



EUROPEAN CENTRAL BANK

EUROSYSTEM



SSM QUARTERLY REPORT

Progress in the operational implementation of the Single Supervisory Mechanism Regulation

In 2014 all ECB
publications
feature a motif
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KEY MESSAGES

This is the second Quarterly Report to the European Parliament, the EU Council and the European Commission on progress in implementing the Regulation on the Single Supervisory Mechanism (SSM Regulation). The report, which is required under the SSM Regulation, covers the three months **between 4 February and 3 May 2014**¹.

The key messages of this Quarterly Report are the following:

- **The establishment of the SSM governance structures, including the related organisational rules and arrangements, has largely been completed.** The Supervisory Board held five meetings during the period under review and adopted its own Rules of Procedure, which enabled the establishment of the Steering Committee. The ECB Decision on the establishment of the Administrative Board of Review was also adopted and a call for expressions of interest for its members is ongoing. The ECB Regulation on the establishment of the Mediation Panel is close to being finalised with a view to its formal adoption in the course of May. The Governing Council adopted an ECB Decision on the ECB representatives on the Supervisory Board and appointed three of these representatives. The Governing Council also adopted an ECB Decision on the close cooperation with the national competent authorities (NCAs)² of participating Member States whose currency is not the euro.
- **The SSM Framework Regulation was adopted by the Governing Council on a proposal of the Supervisory Board and published on 25 April 2014, together with a Feedback Statement on the outcome of the consultation and the amendments which had been introduced.** This complies with the deadline of 4 May 2014 specified in the SSM Regulation. The SSM Framework Regulation sets out the practical arrangements for the implementation of Article 6 of the SSM Regulation (concerning the cooperation between the ECB and the NCAs within the SSM). In line with the SSM Regulation, the draft text of the SSM Framework Regulation was submitted for public consultation between 7 February and 7 March 2014. The outcome of the public consultation was very positive, with broad support for the approach proposed in the consultation document.
- **Work on the SSM Supervisory Manual continued during the period under review.** The supervisory model of the SSM, as reflected in the draft Supervisory Manual, which covers the processes and procedures as well as the methodology for the supervision of significant and less significant institutions, has been further refined using feedback from the NCAs. The manual is a living document intended for SSM staff that will continue to be updated regularly before and after 4 November 2014. The ECB will publish a guide to supervisory practices, clarifying the features, tasks and processes of the SSM.

¹ The first Quarterly Report was published on 4 February 2014, three months after the entry into force of the SSM Regulation on 4 November 2013.

² NCAs also include national central banks with supervisory responsibilities.

- **The establishment of Joint Supervisory Teams (JSTs), which will be the main operational structure for the conduct of supervision by the SSM, has been initiated.** The JSTs will directly supervise the approximately 130 banking groups considered significant in accordance with the SSM Regulation. The establishment of fully functional JSTs is one of the main challenges facing the SSM for the timely assumption of supervisory tasks on 4 November 2014. Besides adequate staff, the task requires the development of operational infrastructures, training and effective organisational arrangements. The SSM is making good progress in selecting the staff and carrying out the preparatory work. It is expected that all the JST coordinators will have been appointed by the end of June and that nearly all of them will have joined the ECB by the end of the summer. Progress in this key area will be monitored closely throughout the year.
- **The staffing of the SSM is proceeding at a satisfactory pace, after initial delays in the appointments at senior manager level.** Staffing in general is taking place in a top-down fashion and the internal planning has been adjusted to take account of the starting dates of the senior managers and to ensure that a critical mass of staff will be available in time for the operational start of the SSM. The large number of applications (more than 8,000 for the positions advertised so far) shows that there is considerable interest in the SSM positions. The timely fulfilment of staffing needs is another main challenge facing the SSM.
- **There has been significant progress in the conduct of the comprehensive assessment.** The selection of portfolios subject to examination in the asset quality review has been concluded, and the execution phase initiated. The details of the scenario of the stress test, as decided by the European Banking Authority (EBA), and prepared in cooperation with the European Systemic Risk Board (ESRB) and the ECB, were released on 29 April 2014.
- **The Supervisory Board approved a Supervisory Reporting Manual, which will provide the data framework to support the conduct of supervision.** The manual is an internal document which lays down the approach for supervisory reporting and describes the data and reporting framework for the SSM.
- The **preparatory work** is also well advanced in many areas, such as IT infrastructure, HR, premises, internal and external communication, framework for supervisory fees, logistical organisation and legal and statistical services.

1 INTRODUCTION

The SSM Regulation³ requires the European Central Bank (ECB), as from 3 November 2013, to send quarterly reports to the European Parliament, the EU Council and the European Commission on progress in the operational implementation of the SSM Regulation.

Under the accountability arrangements with the European Parliament⁴ and the EU Council⁵, these reports should cover, among other things:

- internal preparation, organisation and planning of work;
- concrete arrangements made to comply with the requirement to separate monetary policy and supervisory functions;
- cooperation with other national or EU competent authorities;
- any obstacles encountered by the ECB in the preparation of its supervisory tasks;
- any events of concern or changes to the Code of Conduct.

The first SSM Quarterly Report, which was published on 4 February 2014, covered not only the period from 3 November 2013 to 3 February 2014, but also the preparatory work conducted since the euro area summit of 29 June 2012.

This second report covers the period from 4 February to 3 May 2014. It was prepared by ECB staff and approved by the Supervisory Board, with the ECB's Governing Council being consulted.

The third Quarterly Report will be published in early August 2014.

2 ESTABLISHMENT OF THE SSM GOVERNANCE STRUCTURES

2.1 SUPERVISORY BOARD

A number of further appointments have been made to the Supervisory Board.

³ Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

⁴ Interinstitutional Agreement between the European Parliament and the European Central Bank on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the ECB within the framework of the Single Supervisory Mechanism (OJ L 320, 30.11.2013, p. 1).

