Launch of the banking union: the Single Supervisory Mechanism in Europe

Europe's Single Supervisory Mechanism (SSM) for banks will be launched on 4 November 2014. Whereas banking regulation, ie the development of binding rules regarding credit institutions' conduct, has been closely harmonised for quite a long time already, especially at the EU level, the SSM is the first significant step towards greater communitisation of supervisory practice in Europe, ie the application of these rules as well as monitoring of compliance in individual cases. In future, the European Central Bank (ECB) will perform a pivotal function in supervising banks located in the euro area (and in non-euro-area EU member states that join the SSM voluntarily) and, in so doing, will work closely with national supervisory authorities.

The legal framework for the SSM, which governs responsibilities and the division of tasks between the ECB and national supervisors, was already adopted in 2013 and is now about to be put into operation following a one-year transitional period. In future, the ECB will be directly responsible for the supervision of 120 significant, major banks or banking groups, in close collaboration with national authorities. Joint supervisory teams (JSTs), comprising staff from the national authorities and the ECB and coordinated by the ECB, will play a key role in supervising significant banks. By contrast, medium-sized and small banks will remain, as before, under the direct supervision of the national authorities; however, the ECB can also lay down certain framework conditions for these institutions or, in some cases, intervene in supervision directly. The SSM is akin to a network in which national authorities and the ECB cooperate under the leadership of the ECB.

The SSM is part of the overall banking union project, the next step of which – envisaged from 2016 onwards – will be a Single Resolution Mechanism (SRM) for credit institutions in Europe. Healthy and robust banks are a key precondition for the successful launch of a banking union. To ensure this, all currently existing burdens and weaknesses at banks must be identified in a timely manner and rectified before responsibility for supervision is transferred to the European level. Since these "legacy debts" came into being under the supervision of the currently responsible national authorities, the respective countries are also still responsible for rectifying them, in keeping with the principle of correlating liability with supervision.

To this end, the euro area's largest banks have been subjected to a comprehensive assessment (CA) over the past few months. This CA included not only a review of a selection of banks' balance-sheet and off-balance-sheet items (asset quality review, or AQR) but also stress tests which simulated potential crisis scenarios and assessed the attendant effects on institutions. The results will be published on 26 October 2014, a little over a week before the ECB assumes supervisory responsibilities.

Motivation to create the Single Supervisory Mechanism

Europe's Single Supervisory Mechanism up and running in just over two years

On 29 June 2012, the euro-area Heads of State or Government came to a fundamental agreement to establish a central banking supervisor based at the ECB for member states whose currency is the euro.[1] Just under two-and-a-half years later, the plan, akin to an "organisational *tour de force*", will now become a reality: on 4 November 2014, the ECB will assume responsibility for supervising banks in the euro area, which will herald fundamental change – both institutional and organisational – to current supervisory practice in Europe.

Aim is to diminish close ties between banks and national finances

The SSM is also intended to break the vicious circle between banks and national finances, which played a major role in the crisis. The public funds used to rescue or prop up banks left, in some cases, sizeable holes in government budgets. Unsound public finances, in turn, impacted adversely on banks, for example if they held sovereign debt on their books. The SSM will now take what had previously been purely national banking supervision to a European level, which will also minimise the hazards of potentially inappropriate supervisory forbearance guided by national interests (known as "home bias").

SSM will create comprehensive set of data for supervisors as cross-border supervisory regime

The move towards greater communitisation of banking supervision through the SSM, moreover, reflects the highly integrated and financially interlinked nature of Europe's financial markets. The idea behind the cross-border dissemination and comparison of information is also to detect risks engendered by, or which pose a hazard to, the banking system better and earlier. In addition, the SSM will offer supervisors entirely new vistas for their prudential supervisory work. Ideally, cooperation and the exchange of ideas and opinions across national borders may amalgamate the procedures and *modi operandi* of the individual SSM member countries' national supervisory regimes and migrate them to the SSM's institutional framework. The goal is ultimately to enhance the banking system's resilience and safeguard economic stability in the euro area.[2]

The SSM's structures

The SSM's scope

SSM as a supervisory mechanism for euro-area deposit-taking credit institutions

The Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions entered into force on 3 November 2013.[3] It created the SSM, by means of which extensive banking supervisory powers will be conferred upon the ECB with effect from 4 November 2014. The SSM's remit will extend to all banks engaged in lending and deposit business, ie those banks classified as a deposit-taking credit institution under EU law. It will also cover credit institutions' prudentially consolidated parent undertakings, including financial holding companies and mixed financial holding companies. Responsibility for consumer protection and the prevention of money laundering or terrorist financing will not be transferred to the ECB but instead will remain wholly with national supervisors. In these areas, however, the ECB, where appropriate, is to cooperate fully with the national authorities to ensure consumer protection and to fight money laundering.

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1 On 1 January 2015, Lithuania will become the 19th EU member state to introduce the euro, thereby also acceding to the SSM.
2 For more information on the aims of the SSM see also "The Banking Union – a European perspective: reasons, benefits and challenges of the Banking Union", speech by Yves Mersch, Member of the Executive Board of the ECB, at the seminar entitled "Auf dem Weg zu mehr Stabilität – Ein Dialog über die Ausgestaltung der Bankenunion zwischen Wissenschaft und Praxis" held in Berlin on 5 April 2013, available online at http://www.ecb.europa.eu/press/key/date/2013/html/sp130405.en.html, and Deutsche Bundesbank, Progress towards a European banking union, Annual Report 2013, pp 21-38, available online at http://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Annual_Report/2013_annual_report.pdf?__blob=publicationFile.
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.

Opt-in for non-euro-area EU member states

The SSM's geographical coverage will initially be limited to those EU countries whose currency is the euro. EU member states whose currency is not the euro can opt into the SSM by entering into close cooperation with the ECB. Only the future will tell to what extent the non-euro-area countries actually make use of this option.

Significant and less significant banks

Fundamental distinction between significant and less significant banks

Although the SSM Regulation confers upon the ECB responsibility for supervising all banks within the scope of the SSM, only those institutions classified as significant will be supervised directly by the ECB. A large portion of supervisory decision-making powers with respect to institutions classified as being less significant will initially remain with the national competent authorities (NCAs). Moreover, there will also be common procedures[4] which will be conducted irrespective of whether a bank is classified as significant or less significant.

Criteria for distinguishing between significant and less significant banks

Article 6 of the SSM Regulation sets forth the following criteria for classifying an institution as significant or less significant: size, importance for the economy of the Union or any participating member state, and significance of cross-border activities.

