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## **ECB consultation on draft SSM Framework Regulation – AFME Response**

**7<sup>th</sup> March 2014**

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AFME represents a broad range of participants in European wholesale financial markets. Our membership includes a large number of banks engaged in cross-border business in the EU Single Market, including banks directly supervised in the framework of the Single Supervisory Mechanism (SSM).

AFME has strongly welcomed Banking Union from the outset and has provided a number of submissions to policy-makers both on supervision and resolution aspects of the project.

The establishment of a Banking Union in Europe represents an historical advance. The introduction of the SSM has the potential to transform the supervision of cross-border banks in Europe. However, the achievement of this is not a foregone conclusion. In particular, as AFME has consistently stated, it is essential that the introduction of the SSM is underpinned by certain essential aspects.

The first of these is the recognition that the implementation of integrated supervision cannot be achieved overnight. A transitional phase is necessary; one in which we move from a situation of national supervision to one which, in the future, will be fully integrated.

Secondly, it is essential that the final outcome remains in no sense a hybrid system with overlaps and underlaps, but is a truly integrated and single system of supervision. We recall that Article 4 of the Council Regulation establishing the SSM confers exclusive competence on the ECB to carry out the supervisory tasks set out there in respect of directly supervised entities. Under Article 6 of that Regulation it is the role of the National Competent Authorities to assist the ECB in these tasks.

AFME has argued that the introduction of the SSM represents an unprecedented opportunity to move to an enhanced form of supervision which integrates key lessons of the crisis. As we set out in our paper on achieving high quality and effective supervision,<sup>1</sup> supervision should be intensive, challenging, and outcomes focused. The industry, for its part, should be expected to engage fully and without reservation in the supervisory relationship, on the basis of a culture which regards supervision as a benefit to the firm and something which increases firms' success over the long-term.

Against this background AFME now sets out a number of its views on the draft SSM Framework Regulation. While we recognise that the ECB consultation document is a legal framework regulation thus necessarily characterised by a legal approach and language, we have sought to look through the legal construction to identify the underpinning concepts and dynamics of the SSM as articulated therein. In this respect we have identified a number of material concerns and the need for important improvements.

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<sup>1</sup> Achieving high quality and effective supervision for systemically important firms, <http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=8370>, 20 February 2013

On an important practical note, we take the view that the four week period provided for comments on this important draft regulation is insufficient. The time allowed is inadequate to allow for a full analysis of the details of the proposals or to develop the suggested legal text amendments requested. The curtailed timeframe has meant that we have been unable to consider the full range of issues addressed by the draft regulation. We have accordingly focused on a selected number of topics.

### **Integrated supervision**

AFME and its Members have consistently taken the view that the SSM should be characterised by a high level of integration. While recognising that in the shorter term there will be important transitional needs to maintain continuity of knowledge and availability of sufficient resources and to allow the ECB to build its supervisory means and experience, it is important that the clear end goal is a strongly integrated approach to supervision which avoids gaps, duplications and uncertainty.<sup>2</sup> This should be reflected in the way operational arrangements and the relationship between ECB and NCAs are defined.

It is essential that it is avoided that the overall outcome resulting from the implementation of SSM is more or less the overlaying of the existing mode of national supervision with a new layer of centralised, quantitatively focused supervision. It is important that what emerges from the new arrangements is a genuinely integrated mechanism for implementing high quality and effective supervision across the Banking Union.

### **Joint Supervisory Teams**

A high degree of integration should be reflected in the way supervision is organised and exercised, and in the division of responsibilities within the supervisory system between the ECB, which should exercise leadership and coordination, and National Competent Authorities (NCAs).

AFME has stated that, 'in the initial phase of the SSM, an approach could be envisaged involving supervisory teams comprised of staff from the range of authorities within whose jurisdictions a firm is active. It is important that such a cross-jurisdictional team should be clearly led by ECB personnel.'<sup>3</sup> Over time, however, such teams should consist mainly of ECB-accountable staff with NCAs playing a supporting role in the provision of information and risk-assessment in respect of the local market environment. We do not find this essential concept of a move towards full integration captured in the draft regulation; for example, as it relates to the Joint Supervisory Teams (JSTs).

