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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND  
THE COUNCIL**

**on the Single Supervisory Mechanism established pursuant to Regulation (EU)  
No 1024/2013**

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# **REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL**

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### **I. Introduction**

As highlighted by President Juncker in his State of the Union Address on 13 September 2017,<sup>1</sup> the Banking Union must be completed if it is to deliver its full potential as part of a strong Economic and Monetary Union. Together with the Capital Markets Union (CMU), a complete Banking Union will promote a stable and integrated financial system in the EU. It will increase the resilience of the Economic and Monetary Union towards adverse shocks by substantially facilitating private risk-sharing across borders, while at the same time reducing the need for public risk-sharing.

The financial and sovereign debt crises experienced in the EU during the last decade showed that EU's incomplete economic and financial framework was not sufficient to prevent the emergence of unsustainable policies during the boom years or to allow negative shocks to be effectively absorbed during the subsequent macro-economic correction phase. In particular, the crises revealed the existence of undesirable links between national banking sectors and their sovereigns – the so-called doom loop. The Banking Union was created to break that link and prevent national budgets from being used to bail out ailing banks.

For these purposes, based on the single rulebook, the Commission roadmap envisaged three Pillars for the Banking Union: a single supervisory mechanism, a single resolution mechanism for banks and a common system for deposit guarantees.

In line with the European Council conclusions of 19 October 2012, a single supervisory mechanism was established, in order to ensure supervision of the highest quality, to implement the Union's policy related to prudential supervision of credit institutions in a coherent and effective manner, and to apply consistently the single rulebook. The Single Supervisory Mechanism (SSM) was conceived as a system composed of the national competent authorities (NCAs) in the participating Member States (the Member States which are part of the Euro area, and any other Member State entering into a close cooperation with the SSM) and the European Central Bank (ECB). For this purpose, specific tasks were conferred on the ECB concerning the prudential supervision of credit institutions, via Council Regulation (EU) No 1024/2013 (further referred to as SSM Regulation).

This report provides an assessment of the setting up and functioning of the SSM, in view of determining its effectiveness as the first pillar of the Banking Union. It is part of a broader assessment of the progress achieved in relation to the Banking Union, as set out in the Commission Communication on "Completing the Banking Union". The report also represents the first review by the Commission of the application of the SSM Regulation pursuant to Article 32 of the said Regulation.

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<sup>1</sup> [https://ec.europa.eu/commission/state-union-2017\\_en](https://ec.europa.eu/commission/state-union-2017_en)

The SSM Regulation requires the Commission to undertake a broad review of the overall application of the SSM Regulation, with an emphasis on identifying the potential impact on the smooth functioning of the internal market. This report briefly analyses the central aspects of the SSM Regulation and of its application, listing the main findings. The accompanying Commission working document gives more insight in relation to the topics discussed. Given the early stage of the SSM not all the aspects listed in the Commission's review mandate enshrined in Article 32 of the SSM Regulation could be assessed to the same level of detail. Due to the scope of the review mandate in the SSM regulation, this report is focussed on the legislative, institutional and procedural framework of the SSM. The Commission welcomes other assessments which are currently being carried out, such as the ongoing Financial Sector Assessment Programme (FSAP) of the International Monetary Fund, the convergence checks by the European Banking Authority (EBA) and the various reviews by the European Court of Auditors, which are complementary to this report, and will contribute to a comprehensive assessment of the SSM involving different aspects and perspectives.

Based on document analysis and interviews with relevant stakeholders, the Commission comes to an overall positive assessment of the application of the SSM Regulation and the first years of the ECB acting in its supervisory capacity. The first Pillar of the Banking Union has now been fully implemented and is functional, with clear benefits in terms of level playing field and confidence emerging from the integrated supervision of credit institutions.

In some areas there is scope to further improve the functioning of the supervisory framework. In order to address some of the identified difficulties, the report provides interpretations of the regulatory framework, refers to ongoing discussions of amendments to relevant Union law or suggests how the ECB could reflect this in its operation. At the current juncture, the Commission does not consider it necessary to propose amendments to the SSM Regulation.

This report acknowledges that the supervisory pillar of the Banking Union has been successfully put in place and is fully functional with clear added benefits in terms of financial stability and market integration. This is an important premise for preceding with the completion of the Banking Union before the end of 2019 as set out by the Commission Communication on Completing the Banking Union, adopted at the same time as this Report, and in line with calls made in the 2015 Five Presidents Report<sup>2</sup> and the Reflection paper on the deepening of the Economic and Monetary Union (EMU) (hereafter the 'EMU reflection paper').

## **II. Assessment of the application of the SSM Regulation**

The review focuses on the most important aspects of the functioning of the SSM as a single supervisory mechanism for banks. The analysis is structured around five broad themes that cover the key topics listed in the review mandate enshrined in the SSM Regulation:

- the governance of the SSM;
- the key tools developed by the ECB to perform its supervisory tasks;
- the performance of supervisory tasks by the ECB;
- the interaction with relevant EU and international bodies; and

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<sup>2</sup> [https://ec.europa.eu/commission/publications/five-presidents-report-completing-europes-economic-and-monetary-union\\_en](https://ec.europa.eu/commission/publications/five-presidents-report-completing-europes-economic-and-monetary-union_en).

- the cost-effectiveness of the SSM.

A number of overarching issues cut across these five themes, and are therefore taken into account across the report to give an overall view of the functioning of the SSM. These concern in particular:

- the viability of the SSM construction and the effectiveness of the safeguards embedded in the SSM Regulation;
- the balance between the tasks and responsibilities conferred to the various parties within the SSM;
- the impact of the SSM on the internal market; and
- the adequacy of the tools and powers available to the ECB to perform its tasks.

Several aspects in the mandate given to the Commission in Article 32 of the SSM Regulation could not be assessed in detail, as at this stage there was no sufficient information available to draw substantial conclusions. For instance, given that no close cooperation arrangements were concluded with Member States outside the euro area, it is not possible to assess the impact of those Articles. Also, in relation to the potential impact on national banking systems, although some emerging trends may be noticed, it is too early to attribute this to a possible impact of the SSM and to identify other possible impacts on the structures of the national banking systems. Finally, the mandate to assess the fiscal effects that supervisory decisions may have on participating Member States and the impact of developments in relation to resolution financing arrangements has been affected significantly by the subsequent establishment of the Single Resolution Mechanism (SRM), and therefore should more appropriately be considered once the SRM is reviewed.