Measured by size and importance for the economy of the EU, an institution or group of institutions is currently deemed to be significant if the total value of its assets exceeds €30 billion or 20% of national GDP, unless the total value of its assets is less than €5 billion. A discretionary decision to declare a bank to be significant may also be taken if an NCA considers an institution to be of significant relevance for its domestic economy and the ECB confirms such significance. This decision is always taken at the highest level of consolidation for supervisory purposes. The method applied to determine significance is fleshed out by the SSM Framework Regulation, which was published by the ECB on 25 April 2014.[5]

The ECB may also, on its own initiative, consider an institution to be significant where it has established banking subsidiaries in more than one participating member state and its cross-border assets or liabilities represent a significant part of its total assets or liabilities. The SSM Framework Regulation defines this criterion more precisely to mean that significance on the basis of cross-border activities may be considered only if the ratio of an institution's cross-border assets (or liabilities) to its total assets (or liabilities) is greater than 20%. Cross-border in this context means that the counterparty is a credit institution or other legal or natural person located in a participating member state other than the member state in which the parent undertaking of the relevant supervised group has its headquarters.

In addition, institutions which have requested or received direct public financial assistance from the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM) are also classified as being significant. Moreover, the three most significant institutions in a participating member state are classified as being significant. As it is incumbent upon the ECB to ensure the consistent application of high supervisory standards, it may also, on its own initiative and in consultation with the appropriate NCA, classify an institution or group of institutions as significant. This is predicated on the ECB believing it necessary to supervise directly such entities in order to achieve the goal of ensuring the consistent application of high supervisory standards.

4 For more information on common procedures, see also pp 57-58.
5 Regulation of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17).

Classification as significant affects entire group

These are regarded as "either/or" criteria, ie only one of them has to be met for the institution to be classified as significant. Since significance is determined at the highest level of consolidation, this means that institutions belonging to a group are regarded as significant even if they *per se* do not meet the criteria for classification as significant.

If an institution fulfils the criteria for classification as significant, pursuant to Article 6 (4) of the SSM Regulation it may, owing to "particular circumstances", nevertheless be considered as less significant on a discretionary basis and will therefore not be supervised directly by the ECB. Under the SSM Framework Regulation, "particular circumstances" exist where there are specific and factual circumstances that make the classification of a supervised entity as significant inappropriate. However, this reverse exception should be applied only to case-by-case decisions and under strict interpretation of the term "particular circumstances". Its aim is to avoid inconsistencies in the classification of an institution as significant taking into account the SSM's objectives. This provision will be applied in Germany to the Wüstenrot group; even though the group fulfils the criteria for classification as a significant supervised entity, direct supervision by the ECB does not appear appropriate owing to the group's structure (banking group with a reinsurance company at its apex).

Beginning and end of supervision by the ECB

Classification of institution as significant by means of ECB decision

The date on which the ECB will assume direct supervision of an institution or a group of institutions will be specified in an ECB decision. The institution will be notified of this decision at least one month prior to the date on which the ECB will assume direct supervision. In addition, the institution concerned will be given the opportunity to submit comments in writing prior to the adoption of such a decision.

The ECB will generally review the classification of an institution as significant once a year. If, for three consecutive years, none of the criteria for classification as significant has been fulfilled, the ECB will end its direct supervisory activities. In such an event, the ECB will adopt a further decision stating the end date of direct supervision by the ECB of the institution in question. Here, too, the decision must be adopted by the ECB at least one month prior to the end of direct supervision, and the notified institution must be given the opportunity to comment.

The ECB has published a list with the names of all the institutions and groups of institutions that will be under its supervision.[6] This list, which will be updated regularly by the ECB, also indicates which of the criteria for classifying the institution or group of institutions as significant has been fulfilled. According to the list, with effect from 4 November 2014, the ECB will assume responsibility for the direct supervision of 120 group entities[7] in the euro area, representing nearly 85% of the total assets of all euro-area banks. In Germany, the ECB will directly supervise 21 groups. The member states' NCAs will initially retain responsibility for the direct supervision of the approximately 3,600 less significant banks in the euro area. This figure includes some 1,700 German institutions, which will continue to be supervised directly by the Federal Financial Supervisory Authority (BaFin) and the Deutsche Bundesbank.

6 The list which will be in effect when the SSM is launched on 4 November 2014 is available online at http://www.ecb.europa.eu/pub/pdf/other/ssm-listofsupervisedentities1409en.pdf?acb6610cecc0e97103dd16a8b200a5bc.
7 In some cases, these are also credit institutions or subsidiaries which will be supervised on a stand-alone basis. The 120 group entities are composed of around 1,200 supervised institutions.

Significant supervised entities in Germany

Aareal Bank AG
Bayerische Landesbank
Commerzbank AG
DekaBank Deutsche Girozentrale
Deutsche Apotheker- und Ärztebank eG
Deutsche Bank AG
DZ BANK AG Deutsche Zentral-Genossenschaftsbank
HASPA Finanzholding
HSH Nordbank AG
Hypo Real Estate Holding AG
Landesbank Baden-Württemberg
Landesbank Berlin Holding AG
Landesbank Hessen-Thüringen Girozentrale
Landeskreditbank Baden-Württemberg-Förderbank
Landwirtschaftliche Rentenbank
Münchener Hypothekenbank eG
Norddeutsche Landesbank-Girozentrale
NRW.Bank
SEB AG
Volkswagen Financial Services AG
WGZ BANK AG Westdeutsche Genossenschafts-Zentralbank

The SSM's governance structures

Danger of conflicts of interests between banking supervision and monetary policy would require institutional separation …

Developing the future decision-making structures has probably been one of the greatest challenges in establishing the SSM. European legislators and the ECB faced the task of fitting the new supervisory powers into the ECB's institutional framework in such a manner as to avoid, as far as possible, conflicts of aims and interests between banking supervision and monetary policy. The clear separation of these two areas is mandated by the SSM Regulation (see eg recitals 65 and 73 and Article 25). The ECB's dual role as a central bank and supreme supervisory authority is an example of a situation that could possibly give rise to a conflict of interests. Its primary mandate is to ensure price stability in the euro area. To this end, it can provide banks with liquidity by means of monetary instruments. In its added role as a supervisor, the ECB will now run the risk of reputational damage should one of the institutions it supervises fail. It could, therefore, be tempted to use monetary liquidity instruments to prop up a bank which is actually no longer viable from a prudential point of view, even if monetary policy considerations, especially the objective of maintaining price stability, suggest that such action should be avoided.