The JSTs are the key operational arrangement at the core of the SSM functioning. It is appropriate and necessary that in the first years of operation of the SSM, the JSTs should include staff from ECB and relevant NCAs. In order to achieve deeper integration over time, we suggest they should, after a period of 5 years, be composed mainly or fully of ECB-accountable staff. Article 3 should be amended to state that over a five year period the number of NCA members of the JST shall be progressively reduced.

Article 4 paragraph 2 states that the NCA shall appoint staff members to the JSTs (subject to modification by the ECB under paragraph 3). We believe that the balance proposed here is not the correct one. We would propose to amend Article 4 and 5 so that it is for the NCAs (and NCBs) during

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<sup>2</sup> AFME letter to ECB President Draghi on the Single Supervisory Mechanism  
<http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=8371>, 27 February 2013

<sup>3</sup> AFME letter to ECB President Draghi on the Single Supervisory Mechanism  
<http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=8371>, 27 February 2013

the first five years of operation (see above) to *propose* staff members to join a JST, with the appointment made by the ECB.

Article 4 should also make it clear that in respect of NCA staff membership of any JCT, this should be geographically diverse.

The ECB's JST coordinator should play a leadership role which goes beyond what currently proposed in the draft regulation. The wording of Articles 3(1) and 6(1) and others should be amended to replace the word "coordination" and its cognates with the word "leadership" and its cognates, including referring to the "leader of the JST". The requirement in Article 6(1) that NCA members of the JST should only follow the JST leader's instructions to the extent that this does not "prejudice...their tasks and duties with their respective NCA" should be reversed. The tasks and duties imposed on a member of a JST by their NCA must not conflict with their responsibilities as a member of the JST.

### **Colleges**

Article 9 proposes that where the ECB acts as the consolidated supervisor, the NCAs of the participating member states where the parent, subsidiaries and significant branches are established, shall have the right to participate in the college as observers. We support this approach subject to the caveat that it should hold for the first five years of SSM functioning only. This is to ensure a smooth transition to a fully integrated system over time and to avoid gaps and duplications.

### **Information, requests, notifications and applications**

As regards the procedures for the supervision of significant supervised entities, we feel that the draft provisions do not reflect a strongly integrated approach to supervision including the collection of data and information.

Article 21.1 simply repeats the relevant provision of Article 6(2) of the Council Regulation establishing the SSM in saying that without prejudice to the ECB's power to receive directly, or have direct access to information reported, on an ongoing basis, by credit institutions, the national competent authorities shall in particular provide the ECB with all information necessary for the purpose of carrying out the tasks conferred upon the ECB by that Regulation. AFME believes that it is essential that the ECB receives directly all the information reported by directly supervised entities. Article 21 as well as other articles such as Article 92 should be amended to establish this.

In this context, we do not understand the premise of Article 92. It appears to suggest that information exchange will be particularly important when a directly supervised entity appears to be getting into difficulty. While certainly enhanced activity will be needed in such a case, nonetheless a properly integrated system of supervision will ensure that all such information is in the hands of the ECB on an ongoing basis. We believe that Article 92 requires to be re-written.

Similarly, while moving in an improved direction in this regard, Article 140 also needs to be amended. We would propose in particular that paragraph 3 is either deleted or made subject to a five year period of application.

The principle whereby no one is bound to incriminate or accuse himself should be reflected in the right for any persons requested to provide information to refuse to provide it if, in doing so, they would expose themselves or relatives to the risk of legal prosecution. This principle is stipulated in Article 47 of the EU Charter of Fundamental Rights and this should be made clear in Article 138 and following ones.

## **On-site inspections**

On-site inspections are a key component of supervisory activities. To achieve a high level of integration and avoid gaps and duplications, on-site inspections should be led by the ECB.

