

## **Supervising cross-border banks in Europe**

---

An industry survey in advance of implementation of the Single Supervisory Mechanism

July 2013

## About AFME

---

The Association for Financial Markets in Europe is the voice of Europe's wholesale financial markets. We represent the leading global and European banks and other significant capital market players.

Our purpose is to provide a practical, constructive market view to policymakers on the significant reforms taking place in the European financial system.

**We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.**

**Focus** - on market, wholesale and prudential issues

**Expertise** - deep policy and technical skills

**Strong relationships** - with European and global policymakers

**Breadth** - broad global and European membership

**Pan-European** - organisation and perspective

FINANCE FOR EUROPE

**afme** /

**AFME London**  
St. Michael's House  
1 George Yard  
London EC3V 9DH  
United Kingdom

Tel: +44 (0)20 7743 9300  
Fax: +44 (0)20 7743 9301

**AFME Brussels**  
Square de Meeus 38-40  
100 Brussels  
Belgium

Tel: +32 (0)2 401 8724

## Preface

As we move closer to implementation of the Single Supervisory Mechanism (SSM) under the European Central Bank (ECB), the financial industry recognises the significant step forward that this will represent.

The Association for Financial Markets in Europe (AFME), which represents participants in Europe's wholesale financial markets including the leading cross-border banks, has strongly welcomed proposals for a banking union from the outset.

Not only should banking union increase the integration of Europe's financial markets, allowing them to better support its economy, it will also provide an important opportunity for significant advances in the way that banking supervision is carried out.

These advances should apply not only to cross-border supervision, but to all banking supervision; and not only to supervision within the banking union zone but, thanks to the mandate of the European Banking Authority (EBA) to produce a Single Supervisory Handbook, to all twenty-eight countries of the European Union.

As a contribution to the successful implementation of the SSM, AFME, under the guidance of its Special Committee on Banking Union, has carried out a study into the issue of cross-border supervision. The study is based on a series of interviews carried out during recent months by Anita Millar, Director of ADM Risk, Regulation & Strategy Ltd. with relevant staff in thirteen large banks carrying on cross-border business in Europe. The aim has been to identify key issues in cross-border banking supervision and, based on this, to elicit participants' ideas and concerns about, and suggestions for, the SSM and its operation.

This document contains the summary report of those interviews and their findings. We believe that it provides a valuable contribution to the ongoing work towards implementation of the SSM and to the deepened integration of well-supervised, well-functioning European financial markets.

AFME and its members look forward to engaging closely in the crucial work taking place over the coming months to establish and make successfully operational the SSM and banking union.

## Executive summary

This report sets out the key findings of interviews on cross-border supervision with thirteen AFME member firms with significant cross-border business. These banks, which all fall into the category of 'significant institutions' as defined in the SSM Regulation, include banks headquartered in the Eurozone, in the wider EU, and outside the EU.

The creation of the SSM has the potential to greatly enhance the quality of cross-border supervision in Europe by improving the engagement between banks and supervisors, and addressing a number of inefficiencies in the practices between supervisors.

The SSM should help reverse the current increasing fragmentation of the EU's financial markets. This should be achieved for the European Union as a whole, as well as for the banking union zone.

The success of the SSM will largely be a function of four elements: a) a clear understanding of the objectives and methods of effective prudential supervision; b) the design and implementation of an effective, strongly integrated, operating framework based on adequate resources; c) the establishment of a shared culture and style of supervision within the SSM and across the EU as a whole; and d) improved operation of cross-border decision-making and supervisory colleges.

### SSM operating model

The ECB should adopt a decisive and accountable style of supervision. The SSM operating model should be based on strong integration aimed at high-quality and effective supervision. Unclear or confused lines of authority or accountability must not arise as these will jeopardise the core objectives.

The ECB should develop a detailed transition plan or road map for the SSM. This should indicate a clear route to fully-fledged ECB supervision. In any case the ECB must have final responsibility for decision-making within the SSM from the moment it assumes its supervisory tasks, in order to ensure proper SSM governance from the outset. Issues to be addressed include resolving the 'distance' problem so that local market context, different languages and specificities are fully integrated. A protracted period of transition needs to be avoided and risks of duplication during transition firmly addressed. Grandfathering of existing supervisory decisions will be required.

The SSM will need to be based on a common approach to supervision and a single supervisory culture. The ECB should develop a supervisory manual based on but going beyond the EBA Single Supervisory Handbook. This should include review standards, protocols relating to inspections, the accounting dimension etc.

The EBA and the ECB should work in parallel: while the EBA is responsible for setting rules/standards/guidelines for all of the EU single market, the ECB will be responsible for operational issues relating to the SSM. The ECB supervisory manual should thus be consistent and aligned with the forthcoming EBA Single Supervisory Handbook.

It is essential that the approach taken in the development and operation of the SSM is based on strong dialogue and close engagement between the SSM and supervised firms. To achieve optimal outcomes, based on effective interaction and shared understanding, such dialogue and engagement should take place both at the individual firm level and at the more general industry level.

### SSM framework

There are concerns about the potential impact of the Union versus national law question which could have a significant influence on the functioning and effectiveness of the SSM framework. There is a risk that the ECB could face conflict in its role within the SSM. On the one hand it will be obliged to ensure

that banks under its supervision comply with Union law, but it also seems to be obliged to ensure compliance with national laws. Clarity is sought as to how this tension will be resolved.

It is important to develop a macroprudential framework within banking union that is clear on basic policy objectives, roles and responsibilities, specific policy instruments and methods of coordination among the relevant authorities. There is thus a need to clarify the macroprudential framework within the Eurozone, on the basis of a full understanding of the articulation between the EU28 and the Eurozone levels. Governance issues need to be addressed as regards the ESRB and the ECB in relation to macroprudential policies and tools. As well as the risk of fragmentation arising from different approaches to risk and/or forbearance, there are concerns about the potential for ring-fencing resulting from national macroprudential measures.

The SSM should include safeguards – both to ensure that the ECB is accountable and to provide possible routes for firms and stakeholders to challenge supervisory decisions. It is important that measures are adopted to ensure the confidentiality of market sensitive information.

### **Models approval**

Firms expressed a strong desire for improvement in the manner in which models are approved. The SSM should bring significantly enhanced consistency of approach and shortened delays in model approval processes. This is currently one of the key areas where the SSM is expected to bring improvement. There is the need to ensure that the model approval process is effective and fully operational at all stages in the transition to the SSM.

The SSM should offer a single point of contact, and importantly should leverage scarce expert resources distributed across the constituent authorities. There should be mandatory timeframes and common standards delivering unified model approval criteria.

### **Supervisory Review and Evaluation Process (SREP)**

The SSM should change the way in which Pillar 2 is implemented as regards the handling of a banking group's Internal Capital Adequacy Assessment Process (ICAAP) and related capital or liquidity assessments. A major concern is that to date, Pillar 2 has not been applied in a common manner by supervisors across the EU. The SSM and the development of the EBA Single Supervisory Handbook represent an important opportunity to significantly enhance the consistency of the Supervisory Review and Evaluation Process (SREP) across Europe. This should include enhanced consistency of approach to economic capital and to stress testing, among other aspects, while always recognising the need for firm specific application of such concepts.