### **A. The governance of the SSM**

To achieve its overall objectives of ensuring the safety and soundness of the EU banking system, the SSM requires effective governance and internal procedures, balanced by proper accountability, due process and independence arrangements, subject to clear separation between the monetary and supervisory functions, and an effective distribution of responsibilities between the ECB and the NCAs within the SSM. This section summarises the Commission's findings in relation to the governance of the SSM.

#### ***Accountability, due process and independence arrangements***

The Commission has assessed the ECB's accountability taking into account its political, judicial and administrative dimensions. Based on the information analysed, the review assesses that the accountability arrangements applicable to the ECB are overall effective.

In particular, the various processes and procedures in place for ensuring accountability towards political bodies such as the European Parliament, the Council, the Euro Group, and national parliaments are used frequently in practice.

The ECB is called to account in front of the Court of Justice of the European Union (CJEU) relatively often by addressees of ECB supervisory decisions, which shows that the judicial accountability arrangements are used in practice. Given the liability regime applicable to the ECB and the CJEU's mandate to review the legality of ECB decisions, the ECB offers broader opportunities for judicial review than many NCAs.

As to administrative accountability, the ECB is subject to extensive complementary reviews by various administrative bodies in the EU, namely the Commission, the European Court of Auditors (ECA), the European Banking Authority (EBA) and the European Ombudsman. The ECB has demonstrated that it takes recommendations issued pursuant to such reviews seriously, often translating them into adaptations of its own rules or behaviour. In addition, the ECB actively contributes to the surveillance exercises carried out by the International Monetary Fund (IMF) in euro area Member States, and is playing a key role in the ongoing EU/EA FSAP. This review also looked at the effectiveness of the external audit applicable to the ECB, considering that the scope of ECA's audit mandate over the ECB should be looked at in the context of the overall accountability arrangements applicable to the ECB in its supervisory capacity and in light of the fact that the mandates of national audit bodies over NCAs are very divergent. At the same time it should be highlighted that in accordance with the TFEU, the ECB is subject to an obligation to provide the ECA with any document or information necessary for the ECA to carry out the task corresponding to its legal mandate. It would be welcomed if the ECB and the ECA conclude an inter-institutional agreement to specify the modalities of information exchange in view of permitting the ECA access to all information necessary for performing its audit mandate.

The convergence reports prepared by the EBA seem to be another effective review tool for ensuring compliance by the ECB with the single rulebook. Conversely, based on anecdotal evidence, the EBA's competences to act in cases of breach of Union law appear less effective with respect to the ECB given that the decision making procedure in the EBA requires a double majority from NCAs in participating Member States and NCAs in non-participating Member States, whereas a majority of NCAs from participating Member States would have already supported the ECB decision when adopted by the Supervisory Board and the Governing Council.

The review also shows that adequate independence arrangements are in place and has not found evidence that calls their effectiveness in question.

The ECB has established consultation, due process and internal recourse mechanisms based on detailed frameworks. It is welcomed that the ECB develops a consultation culture beyond its formal obligations and the ECB is encouraged to make use of consultations wherever it intends to further contribute to the harmonisation of rules and practices. Due process rules appear to be backed by a solid framework. It is considered important that the ECB strikes the right balance when setting timelines or labelling documents as confidential, so as to avoid any undue restrictions to the procedural rights of parties concerned by its decisions.

The available recourse mechanism against decisions of the ECB - the Administrative Board of Review (ABoR) - is actively used by those concerned and ECB maintains that its opinions have had an influence in the ECB's supervisory practice broader than the individual cases to which they relate to. This report finds no evidence of shortcomings. It would be useful to take advantage of the growing jurisprudence developed by the ABoR by ensuring more transparency over the work undertaken by the ABoR, for instance through publication on the ECB's website of summaries of ABoR decisions and with due observance of confidentiality rules.

## ***Decision-making***

The Commission has scrutinised the governance arrangements underpinning the ECB's decision-making in relation to supervisory activities.

The ECB's decision-making bodies consist of the Governing Council and the Executive Board. The Governing Council is also ultimately responsible for the decisions taken by the SSM. However, to reflect the specific tasks of the SSM, special supervisory structures (e.g. the Supervisory Board) and procedures (e.g. non-objection procedure) have been established in order to support the Governing Council, when acting upon the tasks conferred to the ECB through the SSM-Regulation.

Given the high number of decisions and their varied typology, the involvement of the Supervisory Board and Governing Council in every decision appears to be an important strain on the resources of these two bodies, involving all NCAs and National Central Banks. There are important differences across supervisory decisions, in terms of complexity, impact and relevance for supervised entities. Such diversity exists across types of decisions (e.g. SREP decisions compared to approvals of CET1 instruments), as well as within the same category of decisions (e.g. fit and proper decision for the Board of a major parent company compared to fit and proper decision for the management of an integrated subsidiary). Such differences were not taken into account in the decision-making process, which led to a disproportionate use of the ECB's resources in case of routine decisions or decisions with a lower overall impact. This situation prevented the ECB's decision-making bodies from focusing on important supervisory matters, and often required a disproportionate amount of efforts and resources from both the ECB and the NCAs in preparing the formal decision-making process<sup>3</sup>. To address these issues the ECB has streamlined decision-making via templates, written procedures, bundling of decisions, and adopted a delegation framework for certain routine decisions or decisions with reduced potential impact.<sup>4</sup> It is still to be tested whether the delegation framework will strike an adequate balance between decisions that are delegated and those that are not, and ultimately lead to a better use of resources.

## ***Separation between supervisory and monetary functions***

In order to prevent conflicts of interest between the ECB's supervisory tasks, on the one hand, and monetary policy and all other tasks exercised by the ECB, on the other hand, the SSM Regulation requires separation between monetary and supervisory functions.