⁵ Memorandum of Understanding between the Council of the European Union and the European Central Bank on the cooperation on procedures related to the Single Supervisory Mechanism, which entered into force on 12 December 2013.

Ms Sabine Lautenschläger appeared before the European Parliament's Committee on Economic and Monetary Affairs at a hearing on 3 February 2014 and was subsequently appointed by the EU Council as Vice-Chair of the Supervisory Board, with effect from 12 February 2014.

On 6 March 2014, the Governing Council appointed three ECB representatives to the Supervisory Board:

- **Mr Ignazio Angeloni**, formerly Director General Macro-Prudential Policy and Financial Stability at the ECB, was appointed with effect from 6 March 2014.
- **Ms Sirkka Härmäläinen**, Member of the ECB's Executive Board from 1998 to 2003, will join the Supervisory Board in May 2014.
- **Ms Julie Dickson**, currently Superintendent of Financial Institutions at the Office of the Superintendent of Financial Institutions (OSFI), the primary Canadian regulator and supervisor of the financial industry, will join the Supervisory Board in August 2014.

On 31 March 2014 the Supervisory Board adopted its own Rules of Procedure, after having consulted the Governing Council. These Rules of Procedure entered into force on 1 April 2014 and were subsequently published on the ECB's website. They supplement the Rules of Procedure of the ECB, which were amended in January 2014 to set out in detail the relationship between the Governing Council and the Supervisory Board.

2.2 STEERING COMMITTEE

The Rules of Procedure of the Supervisory Board also contain provisions concerning the Steering Committee.

The Steering Committee is composed of eight members of the Supervisory Board:

- Chair;
- Vice-Chair;
- one of the ECB representatives;
- five members from the national competent authorities (NCAs).

The five NCA members are each appointed for a one-year term. To ensure a fair balance and rotation among NCAs, the NCAs have been allocated to four groups, according to a ranking based on the total consolidated banking assets in the relevant participating Member State. There must always be at least one member from each group on the Steering Committee.

The mandate of the Steering Committee is to support the activities of the Supervisory Board and to prepare its meetings. Its first meeting took place on 27 March 2014.

2.3 ADMINISTRATIVE BOARD OF REVIEW

Under the SSM Regulation, the ECB is to establish an Administrative Board of Review for the purpose of carrying out internal administrative reviews of the decisions taken by the ECB in the exercise of the powers conferred on it by the SSM Regulation. This internal body is to be composed of five individuals of high repute, from Member States and having a proven record of relevant knowledge and professional experience, including supervisory experience, to a sufficiently high level in the fields of banking and other financial services.

The mandate of the Administrative Board of Review will be to review supervisory decisions at the request of any natural or legal persons to which they have been addressed or which are of direct and individual concern to those persons. The scope of the review should pertain to the procedural and substantive conformity of the challenged decisions with the SSM Regulation.

The draft ECB Decision concerning the establishment of the Administrative Board of Review and its Operating Rules was submitted for consultation to the Supervisory Board and, thereafter, was discussed and adopted by the Governing Council on 16 April 2014. On 1 May 2014 the ECB launched a call for expressions of interest for the members of the Administrative Board of Review, which was published in the Official Journal of the EU.

2.4 MEDIATION PANEL

To help ensure the separation between monetary policy and supervisory tasks, the SSM Regulation provides for a further internal body, the Mediation Panel. The purpose of this body is to resolve – if so requested by an NCA – differences of views regarding an objection by the Governing Council to a draft decision prepared by the Supervisory Board. The Mediation Panel must therefore comprise one member per participating Member State, chosen from among the members of the Governing Council and the Supervisory Board.

The draft ECB Regulation concerning the establishment of a Mediation Panel and its Rules of Procedure was submitted for consultation to the Supervisory Board and, thereafter, was discussed and adopted in principle by the Governing Council on 21 March 2014, with a view to adopting it formally in the course of May, once all the language versions are available.

3 ESTABLISHMENT OF THE SUPERVISORY FUNCTION AT THE ECB

3.1 ORGANISATION

Four new Directorate Generals (DGs) and a dedicated Secretariat to the Supervisory Board have been established to perform the supervisory function of the ECB. The organisational set-up has now been further fine-tuned.

DGs Micro-Prudential Supervision I and II (DGs MPS I and II), which will deal with the direct day-to-day supervision of the around 130 significant banking groups comprise seven and eight divisions, respectively. The allocation of banks between the two DGs is progressing according to a risk-based approach to supervision, i.e. by considering the banks' risk exposures, complexity and business models. The 30 most systemic banks have been allocated to DG MPS I and the rest to DG MPS II.

DG Micro-Prudential Supervision III (DG MPS III), which looks after the indirect supervision of less significant banks, comprises three divisions:

- Analysis and Methodological Support;
- Institutional and Sectoral Oversight;
- Supervisory Oversight and NCA Relations.

DG Micro-Prudential Supervision IV (DG MPS IV), which handles horizontal and specialised services, comprises ten divisions:

- Authorisation;
- Enforcement and Sanctions;
- Internal Models;
- Methodology and Standards Development;
- Planning and Coordination of Supervisory Examination Programmes;
- Centralised On-Site Inspections;
- Supervisory Quality Assurance;
- Crisis Management;
- Supervisory Policies;

- SSM Risk Analysis.

Additional organisational substructures, in the form of two sections per division, have been created in seven of the ten divisions. An independent unit, the Central Operations Office, has also been established to help define the IT functions required by the Micro-Prudential Supervision DGs that will be provided by DG Information Systems and DG Statistics.

Finally, the dedicated **Secretariat to the Supervisory Board** consists of a single organisational unit at Directorate level, comprising two sections:

- Decision-Making Process;
- Decision-Making Policy.

3.2 STAFFING

The SSM recruitment procedure has been organised in a top-down fashion, starting with senior management.

The internal planning has been adjusted to take account of the starting dates of the senior managers and to ensure that a critical mass of staff is available in time for the operational start of the SSM.