Avoiding multiple ICAAP requirements will help to promote a single market in funding and assets and to address the costs issue.

Both within and outside of the SSM, EU countries should standardise their views on operational risk models and approaches for Pillar 1 purposes as well as Pillar 2.

### **Consolidated supervision**

Increasing ring-fencing of capital and liquidity within the EU single market is a significant concern. The recent period has seen a weakening of the model of cross-border supervision based on a strong consolidated supervision. There has been a resurgence in a more fragmentary, localised approach. There is disconnect between the expectations concerning what a consolidating supervisor can achieve, its role, and its powers and tools under the current framework. The advent of the SSM represents an important opportunity to redress this dynamic both within and beyond the banking union zone.

## **Colleges and international cooperation**

While the SSM's operational framework and methodology are being developed, firms see an opportunity to address a number of key practical and operational issues in cross-border supervision.

There is a view that colleges currently – EU or global – are in many cases not effective vehicles for decision-making. In such cases, while they are important for the socialisation of supervisory practices, the facilitation of common approaches and/or the exchange of information, they do not currently form the major channel for delivering harmonisation and consistency.

Within the banking union zone, there will be benefits associated with the move to a single supervision approach. Here the transition from a college approach will need to be well-managed so that it occurs once the SSM becomes operational, and the SSM's transitional programme must ensure that the work and information flows within existing colleges are effectively transferred to the SSM.

Beyond the SSM, the ECB's involvement in European and International colleges should streamline their operation, increase their effectiveness and help bring greater consistency in supervisory practices. In this respect, clarity is sought as to suggestions that national supervisory authorities of SSM member states would continue to sit as 'guests' or 'observers' in colleges. In particular, the longer-term consistency of such an approach with a fully integrated SSM operating model is questioned.

Firms believe that existing bilateral agreements and MOUs are important and should be adapted to the new reality of the SSM as soon as possible, building on existing bilateral agreements and accumulated experience so that continuity is ensured in the most constructive way.

Concerns exist that distortions may arise as regards procedures for establishing branches and the provision of cross-border services, with the possibility of different standards being applied within and outside the SSM.

## **Managing the boundaries**

Participant firms noted that identifying and managing the perimeter of prudential supervision will be important and challenging in a multi-jurisdictional context. A number of grey areas requiring significant attention were identified. These included managing the boundary and interface between micro-prudential supervision and supervision relating to conduct of business, as well as that between macro- and micro- supervision, and between supervision and resolution.

### ***Important note:***

*The focus of this project and the programme of interviews was cross-border supervision in the context of the establishment of the SSM. This has meant that certain important issues relating to the establishment of the SSM and/or Banking Union that do not fall directly within the area of cross-border supervision have not been addressed. Particularly important to note in this regard are the topics of (i) recovery and resolution and the establishment of a Single Resolution Mechanism; and (ii) the forthcoming Asset Quality Review / Balance Sheet Assessment. Both these matters are of great importance to the industry. However they fall outside the scope of the interviews and this report.*

## Introduction

Interviewed firms considered that the creation of the Single Supervisory Mechanism (SSM) has the potential to greatly enhance the quality of cross-border supervision in Europe, by streamlining banks' engagement with supervisors and addressing inefficiencies in the substance and style of engagement between supervisors. Beside this, the SSM appears to be necessary to reverse the current fragmentation of the EU's financial markets.

Participants believe that the SSM will undoubtedly impact on the way cross-border firms are supervised and on the manner in which supervisors engage with these banks. It will bring a step change in these engagement models which will also be modified with changes being introduced by other legislation, such as the Capital Requirements Regulation/Capital Requirements Directive (CRR/CRDIV) and the Recovery and Resolution Directive (BRRD). Additional elements that will directly influence how firms engage with supervisors are the forthcoming Single Resolution Mechanism (SRM) and the Single Rule Book.

AFME and its members have been strongly supportive of Banking Union since its inception; we see it as being vital to stabilise the euro-area, enhance financial stability and address single market fragmentation. The SSM's operational framework and methodology are at the development stage — this provides an important opportunity to address a number of key practical and operational issues in the supervision of cross-border financial firms. In line with the above, this AFME project was initiated in the belief that the industry can play a constructive role in assisting policymakers by providing an industry perspective, and to provide helpful suggestions on setting out and calibrating the features of the forthcoming SSM, particularly from a practical and operational perspective, on the basis of firms' experience with the current cross-border supervisory framework.

A wide range of important issues, questions and possible recommendations have been identified and explored by firms during the interview process. Taken together, they provide an extensive agenda of practical issues.

## Methodology

The research, conducted by Anita Millar, Director of ADM Risk, Regulation & Strategy Ltd., consisted of a mix of desk-based analysis and confidential interviews with AFME's member firms. Interviews were arranged with thirteen AFME member firms. These were conducted over the months of February to April 2013.

The group of participating firms covered the range of 'significant' institutions that the SSM will cover. Geographically, it included a number of firms headquartered in the Eurozone, as well as firms from non-Eurozone and non-EU countries. The interviews were supported by a questionnaire developed by ADM Risk, Regulation & Strategy Ltd. in consultation with AFME's internal committees. Individuals interviewed covered a range of functions with relevance to supervision, including compliance, public policy and supervisory relations.

The interview questions were structured to obtain an understanding of interviewees' current experiences in relation to various issues and their opinions/insights as to how the SSM may or may not address or impact the issues being discussed.

The focus of this project and the programme of interviews was cross-border supervision in the context of the establishment of the SSM. This has meant that certain important issues relating to the establishment of the SSM and/or Banking Union, that do not fall directly within the area of cross-border supervision, have not been addressed. Particularly important to note in this regard are the topics of (i) recovery and resolution and the establishment of a Single Resolution Mechanism; and (ii)

the forthcoming Asset Quality Review/Balance Sheet Assessment. Both these matters are of great importance to the industry. However they fall outside the scope of the interviews and this report.

## Key findings

The key findings of this project can be divided into a number of broad categories. A number of them relate to the organisational arrangements of the SSM and to the challenges in transitioning from the old to the new framework; others relate to the approach to supervision that will be adopted by the ECB under the new framework; while others again relate to the practicalities of supervising cross-border firms in particular. In relation to the latter, participants focused both on cross-border supervision within the Banking Union, more broadly within the EU as a whole, and internationally.

### 1. SSM organisational arrangements and transition period

From an operational point of view, participants take the view that the overall framework set out in the ECB Regulation still leaves a number of important areas of uncertainty – the ‘black box’ aspect described by some. It is perceived as a complex system whose internal workings are for the moment hidden or not readily understood.

Participant firms took the view that the success of the SSM will largely be a function of four elements: a) a clear understanding of the objectives and methods of effective prudential supervision; b) the design and implementation of an effective, strongly integrated, operating framework; c) the establishment of a shared culture and style of supervision within the SSM and across the EU as a whole; and d) improved operation of cross-border decision-making and supervisory colleges.