… which, however, cannot be strictly implemented under current European legislation

However, the necessary strict separation of monetary policy and banking supervision is not possible under European primary law, according to which the Governing Council of the ECB is explicitly mandated to serve as the supreme decision-making body. The fact that ultimate responsibility for both policy areas rests with the ECB Governing Council is not something that the SSM Regulation, which is part of European secondary legislation, can override. Against this background, the SSM's governance structures as they now exist can, therefore, be seen only as a necessary compromise and not as an ideal solution.[8] The latter could be achieved only through a corresponding amendment to primary law.

Even in the area of banking supervision, therefore, the ECB's Governing Council will act as the supreme decision-making body. In order to ensure the maximum possible degree of separation between supervisory and monetary policy decisions, the Governing Council of the ECB will hold separate SSM meetings alongside those on monetary policy issues – yet the composition will remain the same.[9]

New Supervisory Board is core component of SSM's institutional structure

A key role will be played, however, by the new Supervisory Board, which is to undertake "fully" the planning and execution of the supervisory tasks conferred upon the ECB. This Board will also give those non-euro-area member states opting into the SSM the opportunity to take part in the supervisory decision-making process. By contrast, under the current EU Treaties, voting membership of the ECB's supreme decision-making body, the Governing Council, is restricted to the presidents and governors of the central banks of those member states whose currency is the euro. The Supervisory Board will propose to the ECB Governing Council draft decisions on individual supervisory measures for adoption by the Governing Council. Under the "non-objection procedure", a draft decision will be deemed adopted if the Governing Council does not object within a maximum period of ten working days.

The Supervisory Board is composed of its Chair, Vice-Chair, four ECB representatives and one representative of each participating member state's NCA. Where the NCA is not a national central bank (NCB), the NCA may decide to bring a representative from its respective NCB to the Supervisory Board meetings. For the purposes of the voting procedure, however, the representatives of the authorities of any one member state will together be considered as one member. This provision will apply to Germany, since BaFin is given as the country's NCA. At the same time, based on a division of tasks which has been in practice for years, the Bundesbank is closely involved in hands-on supervisory activities – through both off-site supervision and, in particular, on-site inspections. It would, therefore, be virtually unjustifiable not to involve the Bundesbank, the President of which is a member of the ECB's supreme decision-making body – the Governing Council – in the work of the preparatory body.

The Supervisory Board's work is supported by a secretariat and a steering committee. The latter is composed of a "subset" of members of the Supervisory Board. Its task is to prepare Supervisory Board meetings and support its general work.

The Supervisory Board held its inaugural meeting in January 2014. Ms Danièle Nouy was appointed as the Chair of the Board, and the position of Vice-Chair went to Ms Sabine Lautenschläger, a former Deputy President of the Deutsche Bundesbank and currently a member of the Executive Board of the ECB.

Mediation panel to resolve differences of views among NCAs regarding objections of the ECB Governing Council to draft decisions by the Supervisory Board

The mediation panel stipulated in Article 25 (5) of the SSM Regulation is another means by which to ensure the separation of monetary policy and supervisory tasks. It will be called upon when the NCAs of the member states concerned express differences of views regarding objections of the Governing Council of the ECB to a draft decision by the Supervisory Board. The mediation panel comprises one member per participating member state, chosen by each member state among its members of the Governing Council of the ECB and the Supervisory Board. The Vice-Chair of the Supervisory Board will initially chair the meetings of the mediation panel, but without having voting rights. Opinions adopted by the

8 See also Deutsche Bundesbank, European Single Supervisory Mechanism for banks – a first step on the road to a banking union, Monthly Report, July 2013, pp 13-32, available online at http://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly_Report_Articles/2013/2013_076_single.pdf?__blob=publicationFile.
9 See also Article 25 (4) of the SSM Regulation.

mediation panel cannot, however, be binding on the Governing Council of the ECB as it is the supreme decision-making body.

Administrative Board of Review responsible for extrajudicial remedies

The Administrative Board of Review is an additional body established pursuant to Article 24 of the SSM Regulation. It is composed of five individuals of high repute from member states. These individuals must have a proven record of relevant knowledge and professional experience, including supervisory experience. Furthermore, they may not be current staff members of the ECB, the NCAs or other institutions involved in carrying out tasks in connection with the SSM. On 8 September 2014, the Governing Council of the ECB appointed the five members and two alternates for the Administrative Board of Review's first term of office. They include a former member of the Deutsche Bundesbank's Executive Board, Edgar Meister.[10] In substance, the members are to review both the procedural and substantive legality of the supervisory decisions taken with respect to the provisions of the SSM Regulation. The Administrative Board of Review can be called upon by any natural or legal person to whom an ECB supervisory decision is addressed or for whom a supervisory decision is of direct or individual concern. After ruling on the admissibility of the request, the Administrative Board of Review must express an opinion within a certain period. This period should be appropriate to the urgency of the matter, but may not exceed two months from receipt of the request. The opinion will then be remitted to the Supervisory Board and will serve as the basis for preparing a new draft decision. The new decision will abrogate or replace the previous decision. An appeal to the Administrative Board of Review is without prejudice to the right to bring proceedings before the European Court of Justice (ECJ), nor is it a precondition for bringing a case before the ECJ.

Four new ECB Directorates General

Four additional organisational units have been created within the ECB to deal with operational supervisory activities. They are called Directorates General (DGs) in line with the ECB's standard terminology, and are each responsible for certain supervisory tasks (see the chart on page 50).

Practical working methods in the SSM

Creation of Joint Supervisory Teams (JSTs)

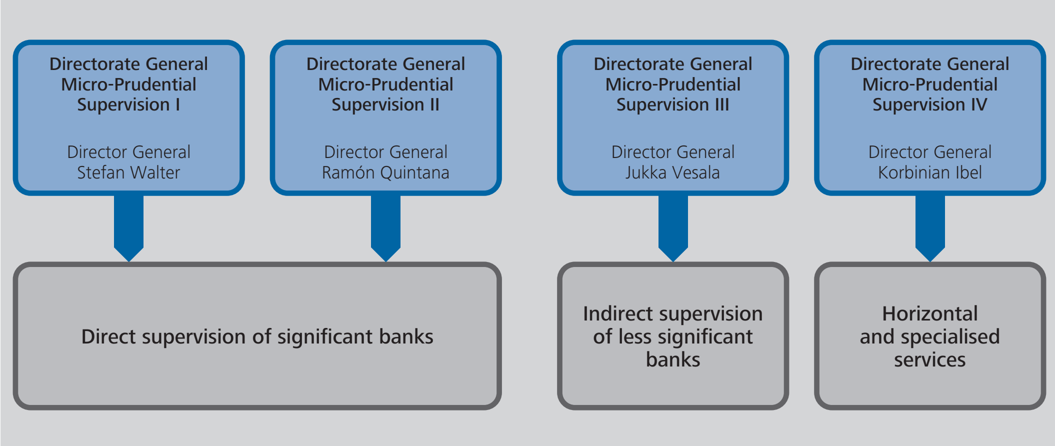
As already mentioned, the ECB will assume responsibility for the direct supervision of 120 significant group entities in the euro area on 4 November 2014. In Germany, 21 institutions will be affected. However, despite the creation of four Directorates General with approximately 800 members of staff at present, the ECB does not have the capacity to exercise supervision over these groups single-handedly. For this reason, Joint Supervisory Teams (JSTs) composed of staff appointed by the NCAs will be established. This means that the national authorities will continue to play a major role in future. By performing analyses and collecting data, they will remain involved in the banking supervision of significant banks. Their supervisory *acquis* and wealth of experience will be particularly relevant to the ECB in those cases in which it must apply national law. This holds true primarily with regard to EU directives, which must be transposed into national law by each member state. Furthermore, in its daily communication with the supervised banks, the ECB can make use of the benefits derived from collaboration with native speakers in the relevant JSTs.

