank data on key risk indicators, which are collected by the EBA from competent authorities across the EU. The ECB has thereby increased the scope of peer analysis and benchmarking of banks beyond the euro area. This will, in general, increase the efficiency and effectiveness of supervision across the EU.

The ECB worked on an MoU with the **European Securities and Markets Authority (ESMA)** regarding both its supervisory and central banking functions, which was signed on 27 January 2016. For the banking supervision tasks, the MoU covers, inter alia, how the authorities will cooperate in performing their respective tasks under EU law, including in relation to financial institutions and markets. In addition, both authorities acknowledge the importance of the links that exist between the safety and soundness of credit institutions and the stability and effectiveness of the financial system.

In 2015 the ECB has also been working – together with ESMA – towards the finalisation of a template MoU, which the ECB and the **national market authorities** may conclude on a voluntary basis in order to ensure the proper supervision of financial institutions referred to in the SSM Regulation and in financial markets legislation. The template MoU covers, inter alia, the topics of information exchange and cooperation on on-site inspections.

Colleges of supervisors

Colleges of supervisors are permanent yet flexible coordination structures that bring together competent authorities involved in the supervision of cross-border banking groups. These colleges continue to play an important role for SSM banks with a presence in non-euro area countries.

Under Article 115 of CRD IV, **Commission Implementing Regulation (EU) 2016/99** and **Commission Delegated Regulation (EU) 2016/98** on the functioning of colleges of supervisors, the consolidating supervisor and the other competent authorities are required to have written coordination and cooperation arrangements in place to steer the functioning of the colleges of supervisors, both in going concern and in emergency situations.

For each significant institution for which a college of supervisors has been established, JSTs have developed written coordination and cooperation arrangements on the basis of a common template developed by the EBA.

The arrangements provide, inter alia:

- information on the overall structure of the group, as well as on the members and observers of the college;
- a description of the arrangements for exchanging information, including the treatment of confidential information and indicators for identifying early warning signs, potential risks and vulnerabilities of banks;
- a description of the framework for the planning and coordinating supervisory activities both in going concern and in emergency situations.

Single Resolution Board

In 2015 ECB Banking Supervision began its cooperation with the Single Resolution Board (SRB) (see Section 2.2.2) and national resolution authorities. The relevant EU and national law prescribes that the ECB and resolution authorities exchange all information necessary for the performance of their tasks. Consequently, the SSM established information exchange procedures with the SRB and the national resolution authorities.

Officials from ECB Banking Supervision attended SRB meetings and high-level policy workshops. ECB staff supported the build-up phase of the SRB with expertise gained through the establishment of the SSM. For instance, ECB experts participated in the work of the SRB Committees and contributed to the SRB's policy discussions and papers, manuals and frameworks.

On 22 December 2015, the ECB and the SRB concluded a bilateral MoU and established general rules for cooperation and information exchange. This will avoid duplication in data collection and an unnecessary increase in the reporting burden of banks. The MoU will help to build a bridge between the relevant pillars of banking union.

Close cooperation

EU Member States whose currency is not the euro may participate in the SSM under a regime of close cooperation. The main conditions for this are set out in Article 7 of the SSM Regulation and the procedural aspects are provided for in [Decision ECB/2014/5](#).³⁴

No formal requests for close cooperation were received in 2015, although some informal exchanges of information took place at a technical level in order to clarify aspects concerning the procedure for entering into close cooperation.

³⁴ Decision of the European Central Bank of 31 January 2014 on the close cooperation with the national competent authorities of participating Member States whose currency is not the euro (ECB/2014/5).

4.1.2 IMF Financial Sector Assessment Programmes

Over the period 2015-18, IMF Financial Sector Assessment Programmes (FSAPs) are scheduled for ten euro area countries: Belgium, Germany, Spain, Ireland, France, Italy, Luxembourg, the Netherlands, Austria and Finland.³⁶ Work on the FSAP assessments for Germany, Ireland and Finland was launched in 2015.

The IMF's FSAPs are comprehensive and in-depth assessments of a country's financial sector, encompassing three main components:

1. the identification of key vulnerabilities and the assessment of the resilience of the financial sector to severe but plausible shocks, usually conducted through stress tests;
2. the assessment of both a country's financial stability policy framework, notably including the microprudential and macroprudential regulatory framework, and its supervisory framework, and supervision practice, centred on the assessment of compliance with the Basel core principles for effective banking supervision;
3. the evaluation of financial safety nets and the financial system's capacity to manage and resolve a financial crisis, with a focus on assessing compliance with the Financial Stability Board's (FSB) key attributes of effective resolution regimes as concerns the banking sector.

FSAPs are country exercises, and national authorities therefore take the lead. Nevertheless, alongside the respective national authorities, the ECB is heavily involved in these surveillance exercises in euro area countries owing to its responsibilities in the areas of microprudential and macroprudential banking supervision.

The main objectives of the ECB's involvement are to:

1. ensure the cross-country comparability and consistency of the banking sector component of FSAPs for euro area countries;
2. exploit to the extent possible synergies with EU/euro area-wide banking stress tests;
3. ensure that the key features of the microprudential and macroprudential banking supervision framework resulting from the establishment of the SSM are accurately reflected at the national level, and that the areas needing further development are identified in the IMF's recommendations.

Since FSAPs primarily come under the country surveillance conducted by the IMF, most of the results and recommendations will continue to be addressed to the respective national authorities. Nevertheless, in view of the new banking supervisory architecture established in the euro area, those recommendations related to the well-

³⁶ These countries are a subset of the 29 jurisdictions with financial sectors deemed by the IMF to be systemically important and for which the Financial System Stability Assessment under the FSAP is a mandatory part of the IMF's Article IV surveillance.

functioning of the SSM will be addressed to the ECB, as legally appropriate. For IMF surveillance and advice to remain effective and relevant, they will need to fully reflect the new policy-making framework and respective competences at the levels of Member States, the euro area and the EU, respectively.