The ECB implemented this through a set of procedural rules, ensuring organisational separation of staff, differentiated meetings and decision-making procedures for the Governing

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<sup>3</sup> NCAs have complained about the resources they need to dedicate for preparing their position for the Supervisory Board and the Governing Council on issues which are not at all relevant from their point of view and which used to be dealt with at middle management level within their organisations.

<sup>4</sup> Decision (EU) 2017/933 of the European Central Bank of 16 November 2016 on a general framework for delegating decision-making powers for legal instruments related to supervisory tasks (ECB/2016/40); Decision (EU) 2017/934 of the European Central Bank of 16 November 2016 on the delegation of decisions on the significance of supervised entities (ECB/2016/41); Decision (EU) 2017/935 of the European Central Bank of 16 November 2016 on delegation of the power to adopt fit and proper decisions and the assessment of fit and proper requirements (ECB/2016/42); Decision (EU) 2017/936 of the European Central Bank of 23 May 2017 nominating heads of work units to adopt delegated fit and proper decisions (ECB/2017/16); Decision (EU) 2017/937 of the European Central Bank of 23 May 2017 nominating heads of work units to adopt delegated decisions on the significance of supervised entities (ECB/2017/17).

Council, differentiated reporting lines, confidentiality rules and mediation of conflicts of interest. Most of the staff performing supervisory tasks is located within organisationally separated departments, has clear reporting lines to the Supervisory Board and is subject to strict confidentiality rules. Certain services, such as the legal service, internal audit or human resources are "shared" by the two functions. This does not undermine the separation principle to the extent that they only perform support functions. However, where such shared services provide advice that is key for the ECB's policy decision-making, reinforced safeguards should be considered.

The preparatory work for the macro-prudential tasks conferred to the ECB by the SSM Regulation is carried out by the ECB's department responsible for financial stability, which is involved in both supervisory and other ECB tasks. At the same time, the specific procedure dedicated to the adoption of macro-prudential decisions based on Article 5 of the SSM Regulation gives the Governing Council a more prominent role throughout the decision-making process, than the role held by the Governing Council in adopting micro-prudential supervisory decisions. Whilst the ECB's decision to leverage on the expertise and capacity of its existing department for anchoring its new supervisory tasks related to macro-prudential powers is understandable, it is important that the ECB ensures that the Supervisory Board is appropriately involved in the decision-making process and that all decisions pursuant to Article 5 of the SSM Regulation are based on a complete draft proposed by the Supervisory Board.

#### ***Division of tasks and responsibilities between the ECB and the NCAs***

The SSM as a system consists of the ECB entrusted at central level with ensuring the overall functioning and efficiency of the system, and the NCAs as a decentralised layer. The SSM Regulation sets out a clear distribution of responsibilities. It entrusts NCAs with assisting the ECB in all its supervisory actions and designates them as primary responsible for the supervision of less significant institutions (LSIs). The ECB, with the assistance of NCAs, conducts direct supervision of significant institutions (SIs), adopts decisions related to common procedures, oversees the consistency of NCAs' supervision of LSIs, gives instructions to NCAs and may take over the direct supervision of LSIs.

This distribution of tasks and responsibilities appears to work well in practice, with the ECB building up knowledge and expertise in its constant interaction with the NCAs, and the NCAs reinforcing their know-how on the basis of more intensive interaction with other NCAs and the ECB. At this stage of the SSM, the distribution of roles between the ECB and the NCAs seems overall balanced.

Although there is no evidence of any existing conflict or intrusive intentions by the ECB, there is some concern from certain NCAs as regards the ECB's role in relation to LSIs. Those NCAs call for predictability over the extent to which the ECB may influence LSI supervision or eventually take it over. The default attribution of supervision of LSIs was given to NCAs and the ECB's right to take over LSI supervision could only be exercised if there is necessary and sufficient justification for departing from that rule. However, provisions in the SSM Regulation conferring responsibilities in relation to LSIs to the ECB should be interpreted as providing the ECB with sufficient flexibility to intervene when necessary for performing its

tasks.<sup>5</sup> Thus, the possibility to give guidance and instructions to NCAs is a key tool for the ECB to ensure a coherent and effective implementation of prudential supervision throughout the Banking Union. Equally important is the ECB's capacity to take over LSI supervision where needed for warranting the consistent application of high supervisory standards. The ECB's flexibility to use these tools should not be subject to additional constraints.

Some questions arise in relation to the remaining competences of NCAs, and the way they may be used for circumventing the distribution of responsibilities within the SSM. Recent structural market developments show a trend for third country groups to have increasingly complex structures in the Union, operating through entities that escape ECB supervision. For instance, the ECB would not have powers over investment firms or EU branches of institutions having their head office in third countries, which may constitute a loophole in its overall mandate and opens the door to regulatory and supervisory arbitrage. A specific concern exists in relation to the largest investment firms that provide key wholesale market and investment banking services across the EU, which are "bank-like" in nature. These firms therefore present a clear risk to financial stability, given their size and interconnectedness. This is why they are subject to essentially the same obligations as credit institutions. However, they are not necessarily authorised and supervised by the same authorities as credit institutions, which might create an un-level playing field in the application of the CRD and CRR. The ongoing reviews of the CRD-CRR and of the prudential treatment of investment firms may provide a good opportunity to address this aspect.

The Commission's assessment acknowledges the specificity of the ECB's duty to apply national legislation transposing relevant Directives and its capacity to derive concrete powers from such national legislation. Clear principles are needed to underpin such unprecedented situation. Thus, it is highlighted that the ECB's supervisory powers under the SSM Regulation should be construed broadly enough to include powers given to national authorities by national law for carrying out supervisory functions under the CRD and the CRR in relation to credit institutions. However, as the ECB's powers can be exercised only within the limits of the tasks conferred on the ECB, it needs to be ascertained on a case-by-case basis whether a specific power given under national law is within the remit of the specific tasks conferred on the ECB or not. Given that such case-by-case analysis is cumbersome and not always predictable, it is suggested that future relevant EU legislation spells out explicitly supervisory powers in directly applicable provisions.