In this framework, there are a number of key questions which will impact the final design and operational structure of the SSM’s operating system, from the division of responsibilities between ECB and national authorities to the style of supervision (e.g. reporting, inspections etc) and the ‘momentum risk’ linked to the transition to the new system.

#### Strong integration

Firms consider it important that a strongly integrated approach is achieved. The SSM’s potential would be undermined if the ECB were to fail to adopt a strong central role and a decisive and accountable approach to supervision. These outcomes are clearly linked to capacity and therefore resourcing is a key concern.

Firms would deem it a ‘failure’ if the ECB were to focus on data collection or simply add a further layer of supervision to what already exists, thus creating a duplicative process. For example, firms might be asked to re-create or re-present model data to two sets of regulators but without the ECB playing the role of central, active supervisor in charge of the system as a whole. Such an outcome would risk maintaining dangerous gaps in supervision between different levels and entities.

Firms identified a number of important questions and concerns related to the above:

- How to precisely divide responsibilities between the ECB and national authorities competent for prudential tasks, and how this division will be effectively communicated to external counterparties in the framework of a meaningful and efficient day-to-day dialogue between firms and their supervisors once the transition to the SSM starts. This should include clarifying responsibilities for subsidiaries of a SSM group within the same country and cross-border;



- Related to the above, the need for a mechanism for deciding where ultimate responsibility for issues will be in case of a disagreement between authorities - for example, the ECB and a local prudential authority, the ECB and a local conduct authority, and between local authorities where there is a conduct regulator and a prudential one;
- The need to have a clear and detailed allocation of supervisory responsibilities that is supported by a clear set of supervisory standards which reflect the ECB's style of supervision;
- Appropriate safeguards and incentives that address the problem of national allegiances that lead to issues of confidentiality and forbearance;
- The need for inclusion of provisions that address the diminished trust between national supervisors that appears to have resulted from the crisis;
- A need for grandfathering provisions to avoid any number of legal issues associated with revisiting and overruling previous supervisory decisions.

### **Transitioning to the new arrangements**

Participants take the view that the forthcoming ECB/SSM would significantly benefit from a detailed transition plan or roadmap to be communicated to external counterparts and firms.

Firms have some general concerns related to the transition phase. There is concern that a protracted transition to the SSM could result in a new layer of supervision where national authorities – which were previously home supervisors – are unable to take supervisory decisions without reference to the SSM's hierarchy. At the same time, the ECB would not be close enough to the issues to make truly informed decisions. If this were to occur, there would be a real risk that the SSM would introduce another layer of duplicative process and a bottleneck of decision-making. The consequence for the industry would be higher costs, less effective decisions (than even in the current scenario) and a damaging and early loss of confidence in the new framework. A well-developed, structured and specific transition plan is thus needed.

Firms consider that there is a need to develop governance processes that ensure that the ECB communicates effectively with firms and allows them to prepare appropriately for the new arrangements. This should involve both individual and more general industry engagement.

In relation to the costs of the new framework, it was stressed that the ECB should develop a clear set of formula and criteria to allocate the costs of supervision to institutions participating in the SSM.

Some participants have also made more specific and detailed suggestions and propositions in addition to what has been suggested above on how the transition to the SSM might be achieved and some of the features that it might include. Set out below are a number of ideas that might be captured in a transition plan based on a number of suggestions from firms.

These suggestions envisage various phases. They put the ECB at the centre of the system, supports the development of a supervisory culture that is unique to the ECB, and tackles the issue of introducing mixed supervisory teams composed of ECB staff and local supervisors – an issue that a number of participants have raised (in relation to Pillar 2). Overall, the below plan tries to address a number of issues that participant firms believe are key for a successful transition to the SSM:

- The 'distance' issue: namely the increased distance between the centre of supervision and the supervised firms;

- The progression of the SSM from a less to a more centralised mechanism, with the evolution of supervisory procedures and protocols and integration of national supervisors;
- Ensuring that the ECB is at the centre of the SSM with full decision-making responsibility from the start;
- Supporting the development of a single supervisory culture;
- Controlling the risk of national distortions within the SSM.

### ***Ideas and suggestions for transitional arrangements***

Below are some ideas and propositions built around a number of indicative phases for the progressive establishment of the SSM. Note: this is not intended to represent an agreed industry proposal for transitioning, but rather an ordered collection of ideas put forward by different interviewees.

#### ***Suggested Phase 0 (ahead of the SSM operational start in September 2014):***

- Define the supervisory approach and culture of the ECB (e.g. outcome-focused, proactive, and forward-looking);
- Develop a clear SSM internal governance structure that ensures that the ECB supervisory approach is consistently implemented, also in the framework of a decentralised system;
- Define a clear roadmap and timetable for phasing-in the SSM's operational arrangements, which ensures the system's development from a less centralised operational structure to a more centralised one. From the start it should be clear that the ECB has ultimate responsibility for prudential supervision. The roadmap should accommodate an evolving approach to internal governance that ensures that incentives are properly aligned in all stages of development;
- Develop an educational programme within the ECB which enables both the ECB leadership and relevant staff to develop and promulgate a common supervisory culture and approach. The programme should also help supervisors to gain a full appreciation of the range of banking business and organisational models within the SSM area;
- The ECB should define human resources policies that govern the hiring, development and retention of professional and permanent staff, and which incentivise staff in a manner that addresses potential moral hazard issues;
- Dialogue with industry and individual firms will be an important part of each phase of transition.

#### ***Suggested Phase 1***

- Responsibility for supervisory decisions resides fully with the ECB and its teams, with a strong involvement of national teams in the field work;
- Deployment of mixed supervisory teams (including staff from different SSM countries) that include ECB-hired (not seconded) and national staff. Supervisory teams would be led by an ECB staff member;
- 'Horizontal teams' would have responsibility for ensuring consistency in model approvals and providing a cross-sector view of different portfolios/issues (mortgages, IT developments etc);

- 'Vertical teams' would look at institution-specific risk profiles, through the review of their governance, credit quality of loans, provisioning, etc;
- An exchange programme could be developed and implemented by the ECB to ensure that supervisory teams working at the local/national level are increasingly mixed. For example, field supervisors in France would get an opportunity to work as field supervisors in Germany or Spain;
- Development of internal protocols that would allow the ECB to effectively coordinate national supervisors and ensure (i) an alignment of supervisory objectives (and a common supervisory approach) and (ii) a supply of relevant and adequate information. These would also help the ECB to monitor staff compliance;
- It is in this phase that firms would expect the complete harmonisation of prudential definitions and risk assessment templates across the SSM and beyond.