4.1.3 EBA Review Panel

In 2015 ECB Banking Supervision participated in peer reviews conducted at EU level. The ECB is a member of the EBA's Review Panel, the role of which is to assist the EBA in fulfilling its mandate. The Review Panel conducts peer reviews of supervisory activities performed by competent authorities with the objective of improving consistency.

In 2015 the EBA's Review Panel performed a review on the "Assessment of the suitability of members of the management body and key function holders". The results were published by the EBA on 16 June 2015. The Review Panel has identified best practices and areas for improvement in the supervisory practices of the competent authorities with regard to assessing the suitability of managers and key function holders in credit institutions.

The ECB has also contributed to the review of the implementation of the Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council. The review, which is still ongoing, aims to assess how competent authorities implement and perform quality assurance of data submitted by individual institutions and the process in place for implementing changes to the implementing technical standards.

4.1.4 Memoranda of Understanding with non-EU countries

To ensure smooth cooperation with third (non-EU) countries, the ECB proposed in 2015 to "step into" the MoUs that the NCAs have already concluded with third-country authorities. Article 152 of the SSM Framework Regulation provides for this approach, thereby ensuring the continuity of the supervisory practices.

With the agreement of the relevant counterparties, which was obtained in the course of 2015, the ECB has now joined the cooperation arrangements that all NCAs have in place with 38 third-country authorities.

In 2015 the ECB also worked on a draft template MoU that would be presented for negotiation with priority third countries throughout 2016.

4.2 Contributing to the development of the European and international regulatory framework

4.2.1 Contribution to the Basel process and EBA work on the single rulebook

Basel Committee on Banking Supervision and Financial Stability Board

In late 2014 ECB Banking Supervision became a member of the **Basel Committee on Banking Supervision (BCBS)**. Consequently, it participated actively in the work of the BCBS and its oversight body, the Group of Central Bank Governors and Heads of Supervision, over the course of 2015.

As reported to the November 2015 G20 Leaders Summit in Antalya³⁶, the BCBS had made progress over the past year towards finalising its post-crisis regulatory reforms and balancing their design against the high-level objectives of risk sensitivity, simplicity and comparability.

ECB Banking Supervision provided expertise and input to around 30 working groups within the BCBS. This was coordinated by the ECB's Supervisory Policies Division in liaison with counterparts from the ECB's DG Macroeconomic Policy and Financial Stability and alongside several other euro area competent authorities and national central banks, the European Commission and the EBA, which are also represented in the BCBS.

The outstanding **Basel III policy reforms** continued to be a priority area for ECB Banking Supervision, which contributed to discussions leading to:

- consultations on: (i) proposed revisions to the standardised approaches for credit risk and operational risk; (ii) the design of an associated capital floor; and (iii) a package of reforms to enhance the comparability of risk-weighted assets calculated using internal ratings-based approaches for credit risk;
- the finalisation of the fundamental review of the trading book (revised framework of minimum capital requirements for market risk);
- a consultation on a proposed deduction treatment for banks' investment holdings of total loss-absorbing capacity (TLAC);
- an upcoming review, including final calibration, of the leverage ratio (with a view to its migration to Pillar 1 on 1 January 2018);
- a consultation to enhance the capital treatment for "simple, transparent and comparable" securitisations in the capital framework;

³⁶ *Finalising post-crisis reforms: an update, A report to G20 Leaders*, BCBS, November 2015, available at: <https://www.bis.org/bcbs/publ/d344.pdf>

- a consultative document on the risk management, capital treatment and supervision of interest rate risk in the banking book.

ECB Banking Supervision also contributed to an upcoming review of the scope of regulatory consolidation, as well as to an ongoing debate on the potential revision of the prudential treatment of sovereign exposures – a strand of work that the BCBS is undertaking in a careful, holistic and gradual manner.

The BCBS is expected to have its policy reform agenda concluded by the end of 2016. The focus of the BCBS's work will continue to gradually shift to: (i) the monitoring of the timeliness and consistency of domestic implementation of reforms – most prominently via Regulatory Consistency Assessment Programmes – and, importantly, of their outcomes; and (ii) operational supervision issues, including the monitoring of the effectiveness of colleges, the role of Pillar 2 in the capital framework, stress testing practices and corporate governance. These are areas which ECB Banking Supervision has also followed closely, and in which it stands ready to step up its involvement.

One important development for ECB Banking Supervision in 2015 related to its institutional representation on the **Financial Stability Board (FSB)**. In its meeting on 26 March in Frankfurt, the FSB Plenary decided to grant ECB Banking Supervision a seat on the Standing Committee on Supervisory and Regulatory Cooperation (SRC). ECB Banking Supervision has started to contribute to the work of the SRC, which is in charge of addressing key financial stability issues relating to the development of supervisory and regulatory policies (on topics such as the “too big to fail” issue and risks stemming from market-based finance) and the coordination of issues with cross-sector implications that arise among financial authorities.

Contribution to the work of the EBA

At the EU level, ECB Banking Supervision continued to work together with the EBA towards the shared objective of fostering effective and consistent prudential supervision and regulation across the European banking sector.

The main task of the EBA is to develop the **single European rulebook** in banking in order to provide a set of harmonised prudential rules for credit institutions in the EU. The EBA also plays an important role in promoting the convergence of supervisory practices in order to ensure a harmonised application of prudential rules. To this end, ECB Banking Supervision representatives participated in some 50 EBA working groups and in the main committee – the EBA Board of Supervisors on which the ECB participates as a non-voting member.

More generally, the SSM facilitates the harmonisation of supervisory practices across national competent authorities to ensure the consistent implementation of the single European rulebook. This is achieved through the JSTs in charge of the operational supervision of significant institutions and the expertise that ECB horizontal functions contribute at all stages of the supervisory cycle.

In the regulatory area, the main focus of the EBA in 2015 related to the CRR/CRD IV, the Banking Recovery and Resolution Directive (BRRD) and the revision of the Deposit Guarantee Schemes Directive.