## **B. Supervisory tools**

In order to perform its supervisory tasks, the ECB has developed and applied a number of key supervisory tools based on the powers conferred to it in the SSM Regulation. This section summarises the Commission's findings on these tools and their utility for ECB's exercise of supervisory tasks.

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<sup>5</sup> This interpretation has been confirmed recently by the CJEU, which highlighted that the exercise by NCAs of direct prudential supervision of LSIs "is overseen by the ECB, which, under Article 6(5)(a) and (b) of the Basic Regulation [SSM Regulation], has the competence to communicate to those authorities 'regulations, guidelines or general instructions to national competent authorities, according to which the tasks defined in Article 4 [of that regulation] ... are performed' and, moreover, to remove authority from a national authority and to 'decide to exercise directly itself all the relevant powers for one or more credit institutions'." See Case T-122/15, Judgment of the General Court (Fourth Chamber, Extended Composition) of 16 May 2017 *Landeskreditbank Baden-Württemberg - Förderbank v European Central Bank*, paragraph 24.



### ***Categorisation of supervised entities***

In order to determine the exact role of the ECB and the NCAs in relation to individual supervised entities, based on the SSM Regulation the ECB must establish whether entities are significant or less significant institutions. Whilst the starting point under the SSM Regulation is a classification based on quantitative criteria, the ECB also takes into account possible "particular circumstances" that would justify a deviation from these criteria. Even though the ECB only exceptionally deviated from the default allocation, more transparency would be welcomed as regards the rationale for re-classification decisions.

The ECB also frequently uses further sub-classifications of supervised entities for various purposes, such as determining the extent of its engagement, exercising day-to-day supervision, applying proportionality, ensuring peer comparison, determining what information should be transmitted by NCAs etc. These classifications are useful for the ECB to ensure a supervisory level playing field between comparable institutions and an efficient organisation of its activities. The interplay between the different classifications and their relevance for various supervisory activities is however not always straightforward. It is therefore recommended that the ECB improves its communication on the methodologies underlying these classifications, as well as on the implications of the various categories in terms of supervisory action.

### ***Joint supervisory teams (JSTs)***

The Joint Supervisory Teams (JSTs) are representative of the SSM as a system; they constitute the tool whereby the ECB leverages on the expertise of NCA staff for performing its direct supervisory responsibilities towards SIs. They are responsible for the ongoing supervision of the SIs, being entrusted with the implementation of the tasks listed in the Supervisory Examination Programme, the coordination of on-site inspections and liaising with NCAs.

The development of the framework for JSTs has been a learning-by-doing process, which still undergoes adaptations. Challenges relate to the fact that JSTs represent a genuine form of supervisory cooperation that requires integration of resources within a new institutional set-up. During the first years of functioning, JSTs have proved to be functional and credible, doing most of the groundwork for supervisory decisions. The ECB has made substantial efforts to develop JSTs into a key tool for harmonised supervision in the euro area. Some concerns however arose in relation to certain structural aspects of the framework that could affect JSTs' efficiency in practice, such as uncoordinated reporting lines, language problems and insufficient staff allocation. The ECB is encouraged to deal timely with these concerns in order to ensure the efficient functioning of JSTs.

### ***Horizontal functions***

One of the objectives of the SSM is to ensure harmonised supervision in the Banking Union. To this end, a dedicated Directorate-General hosts the so-called 'horizontal functions', which define the ECB's supervisory policies, ensure convergence of supervisory approaches among JSTs and coordinate the execution of other essential specialised tasks. The setting up of the horizontal functions is welcomed, as it is essential in ensuring consistency in the application of high-quality supervisory standards to all the banks in the Banking Union.

To be effective in their tasks, the horizontal functions need to promote a balanced cooperation with NCAs. This balance has been largely achieved in the area of supervisory policy development, especially through the establishment of informal support structures with an advisory role (e.g. expert networks). The ECB's use of networks to request NCA's input on policy issues should be welcomed as a flexible tool of cooperation within the SSM. Whilst there is no need for formalising all such structures, a clearer status for stable and influential networks could give a better overview of their mandate, governance and reporting lines. Furthermore, the proliferation of networks should be avoided by streamlining existing structures and identifying areas that would most benefit from the output of such cooperative structures.

Some NCAs expressed criticism as regards cooperation with the horizontal functions, especially in relation to the way the horizontal work influences the output of JSTs. For increased transparency towards NCAs and to prevent bottlenecks in decision-making, the ECB could envisage to report more systematically and timely to the relevant JST coordinators and sub-coordinators on changes proposed by its horizontal functions to draft decisions coming from JSTs.

### ***On-site inspections***

On-site inspections are an essential tool for supervisors to examine compliance and gather information necessary for performing their duties, directly at the place where the supervised entity is located. The ECB has made good progress in setting up its on-site inspection function. Rules and procedures already provide for a significant level of harmonisation of supervisory practices in this area. This will be further reinforced in the near future by a welcomed common SSM training curriculum for on-site inspectors. The ECB should cooperate closely with the EBA on such training program in order to avoid duplications and ensure synergies for inspectors throughout all Member States.

However, the implementation of harmonised procedures still shows divergences, especially in relation to the quantification of the findings from inspections by investigation teams and JST's reactions to those findings. The ECB should foster a consistent implementation of its common procedures for on-site inspections, ensuring that also the outcome of such inspections is duly harmonised.

Moreover, further improvement is still necessary with regard to the staffing of on-site inspection teams. This could be achieved by increasing the proportion of ECB staff, and creating predictability for the ECB as to the availability of NCAs' staff for on-site inspections. It is acceptable for the ECB to occasionally rely on external consultants, especially where specific technical knowledge is required, which sometimes cannot be easily found within SSM resources. However the use of external experts in on-site inspections should be limited and accompanied by appropriate safeguards. For instance, external experts should not be in lead of on-site inspection teams, or should not account for more than half of the members of a team, as this might give rise to potential reputational risk and confidentiality issues for the SSM.