By the beginning of March, ten senior managers had taken up office and were participating in selection procedures for middle management.

Priority was then given to recruiting the middle management of DGs MPS I and II, with the aim of establishing operational JSTs, and to recruitment for three divisions of DG MPS IV (i.e. Methodology and Standards Development, SSM Risk Analysis, and Planning and Coordination of Supervisory Examination Programmes). The majority of these 18 Heads of Division are expected to have taken up their functions by May. In addition, around 100 Heads of Section and Advisers who have already been recruited in these priority areas will be joining the ECB gradually over the next few months. Recruitment for the middle management of DG MPS III will be finalised around May, and that for the remaining middle management of DG MPS IV will be finalised before the summer.

In parallel, vacancies for supervisors for DGs MPS I and II were published in early February. Around 280 supervisors are expected to be selected by June and recruitment of the remaining around 260 professionals for DGs MPS III and IV is expected to be finalised between July and September.

Finally, the recruitment process for the ECB's "shared services" (e.g. IT, HR, legal services, budget, statistics, communications and administration) is also progressing smoothly, with the recruitment of middle management and expert staff mostly running in parallel.

In the interim, around 200 professional experts from NCAs have been, or will be, seconded to the ECB on a temporary basis to support the immediate operational tasks. The final wave of around 120 secondees is expected to start in May and June.

The assumptions underlying the recruitment timeline are realistic, as the first waves of recruitments have confirmed. It is important, however, to keep up the current momentum, particularly in terms of processing applications and completing the selection procedures. The large number of applications (more than 8,000 for the positions advertised so far) shows that there is considerable interest in the SSM positions, a trend which should be confirmed in subsequent recruitment waves. To mitigate the related risks regarding the quality and speed of the recruitment process, the ECB has introduced a number of pre-assessment tools (e.g. online testing, remote written tests, and technical pre-selection interviewing), which can be deployed flexibly, depending on the number of applications.

An additional risk may be the longer-than-foreseen notice periods, meaning that teams may not be completed as quickly as envisaged (in particular, as a number of releasing institutions are now heavily involved in the comprehensive assessment). In any event, there is a clear agreement not to compromise on quality.

3.3 ESTABLISHMENT OF THE JOINT SUPERVISORY TEAMS

The operational supervision of significant banks will be the responsibility of Joint Supervisory Teams (JSTs). Each JST will be managed by a JST coordinator working for the ECB and will comprise a number of supervisors from both the ECB and the NCAs of participating Member States.

The ECB is making good progress in selecting the staff and carrying out the preparatory work for the JSTs. As highlighted above, recruitment for the middle management of DGs MPS I and II is on track. It is expected that all the JST coordinators will have been appointed by the end of June and that nearly all of them will have joined the ECB by the end of the summer. Staffing of the JSTs is also progressing and it is expected that, from among the 280 staff selected by June, the 200 staff considered necessary for the JSTs to be fully operational will have started by September. The remaining staff constitute an additional "buffer" and will join the ECB in the course of October.

The preparatory work for making JSTs operational has been progressing. This includes work on the Supervisory Manual, specifying the roles and responsibilities of the JSTs throughout the different phases of the supervisory process, as well as defining their organisational structure and staffing requirements.

More recently, DGs MPS I and II have established a number of work streams to define the responsibilities, processes and infrastructure necessary for the JSTs to be fully operational by November 2014. These work streams are focused on the following priority areas:

- developing strategies and processes, and dealing with organisational aspects;
- building relationships with key stakeholders, in particular NCAs;
- understanding the risk profiles and establishing supervisory strategies for significant institutions;
- preparing for a smooth handover of supervisory responsibilities;
- preparing steady state tasks and activities related to ongoing supervision.

As part of this process, DGs MPS I and II are making preparations for JSTs to manage the results of the comprehensive assessment and any supervisory responses that may ensue.

3.4 SEPARATION OF THE FUNCTIONAL AREAS

Under the SSM Regulation, the ECB must adopt and publish internal rules to ensure the separation between the supervisory and monetary policy functions (and other tasks of the ECB), including rules regarding professional secrecy and the exchange of information.

A number of processes have already been established to implement this separation in terms of organisation and decision-making. Moreover, from 2015, the organisational separation will be further mirrored and supported by the location of the two functions in separate areas of Frankfurt:

- banking supervision will be housed in the Eurotower, the ECB's current premises in the centre of Frankfurt;
- monetary policy and the ECB's other business areas will be housed in the ECB's new headquarters, currently under construction in Frankfurt's Ostend district.

Work is also progressing to define rules on the exchange of information between the supervisory function and the monetary policy and other functions. These rules will be drafted in full and strict compliance with the applicable laws and regulations on the protection of

confidential information (in particular the Capital Requirements Directive (CRD IV)⁶) and Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the ECB⁷) and the general obligations of professional secrecy, as laid down in the Statute of the ESCB. The ECB is confident that it can achieve full and effective separation, while reaping – wherever possible and desirable – all the expected benefits of combining these two functions within the same institution.

3.5 CODE OF CONDUCT FOR THE ECB STAFF AND MANAGEMENT INVOLVED IN BANKING SUPERVISION

Under the SSM Regulation, the ECB's Governing Council is to establish and publish a Code of Conduct for the ECB staff and management involved in banking supervision. The ECB is currently preparing such rules of ethical conduct as part of a general review of the Ethics Framework that applies to all ECB staff. These new rules will take account of the requirements laid down in the SSM Regulation and the Interinstitutional Agreement. A proposal will be submitted soon to the Supervisory Board and the ECB's decision-making bodies, after consultation with the ECB staff representatives. In line with the Interinstitutional Agreement, the ECB will inform the European Parliament about the main elements of the envisaged Code of Conduct before it is adopted. It is expected that the new rules will enter into force before the ECB fully assumes its supervisory responsibilities in November 2014.