NCAs will remain responsible for less significant banks

Less significant banks will remain largely under the supervision of the NCAs. While the ECB will not be able to issue specific instructions in this area, it will perform a supervisory function for the entire system owing to the responsibility for oversight conferred upon it. However, the ECB will have the option, following consultation with the relevant NCA, of taking over complete responsibility from the NCA for supervision of a less significant bank if it considers

10 See also the ECB press release of 8 September 2014, available online at www.ecb.europa.eu/press/pr/date/2014/html/pr140908.en.html.

Organisation of ECB supervision



Deutsche Bundesbank

this necessary to ensure the consistent application of high supervisory standards.

Special feature in Germany: cooperation between BaFin and Bundesbank in banking supervision

In Germany, BaFin exercises supervision of all institutions in cooperation with the Bundesbank. Although BaFin has NCA status, the Bundesbank is involved in the ongoing monitoring of the institutions under national law. It thus has the status of a central bank with supervisory duties which is not an NCA. More than 1,300 members of the Bundesbank's staff are currently involved in banking supervision, evaluating notifications and reports submitted by the institutions, conducting supervisory discussions with bank management and performing on-site inspections, particularly in the areas of risk management and approval of internal models. BaFin is responsible for sovereign decisions in the form of supervisory measures, which it implements, *inter alia,* on the basis of the Bundesbank's work. Additionally, BaFin has responsibility for supervising financial services institutions and payment services providers, and for consumer protection. Its responsibilities for the latter areas are not affected by the SSM Regulation, however. This tried and tested division of duties between BaFin and the Bundesbank should continue with regard to the SSM as well – directly in relation to less significant banks and via JSTs in the case of significant institutions.

Joint Supervisory Teams

JSTs comprise staff members of the ECB and the NCAs, coordinated by the ECB

To ensure that the national supervisory authorities are adequately involved in the supervision of significant banks, a JST consisting of ECB and NCA staff will be established for each of these institutions. The JSTs will be supported in their duties by the ECB's horizontal and specialised services and the NCAs.

Every team will be headed by a JST coordinator appointed by the ECB. Each NCA represented in the JST will designate a sub-coordinator, who should act as a link to the relevant NCAs.

A core JST comprising the ECB coordinator and the national sub-coordinators will perform a steering function for the JST concerned in order to enable greater efficiency in decision-making. Its aim will be to amalgamate the potentially differing views of the JST members. The core JST will organise the distribution of tasks among the JST members, draft and review the inspection plan and monitor its implementation. In Germany, both BaFin and the Bundesbank will appoint sub-coordinators for the JSTs.

The composition of the JSTs will depend chiefly on the significance, complexity, business model and risk profile of the supervised institution. Moreover, the composition of the JSTs will reflect a supervised institution's share of business activities in the individual SSM member states. As a general rule, a consolidated supervisory approach will be applied for the supervision of a cross-border banking group by the responsible JST. This means that just one JST will be established, consisting of ECB staff, staff of the NCA that supervises the parent undertaking, and staff of the NCA(s) responsible for supervising the subsidiaries (see the adjacent chart).

Core tasks of the JSTs

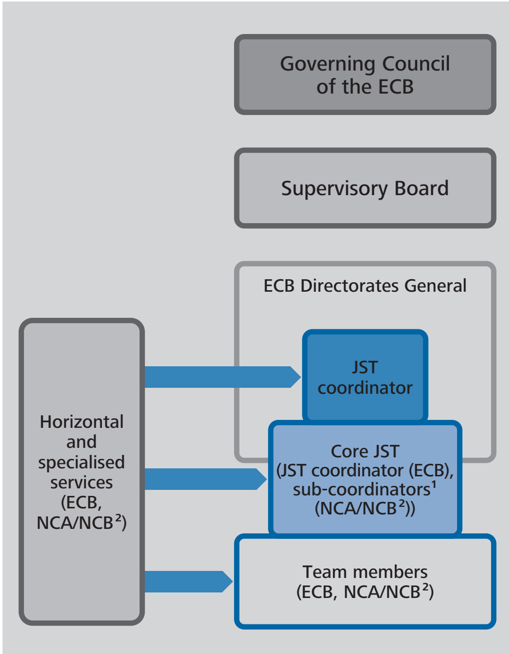
The JSTs will be responsible for implementing guidance issued by the ECB Governing Council and the Supervisory Board. Within the decision-making process, the JSTs will be tasked with preparing draft decisions and coordinating them with the ECB's Directorates General and the horizontal services. The Supervisory Board will subsequently review the drafts and decide on the proposals to be passed on to the Governing Council of the ECB for a final decision.

As part of ongoing supervisory activities, the JSTs will also be in charge of preparing and organising the annual supervisory examination programme and of the operational supervision of all banks subject to direct ECB supervision on a consolidated, sub-consolidated and single-entity level. These tasks include a broad range of processes, such as procuring information, assessing risk, preparing the supervisory review and evaluation process (SREP), performing *ad hoc* analyses, assisting in policy work and regulatory projects, evaluating recovery plans and processing formal authorisation requests. In addition, the JSTs will be involved in approving internal models, will participate in crisis management meetings and will be integrated into colleges of supervisors.

JSTs and Directorate General IV to commission inspections

On-site inspections of significant banks will be commissioned and coordinated by the competent JST and – from an overarching perspective – by the ECB's Directorate General Micro-Prudential Supervision IV. NCA and ECB staff members, one of which will be designated as team leader by the ECB, will also be involved in on-site inspections.