### ***Colleges***

Overall colleges remain the forum to coordinate supervision of cross-border banking groups with activities outside the euro area. They are currently the main tool for interaction with NCAs from non-participating Member States, which appear to value significantly the ECB as

their new counterparty. The ECB has proved to be a credible, well organised chair of colleges and has contributed with high-quality input to college discussions. The colleges are also an important tool for the ECB to perform its tasks in relation to significant branches of credit institutions from non-euro area countries, for which it acts as a host supervisor. The ECB should be praised for the cooperation arrangements it concluded in a short period of time and is encouraged to finalise the remaining negotiations with all relevant authorities.

### ***Options and discretions***

In its start-up phase, the ECB has dedicated remarkable efforts to harmonising the exercise of options and discretions. These efforts were successful and need to be praised, as the resulting harmonised rules on the exercise of options and discretions by competent authorities contributed to improving the level playing field in the euro area, for both SIs and LSIs. It is welcomed that the ECB does not take a broad-brush approach towards harmonisation, but considers each option and discretion individually in the context of different starting points in the participating Member States and different needs characterising the national banking sectors. It is also appreciated that the ECB aims to achieve a level playing field by extending the harmonisation exercise to the supervision of LSIs, whilst taking due account of proportionality. However, it is regrettable that for some options and discretions the goal of issuing a fully harmonized standard has not been reached, with the ECB accepting that different regimes will coexist.<sup>6</sup>

### **C. Performance of supervisory tasks**

The SSM Regulation entrusted the ECB with a number of specific supervisory tasks with a view to ensure the safety and soundness of banks under its supervision. Under this third theme the Commission has assessed the performance of the main supervisory tasks conferred to the ECB.

#### ***Common procedures for authorisations and assessment of acquisitions***

The ECB has been conferred three tasks with regard to all credit institutions in the Banking Union (SIs and LSIs): authorisation, withdrawal of authorisation and assessment of acquisitions and qualifying holdings (referred to as "common procedures"). These tasks are special not only because of the broad scope in terms of entities covered, but also because of the prominent role given to NCAs in performing preparatory work.

The common procedures for authorisations and assessment of acquisitions represent a challenging task for the ECB, given the tight deadlines applicable, the high number of decisions and the complexity of assessing proposals prepared by NCAs based on 19 different national legal frameworks. These procedures intrinsically rely on close cooperation between the ECB and the NCAs. Such cooperation is an obligation within the SSM and should be pursued by all parties, in good faith and at all stages (i.e. the initial approval stage as well as the ongoing verification of compliance). The ECB and NCAs have done a remarkable job and managed to create tools and procedures that help the ECB deliver on its tasks within the applicable constraining timeframe. The evolution of common procedures shows that mutual

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<sup>6</sup> As for example, regarding the transitional arrangements for own funds calculations under CRR.

trust between the ECB and the NCAs is increasing, thus constructively supporting the functioning of the SSM.

### ***On-going supervision of significant institutions: fit and proper assessment***

In order to ensure banks manage their risks in a qualified manner, the ECB is tasked with assessing each member of a significant institution's management as to whether he or she is fit and proper to carry out their tasks. This has caused a very high operational burden for the Supervisory Board and the Governing Council, mainly due to the high number of proceedings and the diverging procedural timelines foreseen in national regimes. For this reason this area was chosen for the first trial of the upcoming delegation framework, which is expected to accelerate the decision-making and reduce backlogs. However, it will not simplify the complexity of the analysis for the ECB as long as the details of substantial rules develop in a non-harmonised way.

The ECB has been actively involved when the EBA developed its consultation document on revised guidelines on fit and proper assessments. The ECB has issued in parallel its own consultation on a guide on fit and proper assessment, which it finalised and published before the finalisation of the EBA guidelines. It is welcomed that there is a clear commitment from the ECB to revise the ECB Guide in light of eventual changes to the finalised EBA guidelines so as to ensure full alignment in terms of content.

### ***On-going supervision of significant institutions: Own funds approvals and waivers***

Approvals of capital instruments reflect core supervisory responsibilities, which should be applied consistently throughout the Union. This area is particularly scrutinised by the EBA, which has a general mandate to review the quality of own funds. Given the EBA's extensive expertise in scrutinising the compatibility of capital instruments issued throughout the Union with the CRR eligibility criteria for own funds purposes, it is important that competent authorities cooperate closely with the EBA in this area. Therefore the ECB is encouraged to set-up a framework ensuring, on the one hand, the internal horizontal scrutiny of all own funds instruments issued by institutions supervised by the ECB and, on the other hand, an effective and consistent cooperation with the EBA as regards the quality assessment of such own funds instruments, in line with the tasks conferred to the EBA.

As regards the use of waivers, it is observed that the ECB has applied some waivers relatively frequently following the definition of conditions for such waivers in the ECB Guide on options and discretions. The prudent application of waivers provided for in legislation is welcomed and should be further pursued by the ECB, including by further facilitating the conditions for their exercise<sup>7</sup> within the limits of the CRR. The harmonised conditions for the application of waivers developed by the ECB could be built upon in the context of ongoing efforts to further develop the Banking Union that consider the possibility of applying waivers on a cross border basis, when this leads to more efficient capital or liquidity management without raising prudential concerns.

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<sup>7</sup> Especially in the case of cross-border liquidity waivers.

### ***On-going supervision of significant institutions: internal models***

The ECB has successfully set up a robust procedure to assess internal models. On balance, the available evidence suggests that the ECB's process for approving internal models is rigorous and well managed. It will improve the credibility of the internal models used by banks under SSM supervision and consequently the trust of investors in the adequacy of banks' capital requirements and ultimately in their resilience. The Targeted Review of Internal Models (TRIM project) is also seen as a good supervisory investment that will lead to an enhanced level playing field and greater harmonisation of supervisory practices.

The setting up of the model approval and review functions was time-consuming and has led to some backlog in model approvals and potentially increased the duration of model approvals in the initial phase. However, evidence provided by the ECB suggests that this will not be the case anymore in the near future. In addition, it has to be highlighted that the ECB provides real added value in terms of quality of model supervision, given the depth of its expertise in particular compared to some smaller NCAs. Also in comparison to larger NCAs, the ECB can provide improved supervision due to its larger peer group size, allowing for more detailed benchmarking of models.