4 LEGAL FRAMEWORK

4.1 PUBLIC CONSULTATION ON THE DRAFT ECB SSM FRAMEWORK REGULATION

Under the SSM Regulation, the ECB must adopt, in consultation with the NCAs and on the basis of a proposal from the Supervisory Board, the framework which sets out the practical arrangements for the implementation of Article 6 of the SSM Regulation (concerning the cooperation between the ECB and the NCAs within the SSM). This framework takes the form of an ECB regulation (the SSM Framework Regulation).

After transmission to the European Parliament's Committee on Economic and Monetary Affairs, in accordance with the relevant provisions of the Interinstitutional Agreement, a public consultation on the draft Framework Regulation was launched on 7 February 2014 for a period

⁶ OJ L 176, 27.6.2013, p.338.

⁷ OJ L 318, 27.11.1998, p. 8.

of four weeks (until 7 March). In addition, a public hearing was held at the ECB on 19 February, which gave stakeholders a first opportunity to ask questions on the draft legal text.

The outcome of the public consultation was very positive. By the closing date, the ECB had received 36 sets of comments. Respondents included European and national market and banking associations, financial and credit institutions, (non-euro area) central banks and supervisory authorities, ministries of finance and lawyers. The comments have been published on the ECB's website.

Most of the comments were technical, requesting clarifications and amendments to specific provisions, which indicated broad support for the general approach proposed in the draft Framework Regulation. The topics most frequently raised included:

- the procedural rules for the adoption of the ECB's supervisory decisions (e.g. the right to be heard, access to files and language regime);
- the methodology for assessing the significance of supervised entities;
- passport issues;
- the regime of close cooperation;
- the status of the less significant supervised entities.

Several respondents also raised questions about the functioning of the JSTs or the on-site inspections – and, more generally, about how the SSM will operate as of November 2014. The SSM Framework Regulation⁸ was published by the ECB on 25 April 2014, together with a Feedback Statement⁹, addressing the comments received in more detail and presenting an overview of the resulting amendments to the draft Framework Regulation.

4.2 ECB DECISION ON CLOSE COOPERATION

Decision ECB/2014/5 of 31 January 2014 on the close cooperation with the national competent authorities of participating Member States whose currency is not the euro sets out the procedure for the establishment of close cooperation – particularly as regards requests to enter into a close cooperation, the assessment of those requests by the ECB and the potential suspension and termination of a close cooperation. The Decision entered into force on 27 February 2014.

⁸ http://www.ecb.europa.eu/ecb/legal/pdf/en_reg_ecb_2014_17_f_sign.pdf

⁹ <http://www.ecb.europa.eu/ssm/consultations/shared/pdf/framework/draft-ssm-framework-regulation-feedback.en.pdf>

Whereas Decision ECB/2014/5 lays down the procedural aspects for entering into a close cooperation, the SSM Framework Regulation sets out how close cooperation operates and how supervision is conducted once a close cooperation has been established. Both legal acts therefore complement the provisions on close cooperation laid down in Article 7 of the SSM Regulation.

So far, no request to enter into a close cooperation with the ECB has been notified by a Member State whose currency is not the euro to the other Member States, the European Commission, the ECB and the European Banking Authority (EBA), in line with procedures envisaged by the SSM Regulation and Decision ECB/2014/5.

4.3 ECB RECOMMENDATION FOR AMENDMENTS TO COUNCIL REGULATION (EC) NO 2532/98 – SANCTIONS

On 25 April 2014 the ECB published a recommendation¹⁰ to amend Council Regulation (EC) No 2532/98 of 23 November 1998 concerning the powers of the ECB to impose sanctions¹¹ in order to clarify the rules applying to:

- the sanctions that may be imposed by the ECB when exercising central banking tasks other than supervisory tasks;
- the administrative penalties that may be imposed by the ECB when exercising its supervisory tasks.

This is to ensure that Regulation (EC) No 2532/98 and the SSM Regulation operate effectively and consistently in the context of the SSM. To carry out the tasks conferred on it by the SSM Regulation, the ECB may impose administrative pecuniary penalties for breaches of directly applicable EU law¹², and sanctions “in case of a breach of its regulations or decisions”¹³ (hereinafter jointly referred to as “administrative penalties”). The principles and procedures applicable to the imposition of administrative pecuniary penalties for breaches of directly applicable EU law under Article 18(1) of the SSM Regulation are laid down in the SSM Regulation and are further specified in the SSM Framework Regulation. Under Article 18(7) of the SSM Regulation, the ECB may impose sanctions for breaches of ECB regulations and

¹⁰ http://www.ecb.europa.eu/ecb/legal/pdf/en_rec_ecb_2014_19.pdf

¹¹ OJ L 318, 27.11.1998, p. 4.

¹² Article 18(1) of the SSM Regulation provides that the ECB may impose administrative pecuniary penalties “where credit institutions, financial holding companies, or mixed financial holding companies, intentionally or negligently, breach a requirement under relevant directly applicable acts of Union law in relation to which administrative pecuniary penalties shall be made available to competent authorities under the relevant Union law”.

¹³ Article 18(7) of the SSM Regulation.

decisions, in accordance with Regulation (EC) No 2532/98¹⁴. Against this background, it is of particular importance to establish a coherent regime for the imposition by the ECB of all administrative penalties relating to the performance of its supervisory tasks under the SSM Regulation.

Moreover, certain rules contained in Regulation (EC) No 2532/98 differ from those laid down in the SSM Regulation. These relate, in particular, to the upper limits of fines and periodic penalty payments, procedural rules and the limitation periods laid down in Regulation (EC) No 2532/98. The recommended amendments to Regulation (EC) No 2532/98 will address these issues.

4.4 DRAFT ECB REGULATION ON SUPERVISORY FEES

For details on the draft ECB Regulation on supervisory fees, see Section 6.2.