Structure of a Joint Supervisory Team (JST)



1 In Germany, the Bundesbank and BaFin will each appoint a sub-coordinator. **2** JST members also include staff members of national central banks (NCBs) which are involved in prudential supervision under national law but are not NCAs.

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German involvement in JSTs

120 JSTs – that is, one JST for each group entity under direct ECB supervision – have been established to come into operation when the SSM assumes supervisory responsibility on 4 November 2014. Supervisors from BaFin and the Bundesbank are involved in 34 JSTs, of which 21 will deal with German SSM institutions and 13 with German subsidiaries of non-German SSM institutions.

SSM Supervisory Manual

An internal Supervisory Manual clarifies details of the supervisory model

The SSM Supervisory Manual is a legally non-binding internal rulebook for staff involved in the SSM. It is based on generally accepted substantive principles for the functioning of the SSM. In particular, these include the risk-based approach and the principle of proportionality. The Manual takes as its basis the proven methods and processes which have been developed from the experiences of the euro-area supervisory authorities and aim to ensure a stable and functioning banking system.

Supervisory Manual describes cooperation within the SSM and with authorities outside the SSM …

The Supervisory Manual describes the procedures for cooperation and decision-making within the SSM, with the interplay between centralised processes and decentralised support being assigned a key role. Cooperation with authorities outside the SSM relates both to cooperation with other national, European and international authorities and cooperation within colleges of supervisors.

… and details the on-site inspection methodology

The Manual also addresses the on-site inspection methods, the SSM risk assessment system and the supervisory review and evaluation process. These approaches are described in detail, while the annex provides supplementary information, particularly about on-site inspections. Since these are core supervisory processes, the aim is to achieve the greatest possible degree of harmonisation in the procedures and to establish a clear framework for subsequent supervisory measures taking into account the principle of proportionality.

The supervisory review and evaluation process plays a key role in achieving efficient and consistent supervisory outcomes. It is based mainly on two pillars: an institution's risk assessment and, in a second step, the methodology for determining the capital and liquidity levels required. The risk assessment should be seen as a forward-looking, overriding and continual assessment of an institution's risk profile and should use both quantitative and qualitative information. After all of the data collected during this process have been evaluated, an assessment will be carried out as to whether the institution has adequate levels of capital and liquidity and, possibly, whether supervisory measures must be taken. In practice, the monitoring of the requirements and indicators as well as the documentation of this process will be incumbent upon the competent JST.

ECB's supervisory procedures

Different procedural rules depending on the competent authority

With respect to the law of administrative procedure to be applied to supervisory procedures within the SSM, a distinction must be made between NCA and ECB procedures.

NCA procedures will be particularly relevant in the case of less significant banks, where the power to issue prudential acts will remain with the NCA. Depending on the scenario, however, an NCA will also be able to issue a legal instrument in relation to a significant institution, for example, if it is instructed to do so by the ECB (Article 9 (1) subsection 3 of the SSM Regulation, Article 22 of the SSM Framework Regulation), or where the necessary powers have not or could not be conferred upon the ECB by the SSM Regulation.

Where the NCAs perform prudential supervisory functions, administrative procedures will be deemed to be national and will be based on the provisions of the relevant national administrative legislation. In Germany, this is governed primarily by the Federal Act on Administrative Procedures *(Verwaltungsverfahrensgesetz),* which applies to the work carried out by both BaFin and the Bundesbank.

ECB issues instruments under European administrative (procedures) law, which differs from German law in some respects

The situation is different where it concerns a procedure to issue prudential acts through the ECB itself – something that will be particularly relevant in the case of significant banks. Here, the application of national laws of administrative procedure will not be an option as European authorities' procedures are governed only by European law. The principles of administrative legislation laid down in European law will, therefore, apply. Although these principles are not, unlike in Germany, codified in a centralised document, they result from the unwritten general legal principles that are accepted as the legal source of European law and which were developed and formulated from ECJ rulings over many years. Against this background, the comment occasionally brought forward that there is no "European administrative law" is inaccurate, since legally binding provisions for the administrative actions of European bodies certainly do exist in the context of European primary law or the unwritten legal principles. Notable examples here are the right to be heard or the right to access files.

European administrative principles fleshed out by SSM Framework Regulation

These provisions of European law are defined more precisely in the SSM Framework Regulation, which the ECB itself has issued, and put into operation for the purposes of supervisory work within the SSM. For example, it respects the right of parties in a procedure – these are primarily institutions that have made an application to the ECB or to which a supervisory decision is to be addressed – to have access to the ECB's file, subject to consideration of both the legitimate interests of third parties to protect their business secrets and the protection of confidential information (Article 32 of the SSM Framework Regulation). The right to be heard is also protected, but in cases in which an urgent decision appears necessary in order to prevent significant damage to the financial system, the hearing can be postponed until after the decision has been adopted. Depending on the matter in question, the ECB also has the scope to determine the time limit for a hearing as well as the form that the hearing will take (for instance, a written comment by the party or an oral hearing in a meeting). The details are stipulated in Article 31 of the SSM Framework Regulation.

Language a politically sensitive SSM issue

A differentiated language regime has been developed to resolve the language issue. The difficulty in this matter arises primarily from the conflict between two opposing objectives. On the one hand, there is the desire for efficient, smooth supervision within the SSM, including cooperation between the participating authorities, which would suggest that a single Europe-wide language should be used in supervisory procedures. On the other hand, there is the principle – reflecting the polyglot character of the EU – that the Charter of Fundamental Rights respects the diversity of languages in Europe and accordingly guarantees the right to address EU bodies in any of the EU's 24 official languages and to receive an answer in that same language (Article 41 (4) of the Charter of Fundamental Rights). In line with this, the SSM Framework Agreement allows for documents sent to the ECB as part of ECB supervisory procedures to be drafted in any of the official languages of the EU. However, the participants in a supervisory procedure can agree to use exclusively one specific official EU language in their communication; from the point of view of efficient administration, English – the ECB's working language – would seem particularly appropriate. It is not obligatory to reach such agreements, however. Credit institutions can, therefore, insist on communicating with the ECB in their respective national languages without this possibly placing them at a disadvantage. It remains to be seen whether this model will become established or whether participants will, in fact, effectively feel pressured to use English in everyday practice within the SSM.

The abovementioned fundamental guarantee of the right to freely choose the official language used applies only to the relationship between EU members and EU bodies. Accordingly, the ECB and NCAs are free to adopt their own arrangements regarding the languages to be used between themselves (Article 23 of the SSM Framework Regulation). The practice established thus far during the preparatory work for the SSM suggests that the vast majority of communication between the SSM authorities will take place in English. The situation will be different for administrative procedures that the NCAs conduct on their own responsibility under national law, particularly with regard to less significant banks. Here, the procedural rules under national law will continue to be adhered to, which in Germany provide for the use of German (section 23 of the Act on Administrative Procedures).