It is important that the SSM engages with the EBA with a view to sharing good practices with non-euro area competent authorities, thereby contributing to supervisory convergence not only in the euro area, but in the whole EU single market.

### ***On-going supervision of significant institutions: Supervisory Review and Evaluation Process (SREP)***

The ECB has succeeded in applying within a very short timeframe a unitary SREP to all SIs, based on a common methodology that incorporates best practices. The 2015 and 2016 SREP exercises have fostered increased capital levels in banks, further reinforcing the stability and resilience of the euro area banking system. In addition, the ECB has proven to be an adaptable and learning organisation by addressing shortcomings and swiftly incorporating regulatory developments into its methodology. In this sense the ECB's achievements in relation to the SREP are remarkable and the ECB's efforts very much welcomed.

The ECB should continue to engage constructively with the Commission and the EBA when further developing its methodologies and processes, especially as regards the application of Pillar 2 guidance. Also, the ECB is invited to incorporate in its SREP methodology the feedback given by the EBA in the context of its convergence assessment work.

The review of SREP decisions by the horizontal functions of the ECB allows for a consistent application of the SREP and contributes to achieving similar SREP outcomes for similar institutions. It is important that the right balance is maintained and that the quest for consistency does not lead to outcomes being constrained into a very narrow band that would de facto ignore the bank-specific nature of the SREP. Furthermore, the ECB is encouraged to improve the communication with NCAs as regards the methods employed to adjust the SREP decisions proposed by JSTs at horizontal level.

### ***In particular: possibility to influence banks provisioning for non-performing loans***

Finally, the ECB is encouraged to apply the whole panoply of supervisory powers to allow risks to be addressed through the most suitable supervisory tools. Existing powers include the

possibility for the competent authority to influence a bank's provisioning level within the limits of the applicable accounting framework and to apply the necessary adjustments (deductions and similar treatments) in case, for example, accounting provisioning is not sufficient from a supervisory perspective.<sup>8</sup> This is particularly important in the context of tackling non-performing loans, as highlighted by the EU Action Plan on NPLs.<sup>9</sup>

### ***On-going supervision of significant institutions: Enforcement and sanctioning***

During its start-up phase the ECB focused on gaining knowledge of the prudential situation of supervised entities, exercising on relatively few occasions its sanctioning and enforcement powers. The effectiveness of the sanctioning and enforcement framework will thus need to be assessed more closely once more extensive practical experience is accumulated. For the sanctioning framework to be implemented in an effective way, it is crucial that both the ECB and the NCAs continue cooperating in good faith.

Some obvious asymmetries (such as the different scope of sanctioning powers as opposed to supervisory powers), the lack of a common set of enforcement and sanctioning measures, as well as a wide margin in interpreting existing EU sanctioning rules may already be noted. These have the potential of impinging on the level playing field and would need to be closely monitored in terms of implications for the effectiveness of ECB's performance of supervisory tasks.

### ***Oversight of NCA supervision of LSIs***

The LSI sector is very diverse and was deliberately left to the direct supervision of NCAs, with the ECB being in charge of overseeing the conduct of supervision by NCAs to ensure consistency of supervisory outcomes and a consistent application of high supervisory standards. The ECB's oversight role is instrumental in shaping such conduct to the extent it would ensure coherent and consistent implementation of prudential rules. Where necessary to ensure a consistent application of high supervisory standards, the ECB may take over direct supervision of LSIs. Given this framework, the ECB has to strike a balance between harmonisation on the one hand and flexibility and proportionality on the other hand. Harmonisation means ensuring a sufficient level of convergence with regard to the supervisory approach applied to LSIs across participating Member States and between LSIs and SIs within participating Member States. This implies the development of common approaches for LSI supervision on core NCA competences.

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<sup>8</sup> Such powers are enshrined in Article 16(2)(d) of the SSM Regulation, which has the same wording as Article 104(1)(d) of the CRD. They do not amount to accounting powers that would allow the ECB to impose a specific provision, but they allow the ECB to influence the provisioning policy of a bank within the limits of accounting standards, for instance where such framework allows for flexibility in selecting policies or requires subjective estimations, and the specific implementation chosen by the institution is not adequate or sufficiently prudent from a supervisory point of view. Furthermore they allow the ECB to require credit institutions to apply specific adjustments (deductions, filters or similar measures) to own funds calculations where the accounting treatment applied by the bank is considered not prudent from a supervisory perspective.

<sup>9</sup> Action plan to tackle non-performing loans in Europe - Council conclusions (11 July 2017), [http://www.consilium.europa.eu/register/en/content/out/?&typ=ENTRY&i=ADV&DOC\\_ID=ST-11173-2017-INIT](http://www.consilium.europa.eu/register/en/content/out/?&typ=ENTRY&i=ADV&DOC_ID=ST-11173-2017-INIT)

Flexibility and proportionality means that NCAs are able to adapt their supervisory activities to the size, complexity and riskiness of the respective institutions. In this context, especially the ECB's efforts to develop a SREP methodology for LSIs that is based on the SREP methodology for SIs, but embeds features that allow for proportionality and supervisory flexibility, are much welcomed.

### ***Performance of macro-prudential functions***

The macro-prudential powers and tools in the CRD-CRR are relatively new, with limited experience acquired by NCAs and designated authorities as regards their application. The ECB's additional macro-prudential powers can only be assessed properly in the context of a more extensive analysis of the use of macro-prudential powers by national authorities. At this stage there do not appear to be major obstacles for the ECB to participate in the coordination of macro-prudential measures within the Banking Union, nor in exercising its top up powers. Timelines for procedures are very challenging, but - as in other instances - may be managed by appropriate timely cooperation.

There are however certain open questions as regards the scope of macro-prudential tools, as well as the interaction between the various tools that can be used for macro-prudential purposes and the corresponding competences of the relevant authorities. One aspect, namely the use of Pillar 2 measures for macro-prudential purposes is currently considered by the co-legislators, on the basis of the Commission's November 2016 proposal on the CRD review, where proposed changes envisage prohibiting the use of Pillar 2 requirements for addressing macro-prudential and systemic risks.