5 SUPERVISORY MODEL

5.1 FINALISATION OF THE SUPERVISORY MANUAL

The Supervisory Manual is an internal document for SSM staff; it covers the processes, procedures and methodology for the supervision of significant and less significant institutions, taking into account generally accepted principles for the functioning of the SSM. It describes the procedures for cooperation within the SSM and with authorities outside the SSM.

A first draft of the manual was submitted to the Supervisory Board at its first meeting on 30 January 2014. However, the manual is a living document that will be constantly updated as the methodology is refined through calibration and procedures are improved using feedback from the NCAs. The manual will therefore continue to be updated regularly both before and after 4 November 2014 when the ECB assumes fully its supervisory tasks.

As the methodology for the risk assessment and capital and liquidity quantification within the SSM Supervisory Review and Evaluation Process (SREP)¹⁵ is largely dependent on the availability and quality of reported supervisory data, considerable efforts are being made to improve the coverage and quality of such data as well as of the supervisory information used in the analysis.

¹⁴ In addition, Article 18(4) of the SSM Regulation requires the ECB to apply Article 18 in accordance with the acts referred to in the first subparagraph of Article 4(3) of the SSM Regulation, including the procedures contained in Regulation (EC) No 2532/98, as appropriate.

¹⁵ SREP is the process used to guide the supervisory review and determine possible additional requirements with respect to specific additional own funds, disclosure or liquidity, or other measures, on the supervised entity.

Three pilot exercises on data collections have been conducted with NCAs on a best efforts basis. Within that framework, particular attention has been given to key variables as well as adjustments and corrections to outliers or missing variables. These efforts identified substantial issues in terms of comparability and quality of data, related, for example, to differences across national accounting frameworks, which hamper the assessment of data, liquidity ratios, and interest rate risk indicators. At the same time, the methodology has been significantly improved so as to reflect how specific business models or particular situations can affect indicator values.

Furthermore, specific attention has been devoted to expanding the sources of market data in order to improve the thoroughness and depth of the supervisory analysis through third party tools. Such sources include data from external providers as well as solutions available in the ECB/Eurosystem. The benefits of expanding the data and information sources are, among other things, the possibility to (i) complement data from supervisory reporting, (ii) exploit potential synergies from other data sources, and (iii) carry out cross-checks of supervisory data.

The capital and liquidity quantification concept within the SREP has been further developed. The SSM approach quantifies capital requirements for risks subject to regulatory minimum requirements (Pillar 1 risks) and for additional risk types which are not already covered by minimum requirements (Pillar 2 risks). The risks are quantified within the SSM SREP framework using information from the SSM risk assessment system (RAS) and the assessment of the institution's Internal Capital Adequacy Assessment Process (ICAAP).

Work has also proceeded on the testing of the initial quantification methodology using data collected from NCAs. Testing work has included the analysis of the impact of specific methodological concepts and the calibration and testing of specific methodologies created for risk quantifications. Moreover, the testing has been linked to the development of tools for the calculations and templates for internal reporting, etc., as well as to decision-making. These activities are also part of the broader SSM IT development work.

The SSM Supervisory Manual will contain an annex detailing the methodology for the on-site inspections, thereby providing the on-site inspection teams with guidance on various assessment issues, as well as defining objectives, techniques and outputs for on-site inspections. The ultimate objective is to ensure consistency between the assessments and the supervisory actions resulting from the inspections by harmonising the procedures and establishing a clear framework for ensuing supervisory actions. The topics included in the methodological annex encompass the following categories (in line with the risk assessment methodology):

- credit risk;
- market risk;

- operational risk (including IT and outsourcing);
- corporate governance and internal control framework (including internal governance, risk control function, remuneration, internal audit and compliance functions);
- liquidity risk and capital issues (capital requirements calculation assessment process and ICAAP review).

Inspectors may use their professional judgement to introduce more granular sub-categories as relevant.

The SSM on-site inspection methodology is not expected to be static but to evolve and be updated over time. In consultation with the NCAs, the ECB aims to review and update the methodology on a regular basis in order to guarantee that it complies with the key principles of the risk-based approach and proportionality, as well as to ensure that it covers additional relevant topics.

5.2 PREPARATION OF A PUBLIC GUIDE TO SUPERVISORY PRACTICES

A public document entitled “Guide to supervisory practices and methodologies in the Single Supervisory Mechanism” is currently being prepared, with the main objective of clarifying the relevant features, tasks and processes of the SSM. The guide will provide supervised entities transparency about supervisory assessment principles, thus helping to alleviate uncertainty about the functioning of the SSM and supervisory expectations. At the same time, it will serve to fulfil the publication requirements to which the SSM is subject, most notably:

- the Interinstitutional Agreement between the European Parliament and the ECB, which envisages the publication by the ECB of a “guide to its supervisory practices on its website”;
- the EBA’s supervisory disclosure framework which, under Article 143(1)(c) of CRD IV, requires the publication of “the general criteria and methodologies” used in the SREP.

The guide will cover the following main areas:

- the SSM as the first pillar of a European banking union;
- the SSM’s overarching objectives, as well as its geographical, institutional and functional scope and the main functioning principles;
- concepts of significant and less significant institutions and the respective criteria;

- key pieces of legislation governing the functioning of the SSM and the way they interact;
- practical operation of the SSM;
- the key structures and bodies of the ECB;
- cooperation between the ECB and the NCAs of participating Member States;
- the approaches to the supervision of significant and less significant institutions and the distribution of tasks between the ECB and NCAs for each of the two approaches;
- the organisational set-up within the ECB;
- cooperation between the SSM and other authorities;
- the concept of close cooperation, through which Member States whose currency is not the euro have an opportunity to join the SSM;
- the key supervisory tasks in different areas of supervision, and their objectives, frequencies and desired outcomes (differentiating between the supervision of significant and less significant institutions);
- procedures to facilitate and ensure the consistency of supervision across the SSM;
- key procedural rules such as entry points and language provisions;
- basic features of the common SSM methodology for risk assessment and the quantification of capital and liquidity requirements.

The intention is to publish the guide well ahead of the start of the SSM operations.