Under the **CRR/CRD IV framework** which came into effect on 1 January 2014 and follows the prudential rules of Basel III, about 250 deliverables are to be developed by the EBA. In 2015 the majority of these related to credit risk, market risk, liquidity and leverage.

Under the BRRD, the EBA has the mandate to issue guidelines and draft regulatory and implementing technical standards in the area of **resolution**, including the functioning of resolution colleges. The ECB participates in the EBA's Resolution Committee, which was established on 1 January 2015 and is entrusted with preparing the EBA's decisions in this regard.

In the oversight area, the EBA expanded its policy and monitoring work on **supervisory convergence in Pillar 2** and issued detailed Pillar 2 risk management guidelines, which serve as a basis for the SREP methodology used throughout the SSM.

With regard to **stress testing**, the EBA is required, in cooperation with the European Systemic Risk Board (ESRB), to initiate and coordinate EU-wide stress tests in order to assess the resilience of financial institutions to adverse market developments. ECB Banking Supervision is responsible for: (i) conveying instructions to the relevant banks on how to complete the exercise; (ii) the quality assurance process; and (iii) the supervisory reaction function.

Within this setting, ECB Banking Supervision has collaborated closely with the EBA on preparing the next 2016 EU-wide stress test. The outcomes of the exercise, including banks' individual results, are expected to be published early in the third quarter of 2016, aligning the finalisation of the exercise with the annual SREP cycle.

4.2.2 Implementation of options and discretions in the CRR/CRD IV

Options and national discretions in the single European rulebook: a remaining obstacle to the completion of banking union

The CRR/CRD IV and, more generally, the single European rulebook aim to establish a level playing field in European banking by reducing the scope for regulatory divergence and inconsistency across countries. Building a coherent regulatory framework is crucial for establishing a single integrated banking market, but is also a complex task from a technical and political perspective. For this reason, the legislator left a certain degree of flexibility to the Member States – normally via their supervisory authorities – as to whether or how to apply specific rules. Such flexibility was intended to accommodate national specificities and different supervisory approaches, at a time when the establishment of a single supervisory authority had not yet been foreseen (the CRR/CRD IV was completed in 2013).

These flexible provisions, which are often referred to as “options and national discretions” (ONDs)³⁷, as well as an inconsistent implementation of provisions in the CRD IV, distort the level playing field, hampering the functioning of the Single Market and of banking union itself. With regard to ONDs, their previous use at a national level has resulted in a heterogeneous and, on many occasions, a more lenient application of the provisions of the CRR/CRD IV across euro area countries.

This has adverse consequences not only for credit institutions and the competent authorities, but also for other important stakeholders, such as analysts and investors. For example, heterogeneity affects the comparability of reported ratios and raises uncertainty with regard to the actual capital and liquidity positions of banks. It also affects the consistency of the supervisory Pillar 2 decisions, especially since there has been a significant level of discrepancy in the national implementation of transitional provisions on capital.

The establishment of a single European supervisor has offered an opportunity to promote integration via supervisory actions, by exercising the ONDs in a harmonised manner throughout the participating Member States. The SSM Regulation sets as a primary objective the “safety and soundness of credit institutions and the stability of the financial system [...], with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory arbitrage.” Fulfilling this mandate presupposes the establishment of a level playing field for all banks participating in the SSM.

The ONDs identified in the CRR/CRD IV affect all areas of the prudential framework and cover a very wide range of treatments: many relate to the definition of own funds and capital requirements for credit, counterparty and market risks, but there are also important provisions concerning large exposures, liquidity and governance arrangements of the institutions.

By launching the OND project, the ECB seeks to address precisely the above consequences and to foster the harmonisation and integration of the banking system, which is fully consistent with its mandate.

Project on options and national discretions

The particular urgency of launching this project was highlighted in the 2014 comprehensive assessment, during which the harmonisation of ONDs was determined as an issue for the SSM to address as a matter of priority. Having examined the impact of the national exercise of transitional adjustments, the majority of which are classified as ONDs and relate to the definitions of own funds provided for in the CRR, the comprehensive assessment exercise estimated that, as of 1

³⁷ There is no binding definition of options or national discretions. According to the EBA's summary, an “option” refers to a situation in which competent authorities or Member States are given a choice on how to comply with a given provision, making a selection from a range of alternatives set forth in EU law, and “national discretion” refers to a situation in which competent authorities or Member States are given a choice whether to apply – or not to apply – a given provision.

January 2014, the CET1 impact across all euro area banks amounted to €126.2 billion;³⁸ transitional adjustments improved the average³⁹ CET1 ratio of significant institutions by 1.5% of risk-weighted assets. However, the effect of the adjustments was heterogeneous and differed across countries⁴⁰, thus distorting the level playing field. The project was also supported by the Eurogroup, which on 24 April 2015 called for concerted work effort on ONDs by the ECB in order to move as rapidly as possible to a more level playing field within banking union.

NCA's contributed to the ECB's work, which consisted of the following three steps: (i) mapping of the scope of ONDs; (ii) designing the policy recommendations and specifications for each OND, and (iii) implementing the agreed policy.

Scope of the OND project

On the basis of recurrent features found among the 167 ONDs identified so far, the provisions were classified according to a set of criteria. The most important criteria are:

- the legal text where they are located;
- the entity to which the option or discretion is granted (i.e. Member State, competent authority or both);
- the modality of application, namely whether the OND can be exercised *ex ante* in a general way and be applicable to all institutions, or whether a case-by-case assessment, based on institution-specific elements, is required.

In the end, the ECB addressed **122 ONDs granted to competent authorities**, as they fall within the ECB's direct competence, with exclusive focus on significant institutions, exercised on a general, as well as on a case-by-case basis. Among these ONDs are the 12 ONDs of the Liquidity Coverage Requirement Delegated Act⁴¹, which were included not only because they are linked to the provisions set out in the CRR on liquidity, but also in order to accommodate the ECB's operational needs due to the Delegated Act becoming applicable as from 1 October 2015.