It is important that the approach to conducting on-site inspections is not only quantitative, on the basis of formal templates designed by the ECB following on from the approach taken in the AQR and Stress Testing exercises. It should also incorporate qualitative elements. This is important to give supervisors a fuller and more informed view of the situation, including of firms' risk management, corporate governance and culture.

Moreover, the ECB should also be granted powers to organise on-site inspections whenever it deems it necessary.

## **High quality and effective supervision**

In our submission on achieving high quality and effective supervision, AFME argued the following:

- The focus of prudential supervision must be the risks to which a firm gives rise. Supervision should be focused on the firm's risk profile, risk appetite, risk culture, risk governance and risk management.
- Supervision should be intensive, challenging, and outcomes focused. There should be a focus on outcomes and reliance on sound judgment.
- Presence, engagement, discussion, analysis and sound judgment are necessary for supervisors to thoroughly understand the activities, business models, risk profile, risk appetite and risk management of highly complex and interconnected financial firms.
- Effective supervision is founded in a relational approach. For firms also this is the most demanding approach. It requires continuing strong demands on firms.
- There should be significant focus on senior management.
- The ECB and other European supervisors should ensure that the supervision of systemically important firms involves a constant and continuous presence in the daily life of the firm. (For clarification: constant and continuous presence can be achieved in different ways and does not necessarily require the permanent embedding of particular supervisory staff within the firm.)

From this it can be seen that in AFME's view, supervision is a dynamic activity which has at its core close and continual engagement. From time to time this engagement results in the taking of formal decisions. However in most cases the ongoing outcomes do not take the form of formalised decisions.

In other words, high quality supervision can be only partially framed as consisting of formal decision-taking processes and procedures. We believe that a conception of supervision that is unduly focused on the preparation and finalisation of formal decisions would lead to an approach to supervision that is process-focused and unduly tick-box in nature. This should be avoided. We believe that the nature of supervision should be judgment-based and outcome-focused, based on ongoing dialogue.

While recognising the legal nature of the consultation document, we feel that the current draft only partially reflects what we consider to be high quality and effective supervision and there is a risk that

supervisory dynamics are misrepresented and the reality of supervisory mechanisms is not fully captured.

We find in this regard that the importance attached in Articles 90 and 91 to the preparation of draft decisions by the NCAs runs a material risk, particularly when combined with the other issues identified in this submission, of skewing the nature and mode of SSM supervision to being a two-layered one, with the central layer comprising formalised decision-making and quantitative analysis and the other, the national one, comprising the ongoing qualitative supervision.

### **Right to be heard**

As regards the supervised entities' right to be heard (art 31), we believe it is important that this specific right is legally formalized in the framework regulation. However, at the same time, this specific right should be accompanied by constant formal and informal dialogue between supervisor and supervised entity.

While we recognise that this specific point might be addressed in the forthcoming ECB supervisory manual, we take the view that the framework regulation's provisions should reflect this. We believe that the right to be heard should also apply to on-site inspections and control stage (art 138 and following), with the firm that should have the right to comment in writing, with a sufficient delay to do so. Comments could be inserted in the inspection report (as an annex, for instance). With regard to the time allowed for parties to provide comments, we take the view that these are often short and it is foreseen that they can be shortened further or eliminated. We would recommend amending art 31.

### **Time limits for supervisory decisions**

Clear time limits should be set for the supervisor to take supervisory decisions, in line with what foreseen in the CRD framework (3 or 6 months elapse time for decisions, e.g. submission of internal models for approval). Moreover, a backstop should be put in place: if the supervisor does not react within the set timeframe, a request should be considered as accepted.

### **ECB supervision of less significant entities**

As regards an ECB decision to directly supervise less significant entities, the draft framework regulation foresees that the ECB may do so where it is necessary to ensure consistent application of high supervisory standard. While this is in line with the dispositions and formulation of the SSM regulation, we believe any such decision should also be linked to the broad concept of risk to financial stability. This would ensure that any bank which poses a risk to financial stability can be directly supervised by the ECB if necessary. The current text of art 67.1 (and 70.1) is minimalist in its approach and we propose amending it.