ECB's investigatory powers

SSM Regulation gives ECB its own directly applicable investigatory powers

To fulfil its supervisory responsibilities, the ECB will be entitled to access findings and analyses that already exist at the national level or are made available through data collection. However, given its responsibility for significant banks in particular, the ECB will not be able to rely solely on data supplied by the competent authorities. Articles 10 to 13 of the SSM Regulation thus set out separate investigatory powers, which – as provisions in an EU regulation – will be directly applicable in the participating member states. In functional terms, albeit not in all details of the requirements and areas of application, these powers correspond to the powers which have already been available to BaFin under section 44 of the German Banking Act *(Kreditwesengesetz)* for a long time, with the Bundesbank carrying out fact-finding activities on BaFin's behalf in accordance with the division of tasks enshrined in German law. The Bundesbank performs this task as part of its responsibilities for off-site supervision as well as through the on-site inspections it conducts on BaFin's behalf.

Article 10 of the SSM Regulation is a blanket clause

Article 10 invests the ECB with sweeping rights to access information. The ECB will be entitled to request all information that it needs to carry out the tasks conferred upon it by the SSM Regulation – not just from the credit institutions or other supervised entities themselves, but also from the entities' employees or from third parties to whom the supervised entities have outsourced functions or activities. The ECB will thus also have the right, for example, to request information from employees of banks or service providers to which certain bank activities have been outsourced. Any existing statutory or professional secrecy requirements will not exempt these parties from the duty to supply information, thus ensuring that supervisors have full access to the data they need. Once the supervisors have accessed this information, however, the data will be subject to confidentiality requirements vis-à-vis third parties. Article 27 of the SSM Regulation sets out these requirements in relation to the ECB's supervisory duties, making reference to other legal acts.

Further powers under Article 11 of the SSM Regulation

Article 11 of the SSM Regulation contains further provisions on investigatory powers. It defines in detail the possibilities provided for but left open in Article 10 allowing the ECB to carry out investigations for supervisory purposes. The ECB will be entitled to require the submission of documents, examine and take copies or extracts of books and records and obtain written or oral explanations from persons obliged to provide information. The ECB will also have the right to interview any other person not specified in Article 10. To do so, it will have to obtain the consent of this person – who is not obliged to provide information *per se* – but not that of the supervised entity, which will not have any rights of forbearance with regard to the interviewing of the person concerned.

Possibility to perform on-site inspections

In most cases, the aforementioned investigatory powers will be exercised by supervisors engaged in off-site activities rather than on the business premises of the supervised bank. However, the SSM provides for the additional option of performing on-site inspections (on the bank's premises). An on-site inspection team will be formed for this purpose. On the basis of an inspection mandate issued by the ECB, this team will carry out an inspection on the bank's premises for a limited period, which may, for example, involve examining documents and internal organisational and governance structures, as well as assessing the entity's day-to-day processes. The SSM Regulation (Article 12) thus invests the ECB with powers to conduct such on-site inspections – where necessary, even without the usual prior announcement to the bank in question. From a legal point of view, an on-site inspection mandated on the basis of this provision will be an ECB inspection rather than an NCA one despite the fact that the ECB will include NCA staff in its inspection teams, if only for resource reasons. To prevent a "home bias" among supervisors and encourage the development of coherent, consistent supervisory practices across the participating member states, supervisors from other member states will also be drafted into the inspection teams on a rotating basis, thus adding a cross-border perspective to the day-to-day work of the on-site supervisors.

Member states and their authorities obliged to afford administrative assistance

The ECB, like the EU in general, does not have its own enforcement officers to avert any obstructions to the conduct of its investigations. The SSM Regulation therefore obliges the national authorities – probably the national police authorities in particular – to afford the necessary administrative assistance to support the ECB and prevent any resistance to its measures (Article 11 (2)). Although the SSM Regulation respects national requirements for authorisation by a judicial authority, which are particularly likely to apply when entering and searching business premises as part of an on-site inspection, the national judicial authority will solely be entitled to control that the decision of the ECB is authentic and that the coercive measures envisaged are neither arbitrary nor excessive having regard to the subject matter of the inspection. The national judicial authority will not be entitled to review the necessity for the inspection or demand to be provided with the information on the ECB's file (Article 13 of the SSM Regulation).

Administrative penalties

Own penalty regime, comparable in function to German legislation on administrative offences

European banking supervision would be neither credible nor effective if the ECB did not also have effectual instruments for penalising breaches of supervisory law and thus for enforcing compliance with the law. Article 18 of the SSM Regulation thus provides the ECB with powers to impose administrative penalties. These penalties are comparable in function to the fines imposed under the German legislation on administrative offences, as they are pecuniary penalties which are imposed by the supervisory authority itself and not by a court.

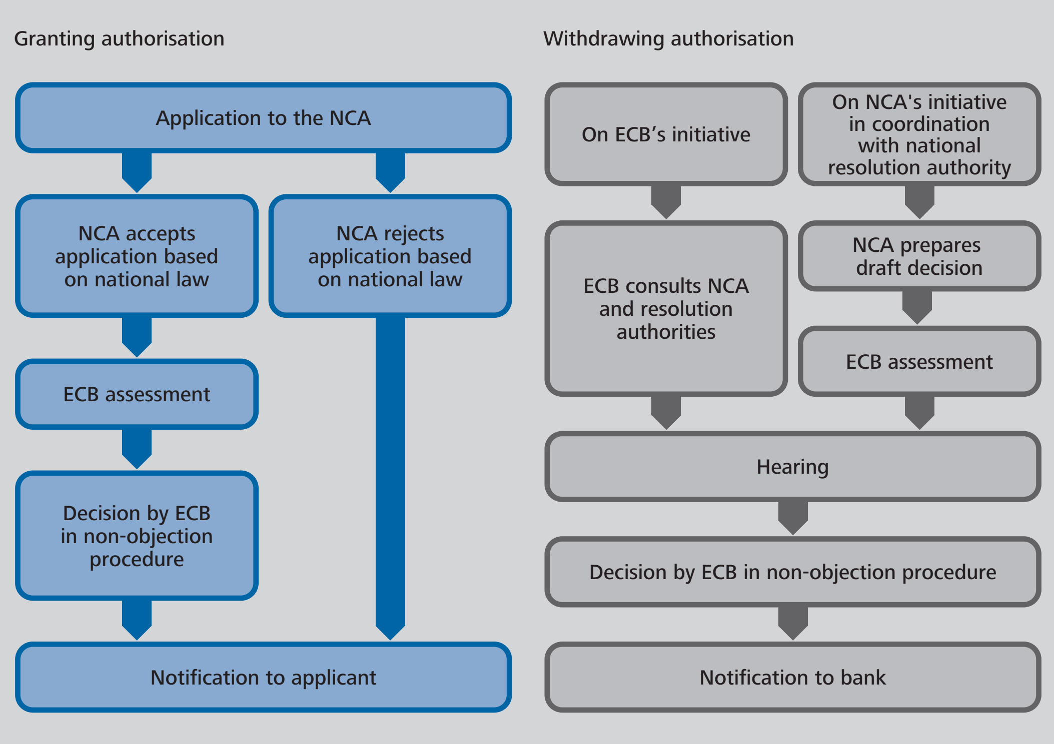
Prerequisites for and scope of ECB powers to impose penalties