³⁸ This amount covers both transitional ONDs and other transitional provisions.

³⁹ A weighted average is used for the computation.

⁴⁰ National rules are to be understood as the minimum pace at which banks need to phase out transitional rules. Therefore, even within a country, banks might have some discretion regarding the way they apply the transitional rules.

⁴¹ Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 on the liquidity coverage requirement.

Figure 5
Scope of the OND project

Competence	Scope	Some examples	
Competent authority [119 ONDs]	All banks (general decision) [44 ONDs]	Transitional ONDs on capital; definition of default; treatment of exposures to public sector entities	Project focus: 110 competent authority microprudential ONDs in CRR/CRD IV, + 12 ONDs in the LCR Delegated Act
	Case-by-case (individual decision) [66 ONDs]	Waivers on liquidity and capital requirements at solo level and development of common specifications; preferential treatments for liquidity requirements	
	Macroprudential [9 ONDs]		
Member States [36 ONDs]	All banks (general decision) [36 ONDs]	[not within scope of the OND project]	Total: 122 (+ 45 out of scope → 167)
Total: 155 (+ 12 ONDs in the LCR Delegated Act → 167)			

Design of the policy and analysis of the impact

The second step in designing the prudential policy – entrusted to a High-Level Group composed of Supervisory Board alternates, hence benefiting from the intense collaboration between the ECB and the national competent authorities – was based on high-level guiding principles. Prudence was the fundamental principle for determining the ECB policy, as convergence towards the lowest standard would not have been acceptable for financial stability reasons. In line with the objectives of banking union and the principle of prudence, the promotion of an open and integrated banking market was pursued.

Compliance with international supervisory standards was another consideration, in particular the global standards originating from the Basel Committee on Banking Supervision and the European standards drafted by the EBA. While the Basel Committee and EBA standards which were relevant for this work were followed, some divergence was allowed, mainly in the interest of ensuring a smoother transition to the new regime. Where the Basel standards either did not provide specific guidance or gave alternative means of implementation, an appropriately conservative approach complying with the principle of prudence, was preferred.

The principle of equal treatment also underpinned the policy development, according to which the same rules should apply for the same business and the same risks, while making appropriate allowance for some cases that may warrant different treatment. Observing this principle plays an important role in enhancing financial integration. Importantly, close attention was also paid to legitimate expectations by market participants, i.e. expectations which were created by previous decisions by national authorities.

For all ONDs within the scope of the project, the ECB has conducted a thorough analysis of previous national implementation and practices, including a quantitative

impact study for selected provisions. The NCAs participated extensively in this work and agreement was reached regarding the 122 ONDs.

In some cases, further analysis will be needed in order to take account of future European and international developments – at the level of the EBA, the European Commission and the Basel Committee.

Implementation of the policy on options and discretions

Following the Supervisory Board's approval of the substance of the ECB's policy, work began on the third step, i.e. the implementation of the agreed policy. The options and discretions were divided between a draft **Regulation** and a **Guide** according to their modality of application (i.e. general or on a case-by-case basis). 35 of the general options and discretions contained in the CRD IV package and the Liquidity Coverage Requirement Delegated Act will be directly exercised through an ECB Regulation that is legally binding and directly applicable. The ECB has also adopted a specific approach in a Guide regarding 82 further options and discretions, including those applicable on a case-by-case basis.⁴² The draft regulation and guide were subject to a public consultation during November and December 2015. Upon finalisation, after taking into account the outcome of the consultation, they were adopted by the ECB in March 2016. The regulation will become applicable in October 2016.

Further work on options and discretions

Following the completion of the first phase of the project, a **second phase** was launched in 2016, aimed at completing the mapping and policy work, covering a smaller set of provisions of a lower priority than the first, or for which additional work was needed.⁴³ In addition, ECB Banking Supervision is assessing to what extent the policy on options and national discretions can be implemented for the **less significant institutions** – after the warranted adjustments according to their specificities – in order to further enhance a level playing field throughout the SSM. Finally, a future line of work, to be pursued with the cooperation of the European Commission and the relevant national authorities, relates to the ONDs that have been exercised through **national legislation**, which remain a relevant source of asymmetry in supervisory treatment across the euro area.

⁴² The five remaining options and discretions were left out of the draft legal instruments, because the ECB refrains from exercising them.

⁴³ The provisions on which additional work is needed are included in Section III of the ECB Guide on Options and Discretions.

4.2.3 Open issues in regulatory harmonisation

The work on options and discretions represents a significant step towards a harmonised regulatory framework in the euro area. Nevertheless, the regulatory playing field in Europe is not as level as it should be.

There appear to be two main sources of fragmentation. The first source is the national transposition of CRD IV. As CRD IV is a directive, Member States are free to choose how they transpose the European rules into national legislation. Consequently, several provisions of CRD IV have been transposed differently across the euro area. This is certainly not a problem in itself as long as the differences are rooted in country-specific risks. But there are many unjustified differences.

The second source of regulatory fragmentation is the supervisory powers under national law that are not explicitly mentioned in CRD IV. This raises the question whether the ECB, as a European institution, can directly exercise such competences. Thus far, this question has only ever been answered on a case-by-case basis. A more consistent approach is required now that European banking supervision is in place.

Many of the variations in national legislation can no longer be justified. Article 1 of the SSM Regulation requires the ECB to carry out prudential supervision "with full regard and duty of care for the unity and integrity of the internal market". The Article also refers to the "equal treatment of credit institutions with a view to preventing regulatory arbitrage". A fragmented regulatory framework makes it difficult for the ECB to meet these requirements.

And new differences are still being created. Some national legislators are converting non-binding supervisory practices into binding legal acts, thereby making it harder for the ECB to harmonise these practices. A recent example is the German law on bank resolution. This law delegates to the Ministry of Finance the power to issue regulations in areas such as internal governance and risk management (the Ministry of Finance has not made use of this power so far).