6 PREPARATION OF OTHER RELEVANT STRANDS OF WORK

6.1 SUPERVISORY DATA REPORTING FRAMEWORK

The SSM Supervisory Reporting Manual, an internal document which lays down the approach for supervisory reporting and describes the data and reporting framework for the SSM, was approved as a living document by the Supervisory Board in April. As the design of the supervisory reporting framework has been prominently driven by the data needed to run a centralised risk assessment system (RAS), the variables included in the reporting framework are categorised by the different risk profiles of a bank.

The Supervisory Board has agreed to launch a third data collection pilot exercise (SSM Pilot Exercise – SPE-3), at the beginning of March, to continue and refine the preparatory work, in particular for the RAS. The key objectives of SPE-3 are to further improve the methodologies used in the RAS. The content of the data collection was closely coordinated with the NCAs. The collection of the latest end-December 2013 data is essential for the ongoing expansion of the current relatively short time series. Importantly, the exercise will also support the transition work by the new JSTs, which will thus be able to use the data series in their own preparatory work. The exercise will help banks, NCAs and the ECB in preparing future regular data collections. Every effort is being made to coordinate the data collection requests efficiently and avoid duplications and overlaps with other data exercises.

Another vital ongoing task is the design of the data framework for less significant institutions. The key challenge is to strike a balance between requiring a meaningful set of data and not overburdening banks, particularly the smaller ones.

The Supervisory Banking (SUBA) data system required for supervisory data and metadata reception in the ECB is in its implementation phase. SUBA will store and process data, validate them and check them for consistency, protect their confidentiality and disseminate them. It will be in line with the EBA's Implementing Technical Standards on supervisory reporting (as published by the EBA in July 2013) and will gradually accommodate other regular supervisory data which have not been harmonised by the EBA. The system will also be able to host both individual and consolidated (group) banking data.

The first phase is scheduled for completion by July 2014. It will be linked to the Register of Institutions and Affiliates Database (RIAD), which is expected to contain institutional information and key business data on the banks and the composition of banking groups (i.e. reference data). The RIAD will also directly support tasks such as the identification of the significant banking groups that will be subject to the ECB's direct supervision.

6.2 SUPERVISORY FEE FRAMEWORK

Under the SSM Regulation, the ECB will levy annual fees on credit institutions established in a participating Member State and on branches established in a participating Member State by a credit institution established in a non-participating Member State. The arrangements for the calculation of the SSM fees are to be established through an ECB regulation, laying down the rules and procedures governing the SSM-related fees, with the aim of achieving cost efficiency and proportionality, in accordance with transparency standards.

In the period since the previous SSM Quarterly Report, the ECB has prepared a draft Regulation on supervisory fees which addresses the following main aspects:

- the criteria to determine the overall amount of the annual supervisory fee;
- the arrangements to calculate the annual supervisory fee of the supervised entities;
- the procedure for the collection of the annual supervisory fee.

Discussions on the draft ECB Regulation on supervisory fees with NCAs have commenced. The next steps will be to finalise the proposal for the ECB's supervisory fee methodology and to issue a draft ECB Regulation on supervisory fees for open public consultation. The intention is to launch the public consultation by the end of May 2014.

6.3 IT INFRASTRUCTURES

The creation of new business processes and operations for the SSM is supported by the following IT work streams.

- *Shared IT services*: new workstations have been set up in the temporary site for the SSM staff, to be followed by a total of 1,100 new workstations by the end of autumn 2014. NCAs will connect to SSM applications through CoreNet, the current Eurosystem/ESCB network infrastructure used by the NCBs (with the exception of a few NCAs, where a different solution may be required). Options for exchanging signed and encrypted messages with non-ESCB NCAs are being reviewed.
- *Collaboration, workflow and information management*: the IT project for managing contact data and the handling of enquiries (e-Contact) is currently being implemented, with first functionalities expected to go live by the end of May 2014. In parallel, work is continuing to improve access to the ECB document and records management system (DARWIN) for NCAs that are separate from their respective NCB.
- *Enterprise resource planning*: the initial business requirements and potential solutions for the SSM budget, organisational structure and reporting-related changes have been identified by business area representatives and are under development; further updates are expected in the coming months. As regards cost calculation, invoicing and payment collection and reconciliation, the ECB has identified SAP's "Public Sector Collection and Disbursement" and "Tax and Revenue Management" modules as suitable solutions. The development of the former module is under way and is benefiting from regular dialogue with business area representatives.
- *Data collection, data quality management and analytics*: the preparation phase of the SUBA data system project has been completed. The key objective of the project is to

enable the ECB to receive specific supervisory data from all SSM countries based on XBRL format in line with the EBA's Implementing Technical Standards framework. Following the preparation and conduct of a comprehensive call-off to select the appropriate IT provider, the selection of the required software elements and the development and technical test of the SUBA prototype to enable supervisory data collection and validation, the project will enter the implementation phase.

- **Information Management System (IMAS):** IMAS will provide the basis to ensure harmonised processes and consistency in the supervision of banking institutions. Especially in the starting phase of SSM, it will be a crucial element in ensuring the application of the common methodology and standards by all JSTs. It will also be a very visible symbol to all NCA members that the SSM is fully operational. Additionally, a stable, efficient and easy-to-use solution should foster acceptance of the SSM on many levels. The decision was taken to use an existing IT solution, with a proven track record at one of the NCAs, as the nucleus for IMAS that will be further customised to satisfy SSM needs.

7 COMPREHENSIVE ASSESSMENT

Significant progress has been achieved in the comprehensive assessment since the submission of the previous Quarterly Report. The three main objectives of the exercise are to:

- establish transparency by enhancing the quality of information available on the condition of banks;
- identify and implement necessary corrective actions if and where needed;
- build confidence by assuring all stakeholders that banks are fundamentally sound and trustworthy.

An asset quality review (AQR) and a stress test are the major methodological building blocks of the assessment.