The key prerequisite for the ECB to impose an administrative penalty is for an entity to intentionally or negligently breach a requirement under directly applicable acts of EU law (particularly regulations) in relation to which administrative pecuniary penalties are made available to competent authorities under the relevant EU law. The SSM Regulation thus does not define any new offences to be penalised but requires a stipulation in other acts of law to have been breached. However, it does make it clear that the powers to impose penalties, which have their legal grounding elsewhere, will now be transferred to the ECB. Nonetheless, the ECB's powers in this area will be confined to imposing penalties on credit institutions, financial holding companies or mixed financial holding companies; it will not be authorised to impose penalties on other legal or natural persons (see also recital 53 of the SSM Regulation). The reason for this restriction is likely to be that any powers to impose penalties beyond the group of supervised entities would encroach upon the areas of general criminal law and legislation on administrative offences, which, according to the division of powers within the EU, largely remain the preserve of the member states.

On the ECB's instructions, NCAs can use national powers to impose penalties

Even so, these restrictions do not necessarily mean that breaches of law which the ECB does not have the power to penalise will inevitably go unpunished. The SSM Regulation (Article 18 (5)) stipulates that the ECB may require NCAs to open proceedings with a view to taking action to ensure that appropriate penalties are imposed. In this way, offences requiring the imposition of penalties already defined in national law can be used for the purposes of the SSM. According to the wording of the SSM Regulation, this procedure is intended, above all, for breaches of directives and penalties to be imposed on natural persons, such as members of the management board of a bank. The corresponding measures are to be imposed in accordance with national legislation. In Germany, this could involve, in particular, administrative offence proceedings brought by BaFin, which

SSM supervisory procedure for granting and withdrawing bank authorisations



Source: ECB.
Deutsche Bundesbank

may result in a fine. However, the SSM Regulation does not confine this possibility to the imposition of penalties by the NCA itself but also entitles the ECB to require the NCA to open proceedings. Consequently, in the member states in which an NCA is permitted to initiate criminal proceedings, the ECB could require that the NCA do so. In Germany, this possibility is unlikely to be relevant, however, as under the German law of criminal procedure BaFin is not deemed to be a criminal prosecution authority and thus cannot initiate criminal proceedings itself.

Criteria for determining size of fines differ from legal tradition in Germany

One noteworthy provision from the perspective of German legislation on administrative offences relates to the criteria used to determine the size of a fine. Under German law, the size of a fine traditionally depends on the severity of the administrative offence and the accusation levelled at the perpetrator; the financial circumstances of the perpetrator are merely an additional consideration (section 17 of the Administrative Offences Act *(Ordnungswidrigkeitengesetz)*). By contrast, the SSM Regulation requires that penalties – whether imposed by national authorities or by the ECB – be effective, proportionate and dissuasive, thus giving general deterrence a more prominent role. The upper limit for pecuniary penalties imposed by the ECB will be twice the amount of the profits gained or losses avoided because of the breach where these can be determined, or up to 10% of the total annual turnover in the consolidated annual financial accounts of the group's ultimate parent undertaking. Where breaches are severe, this could lead to significantly higher absolute penalties than have usually been imposed under German legislation on administrative offences to date. However, these fines are not a means for entities to buy their way out of prudential requirements they dislike; paying a fine will not free institutions from their obligation to act in accordance with the law as it stands.

Law of procedure in penalty proceedings

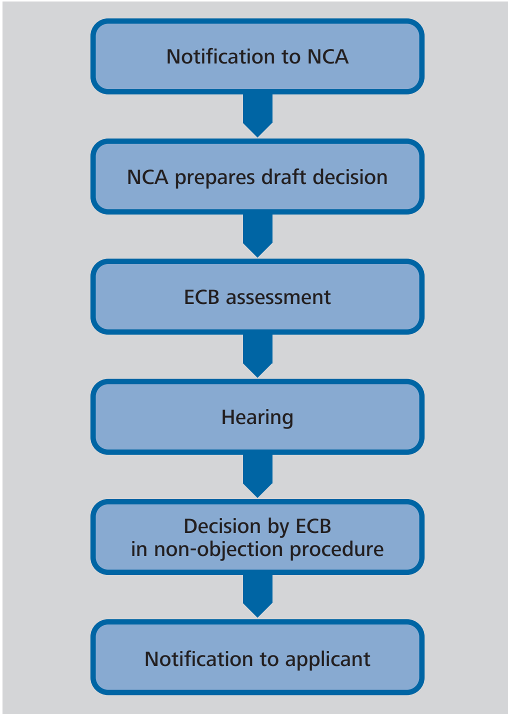
The law to be applied in penalty proceedings will depend on whether the proceedings are being conducted by the ECB itself or whether they have been initiated by a national authority on the ECB's instructions. In the latter case, national law will apply; in Germany, this means predominantly the Administrative Offences Act, much of which refers to the provisions of the Code of Criminal Procedure *(Strafprozessordnung).* In the former case, EU law in the form of Regulation (EC) No 2532/98 will apply. This Regulation, which was enacted when the ECB was established and has since been amended several times, governs the ECB's powers to impose sanctions. Up to now, this procedure has applied mainly to areas relating to minimum reserve requirements and statistical reporting obligations, where the ECB has had its own powers to impose sanctions for some time. With the creation of the SSM, the scope of this procedure will now be extended to include the area of banking supervision. The aforementioned Regulation contains provisions to protect the rights of the affected party, particularly the right to be heard. Decisions regarding sanctions will be adopted by the Executive Board of the ECB, although the undertaking concerned will have the right to request a review of the decision by the Governing Council of the ECB. The right to a judicial review by the ECJ will remain unaffected. The right to take the decision to initiate an infringement procedure will expire one year after the existence of the alleged infringement first becomes known either to the ECB or the NCB or, at the latest, five years after the infringement occurred.