### ***Suggested Phase 2***

- Local supervisors continue to be involved in the field work, but supervision resides fully with the ECB and its teams. The ECB will need to incorporate local staff in its vertical teams;
- The effective coordination and sharing of information among teams should be fully ensured, as it helps guarantee that all relevant information regarding micro-prudential, macroprudential and/or financial stability issues consistently reaches the executive levels of the SSM;
- The ECB supervisory manual should be updated with experiences gathered from the initial functioning of the SSM;
- While English will remain the main working language at the ECB level, its use will not be harmonised for supervision across member states. Local loan documentation and similar items will be written in the local language. Moreover, distances created by culture, legislation, and other factors need to be bridged. It seems appropriate that on-site inspections will have to be to an appropriate extent in the language of the supervised entity, if requested;
- The ECB should carry out - on a yearly basis - a global, public assessment of its relationship with the NCAs and should have a mandate to promote or remove members of national supervisor staff (i.e. all institutions participating in the SSM must clearly recognise the ECB as the institution responsible for the internal management arrangements within the mechanism).

## **2. SSM supervision: Achieving a common approach**

### **Towards a European supervisory culture**

Participant firms identified a number of specific elements which will be extremely important in achieving a common approach to supervision and a single supervisory culture within the SSM and more broadly.

Firstly, participating firms believe that the ECB should adopt a transparent style when communicating with external counterparties and supervised entities.

Secondly, participant firms generally give special importance to language, terminology and interpretation of guidance and rules. It is noted that EU rules are interpreted differently across

jurisdictions and there is concern about these differences – particularly as these can have a material impact (e.g. differing views of what is a ‘conservative average probability of default’ or a ‘default’).

Firms stressed that the current European regulatory framework (CRD, CRD II and CRD III) and the guidance and technical standards provided by CEBS/EBA seem to be insufficient and give rise to significant national discrepancies.

Thirdly, participants believe that proximity of supervisors’ policy teams to firms can assist in providing clarity on possible interpretations of rules. There is a fear that the SSM might increase the distance between those responsible for policy and those who have to interpret that policy. (There could even be an increase in the number of entities involved in the various elements of the policymaking/supervisory implementation chain.) The consequences could include greater supervisory inconsistency when applying the same rules to similar facts, a distancing of policy leads from “real life” situations, and a greater onus on firms to interpret rules and/or a lack of certainty that may hamper business decisions and activities.

The ECB supervisory manual should help to bridge some of those distances; but well-resourced and active day-to-day policy interpretation will remain key.

Participants noted that in order for the ECB to lead on Pillar 2 / SREP while supporting the use of local supervisory resources in on-site reviews, it will need to develop best practices relating to governance, model reviews, risk assessment etc while providing for consistent interpretation of key texts.

Participant firms also raised a number of questions related to the formation of a European supervisory culture within the SSM. For example, they asked how the SSM operational system will be designed to attempt to bridge the distances within the SSM whether these be across actors, geography, cultures, supervisory philosophies, and languages.

Related to this, participants were interested to know how the relationship between English at the ECB level and the respective languages at national level would work in practice, particularly as legal documentation at local level is produced in the national language.

### **ECB supervisory manual**

A variety of views emerged among participant firms on how the ECB manual should look. A theme that was raised was that a uniform corpus of regulation cannot and should not be developed overnight. Instead the evolution of the ECB manual should follow the natural transition to the SSM during which a unified understanding should be progressively deepened.

Participating firms believe that this will represent a key tool on the basis of which much of the relationship, communication and practical functioning of SSM supervision will be organised.

As one interviewee put it: ‘It is a logical deduction that the single supervisor needs to be neater/simpler than the sum of its parts, so the ECB will need its own handbook and will need to socialise how it intends to implement prudential regulation, technical standards and guidance.’

Participants said that the ECB manual should go beyond the normative guidelines of a handbook and include review standards, protocols relating to inspections, the accounting dimension etc. It should be consistent and aligned with the forthcoming EBA single supervisory handbook (as should supervisory manuals in non-SSM jurisdictions).

To ensure the above, it is important that the ECB should consult with firms on the preparation of its manual, which would also encourage dialogue on the changes in supervision that the SSM will introduce.

## **The ECB-EBA relationship**

Participants stated that the EBA and the ECB should work in parallel: while the EBA is responsible for the Single Rulebook and the Single Supervisory Handbook for the entire Single Market, the ECB will be responsible for operational issues relating to the SSM.

For participating firms the key question here seems to be how the ECB at the centre of the SSM and the EBA in charge of the EU single market's level playing field will optimally and effectively coexist. While SSM internal consistency is essential, equally important is the EBA's role in ensuring single market consistency. Hence the importance of strong coordination between the EBA Single Supervisory Handbook on the one hand and the supervisory manuals of the ECB and of the other supervisory authorities on the other. The EBA Handbook should provide the effective framework of principles and guidance for the ECB and other supervisory authorities' manuals.

## **'Union versus national law question'**

There is the belief among participant firms that the 'Union versus national law question' could have a significant influence on the overall SSM framework and its effectiveness.

Firms believe that it will affect the ECB's supervisory mandate, its relationship with the EBA, and determine the scope of any recourse to the European Court of Justice (ECJ) on the part of firms or the general public. The ECB's responsibilities extend to the 'relevant Union law', so while that may include the CRR and CRD IV, the extent to which this extends to other EU measures<sup>1</sup> that impact on credit institutions is not clear. Clarity is also sought on the ECB's responsibility under the CRR/CRD IV's flexibility package.

Participants said that there is a risk that the ECB could be pulled in two different directions in its roles as both a 'home' and 'host' supervisor (within the SSM). Namely, as a 'home' supervisor it will be obliged to ensure that banks under its supervision comply with Union law (i.e. its interpretation of CRR/CRD IV), but as a 'host' supervisor it will also be obliged to take into account national concerns (e.g. the local solvency of banks operating in its jurisdiction) and compliance with national laws.

Participants believe that final decisions relating to the design of the SSM's operating framework would need to reflect a response to the 'Union versus national law question'. On branches for example, it is unclear whether the SSM will include 'override powers' to help manage the split of responsibilities between the ECB and national authorities.

Overall, the lack of a genuine single rulebook across countries within the SSM could represent an important challenge for the ECB. Moving towards a more centralised approach could prove to be difficult as long as different regulatory regimes remain in place, aggravated by the divergences in the implementation of accounting rules across jurisdictions.

## **3. Key issues in cross-border supervision: Model approval**

Participant firms were very interested in understanding the changes that the SSM might bring to the model approval process. There is a general industry desire for greater consistency in the manner in which models are approved, and for shortened delays in model approval procedures. Model approval is one of the key areas where firms underlined frustrations, particularly as regards delays. Firms hope to see improvements under the SSM and believe that the forthcoming framework has the potential to improve the situation.

---

<sup>1</sup> For example, the particular measures in the Markets in Financial Instruments Directive (MiFID) applying to credit institutions.

## **Issues hampering model approval processes in the current framework**

A general view emerged among participant firms that the current supervisory approval process applying to banks' internal models is hampered by capacity issues on the supervisory side. This effectively lengthens the model approval process – reportedly up from 6 months to 1.5-3 years.

Firms are concerned about duplicative supervision arising from an apparent lack of inter-jurisdictional confidence and/or a legal entity focus. Article 129 (2) of the current CRD provides scope for the consolidating supervisor to work together with relevant competent authorities to approve a banking group's internal model application. Theoretically this provision should allow the various authorities involved to work in a complementary fashion and focus on how best to allocate supervisory resources – i.e. having the consolidating/home supervisor lead on more generic group-wide models and leaving local authorities to lead on models that have been developed for a specific local market. However, in practice, supervisors have often not relied on each other's judgement and this has led to duplicative processes involving banks submitting separate and distinct documentation to local authorities as well as their consolidating supervisor, as well as the layering on of local requirements to reflect specificities of local portfolios that go against the spirit of group-wide models.