The entire process formally started with the adoption of Decision ECB/2014/3 of 4 February 2014 identifying the credit institutions that are subject to the comprehensive assessment. The Governing Council adopted this decision on the basis of a proposal by the Supervisory Board.

With a view to the finalisation of the assessment before the operational start of SSM supervision in November 2014, several important milestones have been reached and key processes have been initiated over the past months, as outlined below.

7.1 FINALISATION OF PORTFOLIO SELECTION FOR THE ASSET QUALITY REVIEW

The first phase of the AQR, the selection of portfolios for examination, has been concluded. The selection was made following a risk-based approach and was carried out in close cooperation between the NCAs and the ECB, whereby NCAs submitted proposals to the ECB Central Project Management Office (CPMO) for review in bilateral meetings before reaching agreement on the final selection. The total risk-weighted assets (RWA) of the banking book portfolios selected for the review amount to approximately €3.7 trillion, equivalent to 58% of total credit RWA across the banks subject to the assessment.

In addition, 29 banks with material trading book exposures are subject to a specifically tailored AQR of the trading book. This component consists of a qualitative review of core trading book processes, combined with a quantitative review of the most important derivative pricing models. In the former, the effectiveness and appropriateness of key processes used by banks to calculate and monitor fair value for all trading book positions are assessed. The latter focuses on the robustness of the most material pricing models used to value level 3 derivatives. The selection of the relevant pricing models has been concluded.

7.2 PROJECT MOBILISATION AND CROSS-BORDER COOPERATION

The mobilisation of project structures and relevant resources at the national level was finalised in time for the start of the execution phase of the AQR. NCAs have now concluded the procurement of third parties (external consultants and audit firms) that will support the process. Execution at the national level is coordinated by national project management offices overseen by national steering committees. As described in the previous Quarterly Report, both national structures report to the relevant central structures at the ECB, namely the ECB CPMO and the Comprehensive Assessment Steering Committee (CASC). Inspection teams, consisting of NCA staff and auditors, are carrying out the on-site work at the individual banks. Country teams consisting of ECB experts, tasked with providing technical assistance and contributing to quality assurance at the national and central level, have been established and have already started operating in the individual Member States.

The framework for home-host cooperation in carrying out the comprehensive assessment has been finalised and relevant bilateral arrangements between supervisory authorities have been put in place. This is essential for the execution of the AQR, as many of the institutions covered by the assessment operate internationally and hold non-domestic portfolios which are subject to the assessment. Besides the cooperation among the NCAs of different SSM Member States, the arrangements cover the cooperation between SSM NCAs and supervisory authorities from non-

SSM jurisdictions, both within and outside the EU. A series of workshops with the relevant non-SSM authorities was held at the ECB in order to discuss and agree upon the modalities of cooperation, also involving the EBA, the European Commission and the European Securities and Markets Authority (ESMA).

7.3 PUBLICATION OF THE PHASE 2 MANUAL

On 11 March 2014 the manual containing the specific methodology for the execution phase of the AQR (Phase 2) was published on the ECB's website. The document covers the ten work blocks to be completed during Phase 2, including procedures for:

- validation of data and checks of model inputs;
- valuation of material exposures and collateral and determination of provisioning needs;
- use of industry benchmarks to assess market values;
- quality assurance and progress tracking to ensure timely completion.

The manual serves as a uniform reference for all parties involved in the exercise, providing specific guidelines on the conduct of all relevant steps. Before publication, the manual was subject to an intensive process of technical review and refinement involving the NCAs and relevant audit firms.

7.4 AQR EXECUTION, QUALITY ASSURANCE AND DATA CONFIDENTIALITY

The bank inspection teams commenced their on-site work in February and completed the first work block (processes, policies and accounting review) by the end of March. Work on the data integrity validation and the credit file review is currently ongoing and the collective provisioning analysis started in mid-April. The ECB is aware that the requirements to report a significant amount of granular data within a relatively short time frame entail substantial efforts from banks. The ECB CPMO has endeavoured to streamline the relevant data templates, so as to minimise the reporting burden without compromising the quality of the exercise. The ECB has already held direct discussions with senior representatives of the banks subject to the assessment and will continue this dialogue over the rest of the process.

Quality assurance is of particular importance to safeguard the integrity and comparability of the results of the comprehensive assessment and to ensure a level playing field across institutions

and countries. To this end, the following framework comprising three layers of quality assurance activities has been established:

- bank inspection teams are responsible for validating the quality of their submissions to NCAs;
- NCAs' technical assistance and quality assurance teams and the ECB country teams conduct further checks and validations across banks in the respective jurisdictions;
- the ECB CPMO reviews the quality of national submissions to the centre, also carrying out cross-country checks and analyses.

Ensuring the confidential treatment of all data submitted in the course of the exercise is a key priority, both to protect the rights of the institutions involved and to maintain an orderly communication process, avoiding leakages of information. All parties involved in the conduct of the comprehensive assessment have signed confidentiality agreements and the ECB has made significant efforts to guarantee the safe transmission and storage of data and rule out any undue access.

7.5 STRESS TEST

In a press release issued on 3 February 2014, the ECB confirmed the application of the key parameters for the stress test, as communicated publicly by the EBA on 31 January 2014. The capital threshold for the baseline scenario will be 8% Common Equity Tier 1 (CET1), whereas for the adverse scenario, a threshold of 5.5% CET1 will apply. As one of the two main building blocks of the comprehensive assessment, the stress test for the SSM countries will incorporate the results of the AQR.

The horizon for the stress test will be three years (December 2013 to December 2016). The baseline scenario for the stress test was provided by the European Commission. The adverse scenario was proposed by the European Systemic Risk Board (ESRB), in close collaboration with the ECB and the EBA, as in previous exercises. The details of the scenarios were released on 29 April 2014.