### **D. Relationship with other relevant bodies**

The ECB when performing its supervisory responsibilities closely interacts with other European and international bodies. Effective cooperation is necessary to ensure that the SSM exercises its mandate while contributing to effective bank crisis management and to broader supervisory convergence at EU and international level. The fourth theme of the Commission's review is focusing on the interaction between the ECB and the EBA, the European Systemic Risk Board (ESRB), the Single Resolution Board (SRB), international standard setters (the Financial Stability Board – FSB and the Basel Committee on Banking Supervision – BCBS), and the European Commission due to its role in relation to the issues covered by the SSM and these other bodies.

### ***Interaction with the European Banking Authority – supervisory convergence & stress tests***

The SSM Regulation did not alter the role and powers of the EBA, which remains the regulatory agency responsible for completing and managing the Single Rulebook of the banking sector in the EU, as well as for ensuring the consistent application of the Single Rulebook. The ECB is required to comply with the EBA rules. However, it should be acknowledged that the ECB has to implement EBA rules through its own instruments, which may affect the EBA given the extended application of ECB instruments to 19 Member States. It would be advisable that the ECB regularly refers in its own rules, including those adopted in the form of Regulations, to the corresponding EBA rules or to relevant ongoing EBA working streams. It would also be advisable that the ECB closely coordinates its own implementation initiatives in terms of both content and timeline with those of the EBA. Furthermore, in order to avoid overlaps and inconsistencies in the interpretation of the Single Rulebook, the ECB is invited to cooperate closely with the EBA and make every effort to

avoid that its own Q&A tool covers issues that should be dealt by the EBA or contradicts answers already given by the EBA.

The ECB's intention to ensure full compliance of the SSM with the EBA Guidelines and Recommendations is welcomed. The ECB is urged to continue to strive for full compliance with the EBA Guidelines and recommendations, including with feed-back from EBA's convergence work.

At the same time, the introduction of the SSM has provided an opportunity to progress faster in the pursuit of supervisory convergence. The ECB often facilitates the coordination of positions between the SSM NCAs in the development of regulatory deliverables of the EBA, and provides valuable expertise at all levels of the decision-making process. The ECB is encouraged to be consistently pro-active in all EBA working streams, especially where this is explicitly called for by the EBA.

The ECB is also closely involved in the context of the EU-wide stress test. Given that the stress test is a joint exercise where responsibilities are clearly distributed, it is necessary that all competent authorities involved (including the ECB) and the EBA cooperate closely with each other.

#### ***Cooperation with the European Systemic Risk Board – macro-prudential convergence***

Cooperation between the ECB in its supervisory capacity and the ESRB is necessary to ensure coherence between the ECB's tasks and the overall EU macro-prudential coordination within the ESRB. The interaction and cooperation between the ESRB and SSM technical committees has improved over time, notably as regards information sharing and the avoidance of work duplication, but their scope and focus remains different. The review of the ESRB Regulations<sup>10</sup> proposes to formalise the institutional representation of the ECB in its supervisory capacity in the ESRB governance structure and further enhance the coordination of their activities.

#### ***Cooperation with the Single Resolution Board - early intervention and triggering of resolution***

Since the establishment of the SRB in January 2016 as the Banking Union resolution authority, the SSM and the SRB have to cooperate closely. A Memorandum of Understanding has been signed that allows for the exchange of information necessary for the SRB to prepare and take resolution actions. The actions in 2017 concerning several failing banks showed that the cooperation worked well. Experience from recent cases will help all the involved actors to further improve the practical application of the rules and the functioning of the system. Among the issues involving the SSM, this concerns for example the practical modalities of cooperation and exchanging information between all European and national bodies involved

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<sup>10</sup> Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board ("ESRB Regulation") and Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board ("ECB/ESRB Regulation"). On 20 September 2017, the Commission put forward legislative proposals that propose to formalise the role of the ECB's Supervisory Board in the ESRB. See [https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-538\\_en](https://ec.europa.eu/info/law/better-regulation/initiatives/com-2017-538_en).



in early intervention and resolution, the procedures leading to a decision whether or not a bank is failing or likely to fail and the use of asset quality reviews in order to determine whether the conditions for a precautionary recapitalisation are met. With ever more experience being gained in practice it is important that the cooperation framework is constantly assessed and improved should this be necessary. The Commission will continue to coordinate with the SSM and the SRB for these purposes, with regard to the overall functioning of the resolution mechanism, and including also from the perspective of the EU State aid framework.

When early intervention measures are planned to be taken by the ECB with regard to a supervised institution for which SRB is the resolution authority, such measures should be notified to the SRB, which may prepare for the resolution of the institution concerned and, together with the ECB, shall closely monitor the compliance with the early intervention measures. Some inconsistencies in the legal framework for early intervention measures have been observed and could be addressed by clarifying the use of early intervention powers where they overlap with supervisory powers. Furthermore, it could be envisaged to enshrine early intervention powers directly in the Regulation establishing the Single Resolution Mechanism, so as to allow the ECB to use powers provided for in directly applicable Union law. Until such clarifications are made in the law, including on the instances triggering early intervention, it is recommended that the ECB develops its crisis management strategy, especially defining the circumstances that require early intervention measures, and clearly communicates to the SRB all measures addressed to institutions whose financial situation is deteriorating, to enable more effective cooperation.

Finally, the ECB as the competent authority is empowered to make the determination when an institution under its supervision is failing or likely to fail (FOLF). This determination is a pre-condition for triggering resolution, and the way it is exercised should be examined in future reviews of the SRM.

### ***Participation in the Basel Committee on Banking Supervision and the Financial Stability Board – international regulatory convergence***

It is welcomed that the ECB has obtained and is actively using its membership status in the relevant international standard setting bodies, the FSB and the BCBS. In this capacity the ECB may actively contribute to the international standard setting relevant for the banking sector in a more influential way than the EBA or the Commission, which only have observer status in the BCBS. It remains challenging to achieve full alignment of European members' input in Basel, but the ECB's efforts in this respect, in cooperation with the Commission, are important and should therefore be encouraged.

### **E. Cost effectiveness of the SSM**

This section focuses on the cost-effectiveness of the SSM, assessing the developments in the effectiveness of the supervisory process and in the cost of supervision in the first years of existence of the SSM.