National banking legislation adopted after the establishment of the SSM should adequately consider the ECB's new responsibilities, with a view to facilitating the harmonisation of supervisory practices in the banking union.

5 Reporting on budgetary consumption

The SSM Regulation provides that the ECB must be able to dispose of adequate resources to carry out its supervisory tasks effectively. It further requires that these resources are to be financed via a supervisory fee that will be borne by the entities subject to the ECB's supervisory tasks.

The expenditure incurred for supervisory tasks is separately identifiable within the ECB's budget as prescribed by the SSM Regulation. The budgetary authority of the ECB is vested in its Governing Council. This body adopts the ECB's annual budget following a proposal of the Executive Board after consultation with the Chair and Vice-Chair of the Supervisory Board for matters related to banking supervision. The Governing Council is assisted in matters related to the budget by the Budget Committee (BUCOM), which consists of members from all national central banks of the Eurosystem and the ECB. BUCOM evaluates the ECB's reports on budget planning and monitoring, and reports on them directly to the Governing Council.

5.1 Expenditure for 2015

The expenditure incurred by the ECB for the conduct of supervisory-related tasks consists primarily of the direct expenses of the ECB's Banking Supervision Directorates General and the Secretariat to the Supervisory Board. The supervisory function also relies on shared services provided by the existing functions of the ECB, including premises, human resources management, administrative services, budgeting and controlling, communications, accounting, legal, internal audit, statistical and information technology services. The related expenses are incorporated in the ECB's budget and are separately identifiable.

In April 2015 the Governing Council adopted the Decision of the ECB on the amount to be recovered via supervisory fees in 2015. This Decision determined the estimate of annual expenditure for banking supervisory tasks at €296.0 million for 2015.⁴⁴ At the end of 2015 the ECB's expenditure for banking supervisory tasks stood at €277.1 million, i.e. 6% lower than the estimate of annual expenditure, resulting in a surplus of €18.9 million compared with the amount invoiced in 2015. In accordance with the applicable Regulation, this surplus will be set in full against the total amount to be levied in 2016.⁴⁵

As explained in Chapter 1.3, the Governing Council has decided to reinforce the supervisory resources of the ECB in 2016. This, together with actions targeting specific areas that require additional supervisory attention as communicated in the

⁴⁴ Decision (EU) 2015/727 of the European Central Bank of 10 April 2015 on the total amount of annual supervisory fees for the first fee period and for 2015 (ECB/2015/17).

⁴⁵ Article 9 of Regulation (EU) No 1163/2014 of the European Central Bank of 22 October 2014 on supervisory fees (ECB/2014/41).

document entitled “ECB Banking Supervision: SSM priorities 2016”, will lead to an increase in the total expenditure incurred for banking supervision as of 2016. As a consequence, the steady-state level of the ECB’s total annual supervisory expenditures can only emerge in the medium term.

Table 9
Costs of the supervisory function in 2015

	Actual expenditure 2015 (in € millions)	Estimated expenditure 2015 (in € millions)	Actual expenditure 2014 (in € millions)
Salaries and benefits	141.3	151.7	68.9
Rent and building maintenance	25.5	22.6	13.2
Other operating expenditure	110.3	121.8	74.8
Total expenditure for banking supervision tasks	277.1	296.0	156.9

5.1.1 Salaries and benefits

Salaries and benefits comprise all salary-related expenditures, including overtime, allowances and costs in relation to post-employment benefits, for supervisory staff and staff of the shared services.

The actual expenditure for 2015 salaries and benefits is €141.3 million, i.e. 93% of projected expenditure and representing 51% of the total expenditure for banking supervisory tasks. The €10.4 million difference between projected and actual expenditure can be largely explained by the lower than expected average occupation rate. As of 31 December 2015 approximately 96% of banking supervision-related positions had been filled.

An increase in salary and benefits-related expenditure can be expected owing to the Governing Council’s decision to reinforce the supervisory resources of the ECB in 2016, as explained in Chapter 1.3.

5.1.2 Rent and building maintenance

At the end of 2015 the actual expenditure on rent and building maintenance including depreciation of premises-related assets stood at €25.5 million, i.e. 113% of projected expenditure. The actual expenditure, at €2.9 million above the projected estimate, is primarily explained by an increase in depreciation-related charges for premises-related investments.

In the course of 2015 the Eurotower premises in which ECB Banking Supervision will be relocated were refurbished. The current project schedule foresees that the relocation will be finalised by mid-2016. As a consequence, together with the planned increase in supervisory staff as outlined above, an increase in rent and premises-related charges can be expected from 2016.

5.1.3 Other operating expenditure

The category "Other operating expenditure" includes costs such as consultancy, IT services, statistical services, depreciation for fixed assets (other than premises-related), business travel and training.

Overall, the budgetary performance in this category is below the expenditure projected in April 2015, which at €110.3 million represented a consumption rate of 91%. This was mainly a consequence of the reprioritisation of resources towards the supervisory contribution to urgent financial stability tasks, which resulted in lower business travel, training and associated costs. The lower than projected average occupation rate was also a contributing factor in the underspend.

The actual costs in 2015 incorporate the external support that was engaged for the ECB's supervisory contribution to financial stability tasks, namely the comprehensive assessment of Greek significant institutions, the "regular" 2015 comprehensive assessment and the conduct of on-site supervision, all of which are explained in detail in Chapter 2.

5.2 Fees framework: November 2014-December 2015

Together with the SSM Regulation, the [ECB Regulation on supervisory fees](#) provides the legal framework under which the ECB levies an annual supervisory fee for the expenditure incurred by the ECB in relation to supervisory tasks. The Fees Regulation establishes the methodology for: (i) determining the total amount of the annual supervisory fee; (ii) calculating the amount to be paid by each supervised bank; and (iii) collecting the annual supervisory fee.

In 2015 the ECB, for the first time, sent individual fee notices to all supervised institutions for the actual costs incurred for November and December 2014 (taking into account that the ECB assumed operational responsibility for banking supervision in November 2014) and for the annual period 2015.