7.6 ELIGIBLE MEASURES TO COVER CAPITAL SHORTFALLS

In a press release issued on 29 April 2014 the ECB clarified the measures banks will be requested to take in cases where their capital ratios, as determined following the comprehensive assessment, fall short of the relevant thresholds, in particular in terms of timing and eligible capital instruments.

In case of capital shortfalls, the relevant banks must submit capital plans detailing remedial actions. Capital shortfalls will be expected to be covered within six months for those identified in the AQR or the baseline stress test scenario, and within nine months for those identified in the adverse stress test scenario. The periods of six or nine months will start from the release of the comprehensive assessment results in October 2014.

Concerning the capital instruments to be used, any capital shortfall revealed by the AQR and the baseline scenario of the stress test may only be covered with Common Equity Tier 1 (CET1) capital instruments as defined in Article 50 of the CRR. A capital shortfall arising from the adverse scenario of the stress test may be covered with CET1 instruments and/or convertible or write-down instruments meeting the requirements of Article 52 of the CRR (i.e. Additional Tier 1 instruments). The use of Additional Tier 1 instruments is limited to a maximum of 1% overall RWA, subject to the following specifications¹⁶:

- instruments with a trigger below 5.5% CET1: 0% of overall RWA;
- instruments with a trigger at or above 5.5% and below 6% CET1: up to 0.25% overall RWA;
- instruments with a trigger at or above 6% and below 7% CET1: up to 0.5% overall RWA;
- instruments with a trigger at or above 7% CET1: up to 1% overall RWA.

8 ACCOUNTABILITY

The SSM Regulation and the Interinstitutional Agreement between the European Parliament and the ECB establish clear procedures for appointing the Chair and Vice-Chair of the Supervisory Board. Following a proposal by the ECB's Governing Council, Ms Sabine Lautenschläger, member of the Executive Board of the ECB, was appointed by the EU Council as Vice-Chair of the Supervisory Board on 11 February 2014, following her hearing before the European Parliament's Committee on Economic and Monetary Affairs on 3 February 2014, and Parliament's approval on 5 February 2014.

The SSM Regulation provides for various channels of accountability to the European Parliament and the EU Council. A key channel of accountability is provided through regular

¹⁶ An example of how these specifications are to be applied is provided in the note on the comprehensive assessment published on 29 April together with the above-mentioned press release.

hearings and ad hoc exchanges of views with the Chair of the Supervisory Board in Parliament's Economic Affairs Committee and in the Eurogroup.

The Chair of the Supervisory Board, Ms Danièle Nouy, presented the first SSM Quarterly Report to the European Parliament in a dedicated ad hoc exchange of views on 4 February 2014, and at the ECOFIN Council meeting on 18 February 2014. The European Parliament's Economic Affairs Committee held the first regular hearing with Ms Nouy on 18 March 2014, where she reported and exchanged views on the progress made on the SSM preparations and the comprehensive assessment. The ECB also published the Chair's written answers to MEP questions which were received shortly in advance of that hearing.

Ms Nouy also reported on the establishment of the SSM and the progress of the comprehensive assessment at the meeting of the Economic and Financial Committee Financial Stability Table on 25 March 2014 and the informal ECOFIN Council meeting on 2 April 2014. From 4 November 2014, once the ECB has assumed fully its supervisory tasks, SSM accountability will be rendered towards the Eurogroup in the presence of representatives from non-euro area Member States participating in the SSM.

In line with the Interinstitutional Agreement (Section V), the European Parliament received the draft Framework Regulation on 4 February 2014, in advance of the public consultation launched on 7 February.

Under the Interinstitutional Agreement, the European Parliament's competent committee receives the records of proceedings after each meeting of the Supervisory Board. As these records are generally finalised and approved a month after each meeting, the ECB transmitted – during the period under review – the records of the proceedings of the Supervisory Board meetings held between January and mid-March 2014. These documents were classified by the ECB as “ECB-Confidential”. Against this background, it is worth recalling that the Interinstitutional Agreement (Section I) specifies that the European Parliament shall in particular “implement safeguards and measures corresponding to the level of sensitivity of the ECB information or ECB documents” and “seek the ECB's consent to any disclosure to additional persons or institutions” beyond the members of the Economic Affairs Committee receiving these records.

9 NEXT STEPS AND CHALLENGES

Before the third Quarterly Report, scheduled for publication at the beginning of August 2014, the ECB intends to address in particular:

- the finalisation of the proposal for the ECB's supervisory fee methodology and of a draft ECB Regulation on supervisory fees for public consultation – before launching the public consultation, the draft Regulation will be transmitted to the European Parliament's competent committee in accordance with the Interinstitutional Agreement;
- the selection of the first wave of supervisory staff (around 280) and appointment of JST coordinators;
- the preparation and approval of ECB internal rules on the separation of functions and exchange of information.

The table below outlines these important milestones, as well as those in the last quarter of the transition phase until 4 November 2014, when the ECB will assume supervisory powers.

Important milestones	
Action	Time frame
Launch of public consultation on draft ECB Regulation on supervisory fees	end-May 2014
Appointment of JST coordinators	May/June 2014
Selection of first wave of supervisory staff (around 280)	early summer 2014
Testing phase for supervisory data submission	summer 2014
ECB internal rules on separation of functions and exchange of information	summer 2014
<i>Third Quarterly Report to the European Parliament, EU Council and European Commission</i>	<i>August 2014</i>
Publication of list of significant banks	before 4 September 2014
Selection of second wave of supervisory staff (around 300)	late summer 2014
ECB Decision on the selection of members of the Administrative Board of Review	September 2014 (at the latest)
Review of the ECB Ethics Framework (including ethical conduct for ECB staff and management involved in banking supervision)	September 2014
Outcome of comprehensive assessment	October 2014
ECB Regulation on supervisory fees	October 2014
Publication of ECB guide to supervisory practices	before end-October 2014
<i>Fourth Quarterly Report to the European Parliament, EU Council and European Commission</i>	<i>November 2014</i>
Start of supervisory activities	4 November 2014