### **Avoid duplication and new burdens**

It is paramount that the new system does not result in duplications and new burdens - it should achieve the opposite result. We believe it important that this principle is embedded in the framework regulation. For example, with regards to pending procedures (art 48), the regulation defines a series of rules and procedures. Considering the organisational complexity of this issue (art 48.1 and following), it is important to ensure that efficiency is applied in practice. Further clarity regarding delays and division of responsibilities should be ensured. Institutions should receive, before November 2014, from their Competent Authorities a status report of the pending files (transferred to

the ECB, still followed at NCA level) and a timeframe. We would suggest adding further clarity to art 48.

As for ad hoc requests for information under article 10 of the Council Regulation establishing the SSM (art 139), we believe it is important that the same information is not requested twice by the NCAs and the ECB. We would suggest amending Art 139.2 with the aim to clearly spell out that in no circumstances supervised entities should be requested for the same information twice and to avoid creating unnecessary reporting.

### **Macroprudential tasks and tools**

We took the view previously that macroprudential policy and tools are key in the SSM framework<sup>4</sup>. We have argued that given the ever closer integration of the Eurozone economy, and the creation of a Banking Union in Europe it is essential and urgent to consider further the transnational aspects of macroprudential policymaking. More specifically, we believe that the macroprudential framework envisaged under the Banking Union legal arrangements needs to be implemented in a manner which is effective, coherent and symmetrical. The ECB should ensure that a countercyclical policy is implemented loosening as well as tightening conditions as appropriate.

The provisions included in the draft framework regulation do not fully reflect the principles highlighted above. The ECB is granted the right to apply higher requirements for capital buffers or more stringent measures aimed at addressing systemic or macro-prudential risks (art 101 and following), but this is not sufficient to ensure that macroprudential policy is conducted in a symmetrical way and that the ECB has a central macroprudential role and adequate powers vis-a-vis those of the NDAs.

Moreover, we take the view that in all cases where NCAs/NDAs do not follow an ECB objection to a measure they intend to implement at national level, they should clearly and fully disclose their underlying rationale for doing so. We propose amending Art 104.

### **Language regime**

We take the view that the language regime set in the draft regulation is clear and well set out. It should be able ensure the smooth functioning of the system and the fair treatment of supervised entities from all SSM member states.

With regard to JSTs, the appropriate geographical balance that we envisage with regard to the JSTs' composition should also imply that a particular JST should include members speaking the language of the particular country of a supervised entity.

### **Third country issues**

As regards arrangements with third countries, we take the view that the ECB should, where possible, adopt and appropriately extend existing MoUs and cooperation agreements with third country authorities. This would ensure consistency, efficiency and a level playing field within the SSM. Art 152 should be amended to this effect.

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<sup>4</sup> Banking Union and the Macroprudential policy framework, 25 November 2013, <http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=10070>

## **Stakeholder engagement**

AFME and its members underline the need to ensure effective and thorough stakeholder engagement both in the preparatory phase of the SSM and in its ongoing operation. Going beyond formal consultation, which will remain essential, this requires organised structures and methods of engagement with relevant stakeholders. This will provide a structure for necessary ongoing and timely interaction between the ECB and the supervised community in general thus supporting high-quality and effective implementation of the new supervisory arrangement. It should also provide a means to engage with the users of financial services and other relevant stakeholders.

We take the view that this element should be captured in the framework regulation.

We would encourage the ECB to collect and publish in structured (and of course anonymised) form the outcomes of supervisory decisions that are relevant to understand the supervisory and regulatory framework. This would help the industry build a better understanding of the supervisory framework and approach that is being applied.

We also believe that having a full list of all complementary texts that will be released in the coming period would be very helpful by giving the industry a clear vision of the overall process. A consultation process should be organised also for these forthcoming texts, in particular on the supervisory guidelines.