5.2.1 Total amount levied

The total amount of fees levied by the ECB for the costs of its prudential supervision of the euro area banking sector in the 2014-15 period was €326 million.

This is broken down into:

- €30 million for the costs incurred in the final two months of 2014, as published in the ECB's Annual Accounts 2014;
- €296 million for the anticipated expenditure for the full year 2015, which was communicated by the ECB in April 2015.

The amount to be recovered via annual supervisory fees is split into two parts, related to the status of the supervised entity (significant or less significant), reflecting the varying degrees of supervisory scrutiny by the ECB. This split is determined on the basis of the costs incurred by the business areas of the ECB that are responsible for the supervision of significant entities and those overseeing the supervision of less significant entities, respectively.

Table 10
Supervisory fees

	Actual income 2015 (in € millions)	Total amount levied 2015 (in € millions)	Total amount levied 2014 ⁴⁶ (in € millions)
Supervisory fees	277.1	296.0	30.0
<i>of which:</i>			
Fees on significant entities or significant groups	245.6	264.1	25.6
Fees on less significant entities or less significant groups	31.5	31.9	4.4
Total income from banking supervision tasks	277.1	296.0	30.0

The surplus of €18.9 million between the actual expenditure incurred in 2015 and the amount levied for 2015, as explained in Section 5.1 above, will be set in full against the total amount to be levied in 2016 and distributed to the categories of significant institutions and less significant institutions according to the actual costs in 2015 allocated to the relevant functions.

5.2.2 Individual supervisory fees

At bank level, the fees are calculated according to a bank's importance and risk profile, using annual fee factors supplied by all supervised banks with a reference date of 31 December of the preceding year. The supervisory fee calculated per bank is then charged via annual payments payable in the final quarter of each financial year.

The supervisory fee is set at the highest level of consolidation within Member States participating in the SSM. It is the sum of a minimum fee component for all banks, based on 10% of the amount to be recovered⁴⁷, and a variable fee component for the allocation of the balance of 90% of the amount to be recovered.

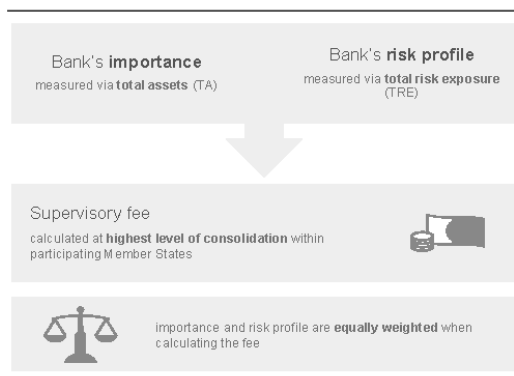
For the calculation of the annual supervisory fees payable in 2015 in respect of each supervised entity and each supervised group, the fee debtors submitted by 1 July 2015 the information on the fee factors with a reference date of 31 December 2014 to NCAs. On 30 July 2015 the ECB made the submitted fee factors data available to fee debtors and invited them to comment within five working days if they considered

⁴⁶ For 2014 the ECB recovered via supervisory fees its banking supervision-related costs for the period commencing November 2014, when it assumed its supervisory tasks.

⁴⁷ For the smallest significant banks, with total assets below €10 billion, the minimum fee component is halved.

the data to be incorrect. Afterwards the ECB calculated the individual fee per bank and banking group.

Figure 6
What determines the variable fee component?



The 2015 annual supervisory fees payable were largely consistent with the provisional estimates provided by the ECB in the public consultation in early 2014. In agreement with the preliminary impact analysis, nearly 50% of the significant entities were required to pay an annual supervisory fee of between €700,000 and €2.0 million for the annual period 2015. Similarly, for the less significant institutions, the preliminary impact analysis indicated that nearly 75% of them were to pay a fee of less than €7,000; according to the 2015 annual fee calculation outcome, 70% of supervised entities fell into this range.

As explained in Chapter 3.1, the ECB has approved a number of modifications in the situation of individual banks. Under Article 7 of the Fees Regulation, the

following changes in relation to a supervised entity at the highest level of consolidation require an amendment of the individual supervisory fee:

- a change in supervisory status of the supervised entity, i.e. the entity is reclassified from significant to less significant or vice versa;
- a new supervised entity is authorised;
- an existing authorisation is withdrawn.

In these cases, in order to issue a refund or a request for an additional fee payment to the supervised entity, a new supervisory fee decision will be taken by the ECB.

A small number of applications for amendments under the provisions of Article 7 have been notified to the ECB after issuance of the supervisory fee notices. The amounts reimbursed or levied under this provision will be set in full against the total amount to be levied.

5.2.3 The first fee invoicing and collection

In October 2015 the ECB issued two sets of supervisory fee notices to the supervised entities. One set of fee notices covered the actual expenditure incurred in the final two months of 2014 as published in the ECB's Annual Accounts 2014, while the other set anticipated the expenditure for the entire year 2015.

A fee notice issued to a supervised group covers the supervisory fees of the entire group. A separate fee notice is issued for a supervised stand-alone entity which is not a part of any supervised group.

At the end of December 2015 the ECB had collected over 99% of fees levied for banking supervisory tasks. The ECB takes all the necessary actions to collect the outstanding amounts from the supervised entities. In the current fee period, the ECB has collected interest charged to supervised entities for late payment of the supervisory fee in the amount of €0.05 million. As provided for in the Fees Regulation, this amount will be taken into account in determining the total amount to be levied in 2016.

More information on [supervisory fees](#) is available on the ECB's banking supervision website. These pages are updated regularly with useful, practical information and are published in all official EU languages.

6 Legal instruments adopted by the ECB concerning banking supervision

The following table lists the legal instruments concerning banking supervision that were adopted in 2015 by the ECB and published in the Official Journal of the European Union and/or on the ECB's website. It covers legal instruments adopted pursuant to Article 4(3) of Regulation (EU) No 1024/2013 and other relevant legal instruments.