Inconsistencies are noted in how supervisors apply judgement when approving models. Such judgements could include decisions to restrict a bank's modelling choices – in accordance with the regulator's appetite for sophisticated operational risk models as compared to a more standardised approach – or to apply regulatory add-ons or multipliers.<sup>2</sup>

A further challenge associated with model approvals is the different national approaches which are particularly important in light of the role of local supervisors in this process. Some firms indicated that the model approval process can be materially different across EU member states and that differences start at the beginning of the model validation process – with the firm's initial communication with the relevant supervisory body.

The role of local supervisors in the roll-out of a group-wide model is not just isolated to a set of implementation issues. It could be the case that, in the approval of operational risk models, under Pillar 1 the home/consolidating supervisor has the final word, but under Pillar 2 it is local supervisors who have the final word. A firm might thus find that when rolling-out a group-wide model in another member state that it has to adapt that model to meet the flavour of local requirements and local requests, or assess the model on local data.

Furthermore, different supervisors can have different appetites for different models. This seems to be particularly true in relation to operational risk models where supervisors use scenario-based models, historical models, Loss Distribution Approach (LDA) models etc. In the current framework, this presents a particular challenge for a cross-border group that is supposed to submit to its home regulator an operational risk model that is applicable to its subsidiaries in other jurisdictions.

One of the most significant challenges relates to staffing. Model approval teams are composed of individuals with scarce technical skills that get overlaid, in time, with a specific set of industry experiences. The relatively scarce nature of such resource is perceived as adding to the challenge of achieving a timely, high quality model approval process.

---

<sup>2</sup> This is an issue highlighted in the recent BCBS paper *'Regulatory consistency programme (RCAP) – Analysis of risk-weighted assets for market risk'* (BCBS 240), pp 12-13.

## **Model approval in the SSM**

Interviewed firms see the opportunity for significant progress in relation to model approval in the context of the establishment of the SSM. The ECB's responsibilities will extend to individual model approvals within the SSM and joint model approvals (involving SSM and non-SSM members). How it exercises its responsibilities will be a function of the SSM's operating framework.

The ECB potentially offers a single point of contact, and a unified process, for banks' model approvals. This should result in significantly improved consistency of approach.

Firms are hopeful that model approval delays will be significantly reduced with the ECB at the head of the process. This depends of course on the ECB having access to the resources that it needs. Beyond this, it is essential that the operating model adopted by the ECB does not allow for the re-emergence of 'host' concerns beyond the integrated approach to model approval.

It might be appropriate to include in the SSM's operational design some mechanism to identify what might be deemed a global or generic model versus a local model for the purpose of identifying when local market expertise of local supervisors is particularly needed in the framework of a model approval. A thorough understanding of the risk profiles of local portfolios requires local knowledge.

On supervisory duplication, some firms expressed the concern that institutions with a parent holding company outside the SSM (but in the EU), and with entities incorporated in the SSM, may face three levels of supervision: a) local supervisor at national level responsible for day-to-day supervision; b) the ECB at the level of the Banking Union zone; and c) the non-SSM supervisor of the parent company. An effectively integrated operating model, combined with a clear transitional roadmap, should avoid such an outcome.

Interviewed firms provided a number of suggestions for implementing model approval in the SSM:

- The ECB should invest in the specialised resources needed to ensure that it has the supervisory capacity to support banks' internal models;
- Models approval should be well-captured in the ECB's transitional plan or roadmap;
- Protocols should be developed that determine the respective roles of ECB staff and local staff for the approval of different types of model;
- The approval process should be subject to mandatory timeframes (as already in place for some supervisory bodies);
- In line with a single market perspective, supervision should remain focused on the consolidated group. In particular, whenever a regulatory risk metric (for example the Value At Risk (VaR) or the stressed VaR) is computed and applied at the level of the parent institution, the supervision (including model approval) should be conducted at this level and should not be duplicated at each local entity level;
- The SSM's operating framework should include ECB supervisory teams that are organised: a) horizontally – responsible for model approvals across credit institutions and sector-specific views of various types of portfolios; b) vertically – institution-specific risk profiles, through the review of their governance, credit quality of loans, provisioning, credit risk management processes and internal rating systems. Horizontal teams would also allow the ECB to leverage/scale the skill set of model approval teams. The supervisory skill set needed to approve models is relatively scarce, so specialist teams that look across institutions would help to address capacity issues and/or low approval thresholds;
- There should be common model approval standards to be applied both within the SSM and across the EU more broadly;

- The new system should be built around a contractual and professional framework that promotes the retention of individuals with the specific and technical skills to approve models;
- The ECB's expectations regarding the independence of the stages relating to the model development and approval process needed to be clarified and communicated.

Overall, interviewed firms very much hope that the SSM will unlock current capacity issues relating to model approvals and streamline the increasingly complex approval process that, for cross-border firms, can feature the involvement of home and local supervisors with independent requirements that reflect different priorities.

#### **4. Key issues in cross-border supervision: Pillar 2**

Participant firms are hopeful that the SSM will improve the way in which Pillar 2 is implemented as regards the handling of a banking group's Internal Capital Adequacy Assessment Process (ICAAP) and related capital or liquidity assessments.

##### **Experience to date and related operational issues with Pillar 2**

Interviewed firms indicated that the Supervisory Review and Evaluation Process (SREP) has not been applied in a common manner by supervisors across the EU. National supervisors might capture the same sets of risks as part of their SREP assessment of an institution, but their approaches to assessing these risks are often very different. Approaches to stress-testing, despite the 2006 CEBS/EBA guidance in this area, were cited as an example of such differences.

SREP refers to the various approaches that national supervisors deploy to evaluate each supervised bank's ICAAP.<sup>3</sup> At the EU level, the consolidating supervisors and relevant competent authorities, by banking group, bring these national SREPs' – and therefore national ICAAPs' – results together to arrive at a Joint Risk Assessment and Decision (JRAD) of an EU banking group's capital requirements. This is a resource-intensive process that begins with the member state-by-member state approach to the ICAAPs. This seems to promote an approach to balance sheet management that does not allow a bank to manage its group-wide balance sheet in an optimal fashion.

This approach can also give rise to logistical complexities. The delivery schedule of nationally based ICAAPs of cross-border firms is determined by the calendars of national supervisors and these are not coordinated across EU countries. This situation introduces a number of challenges, one of which is data reconciliation.

Firms noted that ICAAPs are required for some EEA subsidiaries – even though these subsidiaries are not significant at a group level; there are also ICAAPs for non-EEA jurisdictions and at the individual level. ICAAPs are driven by the lead national supervisor with little input from other regulators.