A longer observation period would be required for a more fundamental analysis of the SSM contribution to the smooth functioning of the single market. Nevertheless, despite the challenges inherent in the first years of SSM functioning, a vast majority of banks under direct supervision of the ECB noticed an improvement in the quality of supervision in 2015, particularly in terms of supervisory consistency across entities of a banking group. This

positive development has also been confirmed by NCAs, which observed marked improvements in the functioning of the supervisory colleges thanks to the effective leadership of the ECB. Moreover, significant institutions have signalled improved interactions with the ECB in 2016.

At the same time, supervisory fees increased since the start of the SSM as the contributions to build-up resources at ECB level are not offset by a reduction of contributions for resources and costs in NCAs. Also in 2016 fees increased slightly compared to 2015, reflecting higher staff levels at the ECB.

The current framework for supervisory fees provides for a clear, transparent and simple way of distributing fees to supervised institutions. Using the average of bank risk weighted assets and total assets as a fee distribution key among supervised banks is the right way forward given remaining uncertainties on the extent to which risk weights applied by banks reflect their actual riskiness. The current ECB fee methodology provides for proportionality by splitting the budget for SIs and LSIs depending on the cost allocation. This budget splitting has ensured that the fees, as a share of total assets paid, are roughly two times lower for LSIs than SIs.

In its upcoming review of the fee methodology, the ECB should consider whether more proportionality could be introduced, e.g. by possibly differentiating between high priority LSIs, the supervision of which is more resource intensive, and other LSIs.

It is noted that the ECB has put in place a functioning performance measurement system, which enables to track the progress achieved in different supervisory and other internal processes, and provides a necessary basis for assessing cost efficiency and effectiveness. This is a laudable initiative that could be further improved to encompass all aspects of ECB's supervisory activities and eventually also include NCAs.

### **III. Conclusions**

On the basis of the analysis reflected in this report as well as in the accompanying Commission Staff working document, the Commission's review shows that the establishment of the Single Supervisory Mechanism was overall successful. Certain organisational challenges could be observed in the initial stage, but the ECB and the NCAs have managed them well, demonstrating a high capacity to react and adapt.

The ECB, with the support of the NCAs, has set up the necessary procedures and tools that enabled the smooth transfer of supervisory competences over SIs and the exercise by the ECB of its coordinating and oversight functions. On the basis of such framework the ECB has taken up fully its supervisory role and has managed to establish in two years a good reputation as an effective and rigorous supervisory authority. This represents a remarkable achievement especially in the context where timelines were extremely challenging and the underlying supervisory realities of the 19 participating Member States were very diverse.

Building on the governance structure of the ECB as laid down in the Treaty, the SSM Regulation intended to set-up workable decision-making procedures that reflect the features of the SSM. It is hoped that this aspect will be largely improved through the new delegation framework that will allow the adoption by intermediate levels of management within the ECB of routine or supervisory decisions having a lower impact.

No major issues have been detected in relation to the independence of the ECB. As regards the separation principle, the ECB should ensure that all safeguards are in place and applied, especially as regards services underpinning both the supervisory function of the ECB and all other functions performed by the ECB. The ECB is also invited to ensure the appropriate involvement of the Supervisory Board in macro-prudential decision-making.

This initial phase of the SSM was important for gaining the trust of all relevant stakeholders. To establish such trust the ECB in its supervisory capacity was repeatedly assessed and held accountable by political, judicial and administrative bodies. The use of mechanisms for holding the ECB accountable has been intense and regular, and did not demonstrate major shortcomings in the way the ECB pursues its supervisory tasks. Certain disagreements arose concerning the scope of the mandate of the ECA to review the ECB – an issue that is expected to be solved through the declared commitment to better cooperation in the context of the second review that will be conducted by the ECA.

A fundamental dimension of the SSM consists of the interaction between the ECB and the NCAs. Apart from some initial uncertainties as regards the supervisory powers enshrined in national law, no major problems have been identified as affecting the distribution of tasks and responsibilities in the SSM Regulation. In practice cooperation has been gradually evolving, with trust between the various parties being progressively built up in parallel with ever more shared experiences. NCAs in participating Member States demonstrated their willingness to efficiently cooperate with the ECB and assist it in developing supervisory policies and implementing supervisory acts. The cooperation in good faith between the ECB and the NCAs is essential and all parties are invited to continue to cooperate loyally.

The relationship between the ECB and the EBA constitutes another important aspect of the functioning of the SSM in the context of the internal market. This review observed a positive dynamic of interaction which is mutually beneficial, and encourages the ECB to continue cooperating and coordinating with the EBA, especially as regards the implementation of the single rulebook.

The effectiveness of supervision of euro area banks has improved already in the first years of SSM functioning. For SIs, the regulatory framework is more harmonised, and supervision is based on common methodologies applied in a consistent way. The quality of supervision is perceived as having increased in relation to several core supervisory areas, especially the SREP, internal models, fit and proper assessments and the functioning of colleges. The ECB also took important steps in harmonising supervisory practices for LSIs, but more time is required to increase the level of harmonisation and promote the use of common best practices in the supervision of LSIs. Overall, there is a positive impact on the level playing field between SIs in the participating Member States, as well as between SIs and LSIs in participating Member States. Furthermore, given the very positive appraisal of the ECB's role in the supervisory colleges and its substantial contributions to the discussions at the EBA, there are positive spill-over effects throughout the internal market.

Overall, the application of the SSM Regulation appears to work well in practice, with no major changes needed to the legal framework at this stage. The shortcomings noted in this report may be corrected mainly through actions to be taken by the ECB or through amendments to relevant Union law that are currently discussed by the European Parliament and the Council in the context of the Proposals made by the Commission in November 2016. Certain aspects of the application of the SSM Regulation will need to be further monitored and assessed in more detail once more experience with the SSM is acquired.

The Commission concludes that the supervisory pillar of the Banking Union has been successfully established, functions well and proves its effectiveness. The SSM represents a solid reliable element of the Banking Union that could prove its full potential in the context of a completed Banking Union.