ECB regulations

Number	Title
ECB2015/13	Regulation (EU) 2015/534 of the ECB of 17 March 2015 on reporting of supervisory financial information (OJ L 86, 31.3.2015, p. 13)

ECB legal instruments other than regulations

Number	Title
ECB2014/59	Decision (EU) 2015/433 of the ECB of 17 December 2014 concerning the establishment of an Ethics Committee and its Rules of Procedure (OJ L 70, 14.3.2015, p. 58)
ECB2015/2	Recommendation of the ECB of 28 January 2015 on dividend distribution policies (OJ C 51, 13.2.2015, p. 1)
ECB2015/4	Decision (EU) 2015/656 of the ECB of 4 February 2015 on the conditions under which credit institutions are permitted to include interim or year-end profits in Common Equity Tier 1 capital in accordance with Article 26(2) of Regulation (EU) No 575/2013 (OJ L 107, 25.4.2015, p. 76)
ECB2015/7	Decision (EU) 2015/530 of the ECB of 11 February 2015 on the methodology and procedures for the determination and collection of data regarding fee factors used to calculate annual supervisory fees (OJ L 84, 28.3.2015, p. 67)
ECB2015/8	Decision (EU) 2015/716 of the ECB of 12 February 2015 amending Decision ECB/2004/2 adopting the Rules of Procedure of the ECB (OJ L 114, 5.5.2015, p. 11)
ECB2015/12	Guideline (EU) 2015/656 of the ECB of 12 March 2015 laying down the principles of an Ethics Framework for the Single Supervisory Mechanism (OJ L 135, 2.6.2015, p. 29)
ECB2015/16	Decision (EU) 2015/611 of the ECB of 27 March 2015 on public access to ECB documents in the possession of the national competent authorities (OJ L 128, 23.5.2015, p. 27)
ECB2015/17	Decision (EU) 2015/727 of the ECB of 10 April 2015 on the total amount of annual supervisory fees for the first fee period and for 2015 (OJ L 115, 6.5.2015, p. 36)
ECB2015/21	Decision (EU) 2015/639 of the ECB of 27 April 2015 identifying the credit institutions that are subject to a comprehensive assessment (OJ L 132, 29.5.2015, p. 68)
ECB2015/36	Decision (EU) 2016/3 of the ECB of 18 November 2015 laying down the principles for providing feedback on the performance of national competent authorities' sub-coordinators in the joint supervisory teams of the Single Supervisory Mechanism (OJ L 1, 5.1.2016, p. 4)
ECB2015/38	Decision (EU) 2015/2218 of the ECB of 20 November 2015 on the procedure to exclude staff members from the presumption of having a material impact on a supervised credit institution's risk profile (OJ L 314, 1.12.2015, p. 66)
ECB2015/49	Recommendation of the ECB of 17 December 2015 on dividend distribution policies (OJ C 438, 30.12.2015, p. 1) Decision of 23 November 2015 on whether instruments to be issued by National Bank of Greece S.A. ('the Supervised Entity') meet the criteria for Common Equity Tier 1 instruments in accordance with Article 31 of Regulation (EU) No 575/2013, published under the "Letters to banks" section of the ECB's banking supervision website Decision of 23 November 2015 on whether instruments to be issued by Piraeus Bank S.A. ('the Supervised Entity') meet the criteria for Common Equity Tier 1 instruments in accordance with Article 31 of Regulation (EU) No 575/2013, published under the "Letters to banks" section of the ECB's banking supervision website Memorandum of Understanding between the Single Resolution Board and the ECB in respect of cooperation and information exchange, 22 December 2015

7 Glossary

Banking union: one of the building blocks for completing Economic and Monetary Union, which consists of an integrated financial framework with a single supervisory mechanism, a single bank resolution mechanism, and a single rulebook, including harmonised deposit guarantee schemes, which may evolve into a common European deposit guarantee scheme.

CRR/CRD IV: Capital Requirements Regulation and Directive: Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR) and Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV). They are often jointly referred to as CRD IV.

ECB supervisory decision: a legal act adopted by the ECB in the exercise of the tasks and powers conferred on it by the SSM Regulation. It is addressed to one or more supervised entities or supervised groups or one or more other persons and is not a legal act of general application.

Enforcement and sanctioning powers: powers available to the ECB aimed respectively at (i) compelling a supervised entity or person to comply with the prudential requirements, i.e. enforcement; and (ii) punishing a supervised entity for the lack of compliance with the prudential requirements through a pecuniary sanction.

European Banking Authority (EBA): the EBA is an independent EU authority established on 1 January 2011 to ensure effective and consistent prudential regulation and supervision across the EU banking sector. Its main task is to contribute to the creation of the European single rulebook in banking, the objective of which is to provide a single set of harmonised prudential rules throughout the EU. The EBA also plays an important role in promoting convergence of supervisory practices across the EU and is mandated to assess risks and vulnerabilities in the EU banking sector.

Failing or likely to fail: one of the three cumulative conditions determining whether resolution authorities should take resolution actions for a credit institution. Article 32 (4) of the Banking Recovery and Resolution Directive (BRRD) defines when a credit institution shall be deemed failing or likely to fail (a determination to be made by a supervisory or resolution authority).

Internal Capital Adequacy Assessment Process (ICAAP): the strategies and processes which banks are required to establish to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or might be exposed. The competent authorities review ICAAP as part of the SREP.

Internal Liquidity Adequacy Assessment Process (ILAAP): the strategies, policies, processes and systems which banks are required to establish for the management and monitoring of liquidity risk and funding positions. The competent authorities review ILAAP as part of the SREP.

Internal model: any risk measurement and management approach applied in the calculation of own funds requirements that is proprietary to a credit institution and requires prior permission by the competent authority in accordance with Part Three of the CRR.

Joint Supervisory Team (JST): a team of supervisors composed of ECB and NCA staff in charge of the supervision of a significant supervised entity or a significant supervised group.