---

<sup>3</sup> In 2007 the UK's FSA published an often referenced ICAAP template for the production of a bank's ICAAP – [http://www.fsa.gov.uk/pages/about/what/international/pdf/icaap\\_sub.pdf](http://www.fsa.gov.uk/pages/about/what/international/pdf/icaap_sub.pdf) – and although regulatory expectations concerning the substance of an ICAAP have moved on, the template clearly sets out that the purpose of an ICAAP document is to inform the Board of: (i) the ongoing assessment of the firm's risks (whether they be Pillar 1 or Pillar 2 risks); how the firm intends to mitigate those risks; and how much current and future capital is necessary having considered other mitigating factors. The ICAAP document is also about how the firm explains to its supervisor (in this case the FSA) its internal capital adequacy assessment process.



In the absence of any formal framework governing the form, frequency and intensity of ICAAP processes (either within or outside of the EU), the onus is on the banks to individually develop a programme to roll-out its various ICAAP submissions as consistently as possible, as standardisation is very difficult. Participant firms underlined that inconsistent ICAAP results across member states are evident, even for ICAAPs undertaken in relation to subsidiaries of the same banking group.

One of the drivers of this inconsistency seems to be stress tests or risk measurement methodologies adopted by local supervisors that reflect the peculiarities of each country and a local view of each subsidiary – rather than looking at the subsidiary in the context of the overall banking group.

Another source of inconsistency is that while supervisors may agree on common/broad risk categories, how these risks are defined can differ across jurisdictions.

One firm highlighted its experience of attempting to reflect, in its ICAAPs, diversification benefits associated with being exposed to different categories of risks – the correlation of which was less than one. It found that while its college was interested in its aggregation methodologies and supervisors appeared to agree to them in theory, when it tried to implement this methodology at the national level the college's view was not accepted.

In some countries, diversification benefits are accepted while in others they are not. And even where they are accepted, the basis for acceptance can differ across jurisdictions both in terms of details and methodologies. Also, where countries accept the same methodologies they may require them to be applied differently.

Similarly, firms report that supervisors do not share a common view as to the treatment of 'other risks' and 'downturn' parameters in ICAAP submissions. Supervisors appear to have favourite 'other risks' which differ from country to country.

Interviewed firms said that the RAS is an important element in identifying a bank's risk profile and summarising, in an understandable and consistent way, the risks that the bank is facing, considering elements such as inherent risk, internal control and risk management. Here, harmonisation would help to drive convergence: national RASs have not been normalised and approaches differ. There are too many national frameworks, measuring the same categories of risk (e.g. credit risk or operational risk) in different ways (e.g. dissimilar scoring methodologies), and, as such, there is insufficient common ground to allow assessments to be normalised and aggregated in any meaningful way.

Other differences emerged:

- Host/local regulators might tend to require higher solvency ratios from subsidiaries than the home regulator requires from the group;
- Some regulators impose add-ons as Pillar 1 charges rather than Pillar 2 which does not seem to be in the spirit of the Basel accords;
- Timing differences owing to differences in ICAAP submission dates can make the aggregation of data difficult.

In terms of general recommendations, interviewed firms stressed the importance of streamlining the approach to multi-ICAAP requirements to promote a single market in funding and assets and to address the costs issue. Moreover, firms stressed that both within and outside of the SSM, EU countries need to standardise their various views on operational risk models and approaches for Pillar 1 purposes as well as Pillar 2. This would reduce complexity and enhance transparency, allowing capital charges across banks – for operational risk – to be comparable.

On-site supervisory inspections and stress-testing are seen as other key elements of the current Pillar 2 assessment process. Firms report important variations in the way supervisors in the EU approach

Pillar 2 stress-testing. It was also suggested that one major jurisdiction has backed away from looking at economic capital concepts, while the rest of Europe has not.

Moreover, it was noted that there are stress-testing requirements that might be included in a firm's ICAAP but that are also used to support other regulatory/supervisory requirements, and in particular those relating to recovery and resolution planning. The overlap and duplication that arises means firms are faced with compiling multiple reports with similar information relating to the models and threshold parameters used under various stress tests.

Beside the above recommendations, participant firms also raised a number of relevant questions, related to how far the SSM will go in allowing banks to match their assets and liabilities on a cross-border basis; whether non-SSM firms will be required to produce an SSM-level ICAAP; and whether a fully harmonised approach to CRR/CRD IV, and therefore Pillar 2, will be possible, given implementation flexibility and discretionary powers.

### **Pillar 2 and SSM**

Participant firms took the view that Pillar 2 will be informed by the shape of the SSM's operating framework and how the ECB's mandate (vis-à-vis national authorities) will be discharged and supervisory resources allocated.

Firms expressed uncertainty over the ECB's intended style/approach to supervision and, in particular, how it might approach Pillar 2 and define and manage the boundaries of micro-prudential supervision.

As for on-site inspections, it is anticipated that the ECB's inspection teams will be mixed – i.e. including central and local supervisors. However, firms believe that the degree to which they are successful will be a function of the degree to which this mixture can address issues of national forbearance and bridge language and cultural gaps.

Given the need to have local specialised knowledge of particular markets, interviewed firms stressed that the ECB should consider developing supervisory review standards governing on-site visits taking into account the need to rely on local market knowledge.

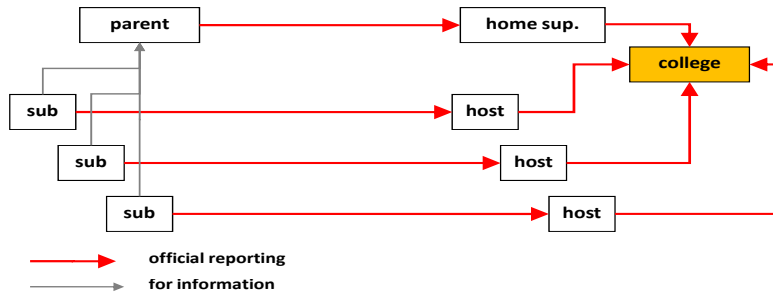
A common risk assessment system (RAS) should be developed at both the EBA and SSM levels. There will be a need to harmonise and normalise ICAAP processes and procedures in a manner that is consistent with the development of a common RAS and which takes into account specific characteristics of each bank and jurisdiction (portfolio segmentation, internal models etc).

The box below presents a detailed proposition, based on the comments of a number of firms, as to what a streamlined ICAAP process could look like for an SSM-supervised firm, instead of a member-state-by-member-state approach.

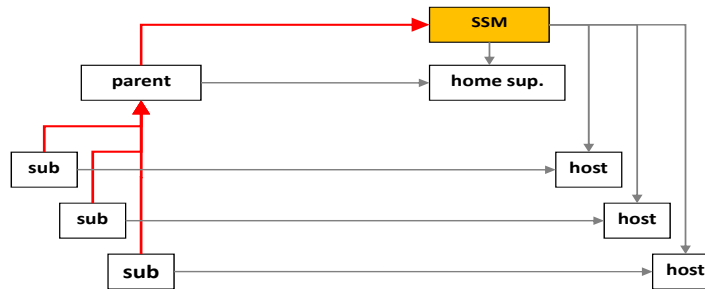
**Proposition: ICAAPs process for cross-border groups in the SSM**

It was proposed that the governance set-up of the current ICAAP process should be reconsidered for cross-border banking groups for which the ECB is the consolidating supervisor. It is expected that the preparatory ICAAP work currently undertaken by EU colleges will be transferred to the SSM’s operating framework, so there is an opportunity to streamline the currently complex ICAAP process and reduce the need to reconcile data because of differences in national supervisory calendars. Streamlining could help to ensure a more harmonised approach to Pillar 2 and allow banking groups to optimise funding.