Maximum distributable amount (MDA): breaches of the combined buffer requirement (CBR) lead to mandatory restrictions on distributions (e.g. dividends, coupon payments on AT1 capital instruments, discretionary bonuses). A bank which fails to meet its CBR will be automatically prohibited from distributing more than the MDA. The MDA is the bank's distributable profit multiplied by a factor ranging between 0.6 and 0, depending on by how much CET1 capital falls short of the CBR.

Minimum requirement for own funds and eligible liabilities (MREL): requirement for all EU credit institutions, with the aim of enabling credit institutions to absorb losses in case of their failure. The MREL requirement is part of the Banking Recovery and Resolution Directive (BRRD). It has the same goal as the TLAC requirement. However, the specific capital requirements prescribed by MREL are calculated differently, following criteria set by the EBA.

National competent authority (NCA): a public authority or body officially recognised by national law, which is empowered by national law to supervise institutions as part of the supervisory system in operation in the Member State concerned.

Non-objection procedure: standard decision-making process established by the SSM Regulation for the ECB's supervisory activities. The Supervisory Board takes draft decisions, which are submitted for adoption to the Governing Council. Decisions are deemed to be adopted unless the Governing Council objects within a defined period of time, not exceeding ten working days.

Passporting procedures: procedures concerning the freedom of establishment and the freedom to provide services in other Member States by any credit institution authorised and supervised by the competent authorities of another Member State, provided that such activities are covered by the authorisation (as regulated by Articles 33 to 46 of CRD IV).

Qualifying holding: a holding in a credit institution, which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that credit institution.

Significance: the criterion that determines the allocation of supervisory responsibilities to the ECB or the NCAs within the Single Supervisory Mechanism. The level of significance of credit institutions is based on criteria set out in the SSM Regulation, and specified in the SSM Framework Regulation.

Single Resolution Mechanism (SRM): a mechanism, which became fully operational on 1 January 2016, establishing uniform rules and a uniform procedure for the resolution of credit institutions established in the banking union. It is backed by a Single Resolution Board, which is the European resolution authority for the banking union, working in close cooperation with the national resolution authorities of participating Member States. For the purposes of resolution, the SRM has at its disposal a single resolution fund.

Single rulebook: the single rulebook in banking aims to provide a single set of harmonised prudential rules which credit institutions must respect throughout the EU. Beyond the legislation elaborated by the European Parliament and the EU Council with the assistance of the European Commission, the EBA has the competence to further develop this single rulebook and monitor its implementation.

Single Supervisory Mechanism (SSM): a mechanism composed of the ECB and national competent authorities in participating Member States for the exercise of the supervisory tasks conferred upon the ECB. The ECB is responsible for the effective and consistent functioning of this mechanism, which forms part of banking union.

SSM Framework Regulation: the regulatory framework setting out, in particular, the practical arrangements concerning the cooperation between the ECB and the national competent authorities within the Single Supervisory Mechanism, as provided for in Article 6 of the SSM Regulation.

SSM Regulation: the legal act creating a single supervisory mechanism for credit institutions in the euro area and, potentially, other EU Member States, as one of the main elements of Europe's banking union. The SSM Regulation confers on the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions.

Supervisory Examination Programme (SEP): In accordance with Article 99 of CRD IV, ECB Banking Supervision adopts annually an SEP for the institutions it supervises. This programme defines for each significant institution the main supervisory activities that will be carried out to monitor risks and to address weaknesses. It identifies which institutions are intended to be subject to enhanced supervision. The SEP for a significant institution covers ongoing supervisory activities, on-site inspections and internal model investigations.

Supervisory Manual: a manual detailing the general principles, processes and procedures as well as the methodology for the supervision of significant and less significant institutions, taking into account the principles for the functioning of the SSM. It describes the procedures for cooperation within the SSM and with authorities outside the SSM. The Supervisory Manual is an internal SSM staff document; a

shorter [Guide to banking supervision](#), explaining how the SSM operates and detailing the SSM's supervisory practices, was published in November 2014.

Supervisory Review and Evaluation Process (SREP): the process used to guide the supervisory review of significant and less significant credit institutions and to determine whether (on top of minimum requirements) possible additional requirements should be applied with respect to own funds, disclosure or liquidity, or whether any other supervisory measures should be applied.

Total loss-absorbing capacity (TLAC): a standard for global systemically important banks (G-SIBs), agreed by the Financial Stability Board in November 2015, designed so that G-SIBs will have sufficient loss-absorbing and recapitalisation capacity available in resolution to implement an orderly resolution that minimises any impact on financial stability, ensures the continuity of critical functions, and avoids exposing taxpayers to loss with a high degree of confidence. The minimum TLAC requirement is measured against a risk-weighted and a non-risk-weighted benchmark. The TLAC requirement will apply from 2019.

Abbreviations

Countries

AT	Austria	HU	Hungary
BE	Belgium	IT	Italy
BG	Bulgaria	JP	Japan
CH	Switzerland	LT	Lithuania
CY	Cyprus	LU	Luxembourg
CZ	Czech Republic	LV	Latvia
DK	Denmark	MT	Malta
DE	Germany	NL	Netherlands
EE	Estonia	PL	Poland
IE	Ireland	PT	Portugal
ES	Spain	RO	Romania
FI	Finland	SE	Sweden
FR	France	SI	Slovenia
GR	Greece	SK	Slovakia
HR	Croatia	UK	United Kingdom

Others

AQR	asset quality review
BCBS	Basel Committee on Banking Supervision
COREP	common reporting
CRD IV	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
ECB	European Central Bank
ESRB	European Systemic Risk Board
EU	European Union
FINREP	Financial reporting
FSB	Financial Stability Board
JST	Joint Supervisory Team
LSI	less significant institution
MoU	Memorandum of Understanding
NCA	national competent authority
RAS	risk assessment system
SEP	Supervisory Examination Programme
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism

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