*Current ICAAP process for a cross-border bank*



*Proposed ICAAP process for an SSM cross-border bank*



**5. Key issues in cross-border supervision: colleges**

Interviewed firms underlined that in many cases colleges – whether they be EU colleges, core colleges or global colleges – have not been vehicles for decision-making. Supervisory colleges are considered important for the socialisation of supervisory practices, the facilitation of common practices and/or the exchange of information, but they are currently not the major channel for delivering harmonisation and consistency.

Participating firms expect that colleges within the banking union zone – which for some firms represent the core college as well – would eventually be supplanted by the SSM. There is a view that benefits could be associated with this transfer, as long as it occurs once the SSM becomes operational and the SSM’s transitional programme ensures that the work and information flowing within these colleges are properly transferred to the SSM’s operating framework.

Participant firms expect that the creation of the SSM and the ECB’s role as a consolidating supervisor would bring changes to many of the colleges: the intra-SSM colleges would disappear, whereas wider colleges outside the SSM could be simplified, potentially bringing significant efficiency gains.

It appears that the above change will be a function of the metrics used to determine the colleges’ composition and could be potentially constrained by the ECB’s capacity to execute on its college – and related supervisory – responsibilities. This lack of capacity might mean a reliance on local supervisors. Clarity is sought as to suggestions that national supervisory authorities of SSM member states would continue to sit as ‘guests’ or ‘observers’ in colleges. In particular the longer term consistency of such an approach with a fully integrated SSM operating model is questioned.

With respect to global colleges, the ECB’s participation could help promote an outcomes-focused approach within the banking union zone and support broader consistency in supervision and mutual learning. Such participation will also be important for developing the ECB’s relationship with third-party supervisors.

Firms identified the importance of the framework of bilateral agreements and memoranda of understanding (MOUs) currently in place. The continued effectiveness of these agreements and MOUs is regarded as being essential to ensuring a successful transition to the new framework.

## **6. Key issues in cross-border supervision: consolidation and rolling back fragmentation**

Firms said that the consolidating supervisor is normally the authority responsible for the ultimate parent. However there are cases where firms are subject to sub-consolidation requirements.

It was underlined by participant firms that there recently seems to have been a move away from consolidated supervision to a more local approach, increasingly focused on legal entities. Moreover, it was stressed that there is probably a disconnect between the expectations concerning what a consolidating supervisor can achieve, its role, and the actual tools the consolidating supervisor is given under the current CRD and forthcoming CRR/CRD IV. Effective tools appear to be few in number (e.g. Art 129 on EU banking group’s application to use models). It is hoped that the move to the new arrangements within European supervision will help reverse this process of fragmentation.

There is uncertainty amongst firms as to whether liquidity and capital requirements will be looked at on an SSM level or whether they will continue to be looked at on a national level, albeit by the ECB in case of direct supervision. The issue of ring-fencing of liquidity and capital and the current trend towards the fragmentation of financial markets is developed further in section 8 of this report.

Firms wondered how the current consolidation rules will be implemented in relation to the calculations under the framework’s significance criteria and, more generally, how the ECB intends to implement the consolidation rules and its approach to consolidated supervision.

Some interviewed firms expressed uncertainty as to whether the ECB would seek to require the consolidation of the SSM operations of non-SSM or third-country banks with branches or subsidiaries.

On reporting, participating firms asked what reporting platform the ECB will use for the purposes of the SSM e.g. Common Reporting (COREP) and Financial Reporting (FINREP).

Moreover, participants stressed that, from an operational perspective, it is unclear whether SSM reporting will go beyond what is already produced in English on a consolidated basis. Firms call for consolidated, consistent and simple approaches.

## **7. External dimension of SSM**

### **Bilateral agreements and MOUs today**

Interviewed firms share the view that bilateral agreements and MOUs are important for the industry. Work done by the colleges can currently often be seen as secondary to these agreements along with the technical and knowledge transfers and training courses with third-country supervisors.

Often the lack of such agreements has been the cause for delays in meeting the deadlines of the approval process for Internal Ratings Based (IRB) models. But while these agreements are essential to some firms with a particular business model, they are by definition bilateral so they can look like a patchwork with third countries having MOU/bilateral agreements with any number of EU member states, but not with the EU as a whole.

### **Impact of the SSM on MOUs/bilateral agreements**

Participant firms said that there is a risk that MOUs and bilateral agreements will get overlooked as the SSM is set-up. There is wide concern that these MOUs/bilateral agreements will not constitute an immediate priority for the ECB. If so, this could have ramifications for the firms involved and the ECB's reputation more widely outside of the SSM.

In light of the above, participants believe that it would be important to provide arrangements for existing bilateral agreements and MOUs continuance through grandfathering or novation.

Participants asked whether a novated agreement would just cover the SSM banks for which the agreement was initially negotiated or whether it would be extended to all SSM banks.

## **8. Supervision in the EU28 single market for financial services**

The SSM has the potential to improve the functioning of the single market for financial services, starting with the reversal of the trend towards the fragmentation of financial markets. A number of issues are at the core of such fragmentation and, while recognising that the SSM is a fundamental element in trying to reverse such trend, firms also see it as a first, insufficient step, which must be supported by other proposals including in the area of resolution.

### **Ring-fencing of liquidity and capital in the EU single market**

The ring-fencing of capital and liquidity within the single market is a concern for many interviewed firms. To some degree, all interviewed firms are observing the shift away from consolidated supervision to a model that is increasingly focused on legal entities. This is occurring both within Europe and internationally. In this light, firms are generally under pressure to change the legal status of their branches to subsidiaries. This is directly linked to what some called the 'Balkanisation of supervision' and the fragmentation of the single market, which firms tend to link to competition issues.

This trend in financial regulation is of particular concern to EU firms, which are seeing increasing fragmentation of EU financial markets along national lines. As a consequence, there was a clear

interest in the Commission's recent efforts to remind national banking supervisors about the free movement of capital and on the use of prudential measures.

Some participants highlighted experiences with requirements from national supervisors that have the effect of 'localising' the balance sheets of banks operating in their jurisdiction, thereby thwarting banking business models that look to collect deposits (or resources) in one member state and re-cycle them in other member states. In particular, firms experienced specific requests aimed at ensuring that an operation in one member state does not lend more than that operation's own equity will support (although this varies across supervisors) to other subsidiaries in a group – or the parent. Furthermore, attempts to bring assets originated in one member state to liabilities incurred elsewhere met with resistance from regulators who argue that the assets cannot be moved because they are linked to some other exposure.

Some firms noted that some national authorities disallow a bank's liquidity subsidiary from making excess liquidity available at market prices to other parts of the group even where the bank has complied with minimum quantitative requirements.

Interviewed firms are eager to see whether the SSM together with the EBA will have the potential to reverse this trend towards increased fragmentation of European financial markets.

It was also highlighted by some participant firms how large exposure (LE) rules are being deployed to ring-fence liquidity therefore hampering the circulation of liquidity within a banking group and localising its balance sheets. The large exposure limit as set by the CRD is 25% of a financial institution's own funds, but member states have the right to adopt more stringent measures. It is noted that some member states seem to be putting LE limits on the cross-border intra-group exposures which are excessive and linked to perceptions of country risk rather than firm-specific risk.

Firms believe that the CRR/CRD IV could help to harmonise the regulation and supervision of liquidity and that this will be supported by responsibility for the liquidity of cross-border branches residing with the home supervisor (rather than the host supervisor as under the current CRD). Firms are not unanimous on how this might interact with the SSM.

There is the view that the SSM can positively reinforce those provisions of the CRR/CRD IV that allow the formation of liquidity subgroups between a bank's subsidiaries that are located in different SSM member states. Moreover, the ECB's ability to wind-back national ring-fencing measures could be hampered by CRR/CRD IV's flexibility package.

Much will depend on how the CRR/CRD IV's consolidation regime is conducted under the SSM. There are concerns as to the possibility that there could emerge (horizontal) capital and liquidity requirements at member state level and then further (vertical) requirements at SSM level.

### **Single market – branches and provision of services**

Some concerns were expressed that the SSM might give rise to competition issues, in the context of establishing branches or providing cross-border services where some Member States are in the SSM and others outside.

The adoption of different standards outside and inside the SSM could give rise to unwarranted barriers to trade. Concerns were expressed, for example, that a firm located outside of the SSM, but in the EU, wanting to establish a subsidiary or branch within the SSM, may face additional hurdles.

In general, it was also noted that with regard to notification procedures relating to branches there have been situations where supervisors have asked for more information than legally required and supervisors have, on some occasions, taken more time to make a decision than is prescribed by law.

Complexity could be added by the interface between prudential and conduct supervision, with the ECB coordinating the SSM but the national conduct regulators on the ground making further rules. The

degree of complexity will depend on whether the ECB adopts a narrow view or broad view of prudential supervision.

With regard to branch notifications, a concern is the requirements relating to the establishment of cross-border branches in the SSM. There is a concern that non-SSM EU banks branching into the SSM will need to notify the ECB, while third-country banks would need to notify local authorities.

Participant firms believe that a single legal framework for the assessment of branches would be helpful. With the single rule book, the assessment of an application to establish a branch should be based on the same rules for all relevant supervisors particularly as the establishment of branches within the EU – both in and outside of the SSM – remains the responsibility of the national supervisor. It is noted that the EBA is currently consulting on branch notification procedures, with a view to establishing standard forms, templates and procedures.

Moreover, in the SSM context, it would be regarded as helpful if the ECB could make the final decision in those cases where national supervisors disagree or go beyond the legal framework.

## **9. Macprudential**

### **Macprudential policy in the SSM**

Participant firms believe that it is important to develop a macroprudential framework within banking union that is clear on basic policy objectives, roles and responsibilities, specific policy instruments and methods of coordination among the relevant authorities.

However, interviewed firms noted that there was confusion regarding such a framework, including with regard to the SSM Regulation text. Firms noted the uncertainty that this new policy tool introduces – with its national and SSM-level features – both in terms of its ‘newness’ and the routes through which it is being introduced (i.e. the proposed SSM regulation, the upcoming CRR/CRD IV, the ESRB regulations etc).

Overall, there is a need to clarify the macroprudential framework within the Eurozone, on the basis of a full understanding of the articulation between the EU28 and the Eurozone levels.<sup>4</sup>

The uncertainty in the proposed macroprudential framework goes beyond its structure, and also encompasses: a) its predictability, and the parsimony of the methodology applied (i.e. the model should be predictable); b) its functionality (i.e. previously capital was fixed at 8% but now the requirements will be dynamic); c) the tools (i.e. which tools will be adopted and how will they be used); and d) the allocation of responsibility for macroprudential supervision.

Aligned to the concerns over national macroprudential measures being linked to questions of risk appetite or national forbearance, participant firms noted that these measures might turn into another form of ring-fencing, as national authorities only have an obligation to duly consider the ECB’s opinion on national macroprudential measures (Article 4a of the SSM Regulation).

### **ECB and ESRB**

Participant firms also take the view that there is a lack of clarity concerning the ESRB and the ECB’s arm of the SSM in relation to macroprudential policies and tools. Moreover, the lack of discussion regarding the ECB’s role versus that of the ESRB seems to represent an important gap in the design of the SSM and is likely to give rise to governance issues.

---

<sup>4</sup> AFME will also reflect upon this issue in the framework of the response to the European Commission consultation on the review of the ESFS.

Firms also stressed the need to look at the interaction of monetary policy objectives at the European level with the macroprudential framework.

Overall, given the complex mapping of supervisory responsibilities that the SSM's proposed macroprudential framework gives rise to, participants indicated that the framework and the implementation of macroprudential measures would require coordination.

Some firms brought forward the idea that there could be a progressive shift in the balance of power within the SSM's macroprudential framework in favour of the ECB and away from member states, with the ECB having power of veto over macroprudential decisions in a framework that also clarifies the role of the various authorities involved in the macroprudential process.

In parallel, firms believe that further consideration needs to be given to how to make the ESRB more visible.

## **10. Safeguards**

A key question raised by participants is what safeguards the SSM will offer to ensure the possibility of effective challenge to supervisory decisions of the ECB.

There is a general agreement among firms that the SSM needs to include safeguards – to both ensure the ECB is accountable and to provide possible routes for firms to challenge supervisory decisions, however rare that may be.

Providing banks, or other stakeholders, with the opportunity to challenge a supervisory decision or rule, under the SSM's framework, requires the identification of the authority that is responsible. This invites a discussion of the ECB's responsibilities in a framework that is expected to be characterised by the (partial) centralisation of supervision, but with national authorities having discretion over a number of key elements in CRD IV/CRR.

The enforcement of national regulations by the ECB could raise a number of complex procedural issues given that it is understood that challenges to the ECB are not justiciable before national courts, and recourse to the ECJ might be slow.

## **11. Supervisory perimeter**

Participants noted that setting and managing the perimeter for what is prudential and what is not prudential will be both important and challenging in a multi-jurisdictional context.

A number of important interfaces that need to be addressed were identified during the interview process. These included managing the boundary and interface between micro-prudential supervision and supervision relating to conduct of business, as well as that between macro- and micro-supervision, and between supervision and resolution.

On the grey area between micro-prudential and conduct matters, participant firms suggested that the SSM operating system needs to include mechanisms/protocols/agreements that help manage the inter-regulatory conflict that could arise with the implementation of an SSM-wide model applied over multiple jurisdictions where some of these jurisdictions have separate authorities responsible for prudential and markets supervision.