Common procedures

Three common procedures implemented jointly by ECB and NCA

The aforementioned division of tasks between the ECB and the NCA, which is based on whether or not an entity is classified as significant, will not apply to three areas. In these areas, the ECB and the NCA will jointly implement "common procedures" which apply to all entities, regardless of whether they are classified as significant or less significant.

Supervisory procedure for decisions on the acquisition of qualifying holdings



Source: ECB.
Deutsche Bundesbank

Applications for authorisation must be submitted to NCA

The most important common procedure will relate to decisions on authorisation to take up the business of a credit institution. Authorisation has already been required for such activities for a long time. While the appropriate authorisation has been granted by NCAs until now, the ECB will have sole responsibility for granting authorisation in future. However, applications for authorisation will have to be submitted to the relevant NCA. The NCA will then assess whether the applicant complies with all conditions for authorisation laid down in the relevant national law – which may go beyond the requirements under EU law. If so, the NCA will submit a draft decision to the ECB proposing that the ECB grant the applicant authorisation to take up the business of a credit institution. Nonetheless, the ECB will further assess the application on the basis of the conditions for authorisation laid down in substantive European law (particularly Article 8 *et seq* of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV)) and will take the final decision on whether an application for authorisation is to be accepted or rejected (details are set out in Articles 73 to 79 of the SSM Framework Regulation).

Common procedure also for withdrawal of authorisation

In a similar vein, a second common procedure will deal with the withdrawal of an authorisation, also through cooperation between the NCA and the ECB. Any NCA will be able to propose the withdrawal of an authorisation, based on either national or European law (Article 80 of the SSM Framework Regulation), although here, too, the ECB will take the final decision on whether to follow this proposal. The ECB will also be able to initiate a withdrawal of authorisation procedure on its own initiative; in such cases, it will be obliged to consult with the relevant NCA but, again, will ultimately have the final say.

Acquisition of qualifying holdings

The third common procedure will apply to the area of qualifying holdings. European law already requires any natural or legal person, or several such persons acting in concert, wishing to acquire a qualifying holding in a credit institution to notify the NCA in advance. A qualifying holding is defined as a holding in an undertaking which represents 10% or more of the capital or voting rights or which makes it possible to exercise a significant influence over the management of that undertaking. Although no authorisation is needed to acquire a qualifying holding, the supervisory authority is entitled to forbid the acquisition within 60 working days. Under the SSM, notification of an intention to acquire a qualifying holding in a credit institution will still have to be addressed to the relevant NCA, which must inform the ECB and submit a draft decision to oppose or not to oppose the acquisition to the ECB. Here too, however, the ECB will not be bound by the NCA's draft decision but will have the final say on whether or not to oppose the acquisition (Article 87 of the SSM Framework Regulation).

In summary, it can be said that the common procedures clearly illustrate the ECB's overall responsibility for the entire banking sector of the participating member states – and not just for significant banks. Especially the withdrawal of authorisation, as a last resort in the prudential toolkit, will be the preserve of the ECB, including for less significant banks.

Procedures for engaging in cross-border activities

SSM also influences passporting regime within the EEA

While the authorisation of credit institutions in an SSM member state is always subject to an ECB decision, different rules apply to the establishment of legally dependent branches, which essentially require what is known as a "European passport". This allows credit institutions which are authorised in one European Economic Area (EEA) country to establish branches in any other EEA country without needing to obtain separate authorisation to do so. Notification is mandatory, however. Credit institutions are required to announce their intention to establish a branch in order to enable the supervisory authorities of the member states in question to monitor compliance with the rules of what is known as the "passporting regime". A notable objective here is to allow the competent authorities in the host member state to assess whether, taking into account the activities envisaged, there are any reasons to doubt the adequacy of the administrative structures or the financial situation of the credit institution in question (see Article 35 (3) of CRD IV). Procedures which were developed by the European Banking Authority (EBA) and which are likewise impacted by the establishment of the SSM are to be used for this purpose.[11]

Procedures for establishing a branch domiciled in the SSM area

If a credit institution with headquarters in the EEA intends to establish a branch in another SSM member state, responsibility for passing a

11 See also Commission Implementing Regulation (EU) No 926/2014 of 27 August 2014 laying down implementing technical standards with regard to standard forms, templates and procedures for notifications relating to the exercise of the right of establishment and the freedom to provide services according to Directive 2013/36/EU of the European Parliament and of the Council.

Procedures regarding macroprudential powers

The recent financial crisis showed that – if the worst comes to the worst – safeguarding the stability of individual financial institutions is not enough to guarantee the stability of the financial system as a whole. As financial agents are closely interconnected, the failure of one significant financial institution can put the stability and functioning of the entire financial system at risk and may, ultimately, have a considerable adverse impact on the overall economy. It is the task of macroprudential supervision to oversee the financial system as a whole, making it a necessary extension of the traditional microprudential supervision of individual financial institutions. At the same time, macroprudential supervision relies on microprudential findings. For example, the information that is made available in the institutions' prudential reporting data is essential for macroprudential policy in order to estimate the extent of systemic risk build-up in individual credit institutions or groups of credit institutions.

In order to achieve this objective, Article 5 of the SSM Regulation stipulates that responsibility for macroprudential tasks and tools will remain, first and foremost, under the control of the supervisory authorities, ie at the national level to all intents and purposes, even after the launch of the SSM. However, the ECB will have the power to sharpen the macroprudential tools deployed on the basis of European legal acts. This legislation also encompasses the option of requiring the application of certain macroprudential tools to the financial institutions in the countries participating in the SSM, even if the tools in question have not yet been activated in the member state. At present, the ECB does not have the power to ease the tools imposed at the national level.

This asymmetrical intervention model is designed to prevent the national authorities from forbearing to implement necessary stringent measures out of consideration for their potential adverse impact on economic activity and employment in their countries, and therefore from failing to take early action to counteract build-ups of risk with possible cross-border implications. However, it should be noted that the ECB only has the power to sharpen those tools that are based on the CRR and CRD IV. All ECB measures are, therefore, limited to the banking sector; it consequently has no power to influence developments in the insurance sector, for instance. One example of a macroprudential tool provided for under the CRR is the countercyclical capital buffer, by means of which surcharges on own funds requirements pursuant to the CRR can be imposed on credit institutions. It can be adjusted by the competent authorities in the course of a financial cycle in such a manner that the additional capital requirements imposed on the credit institutions in the course of said cycle can fluctuate in line with systemic risks. During cyclical build-ups of risk, this means that the financial institutions' ability to absorb losses is strengthened, while lending is curbed to a certain extent. In the event of a cyclical downturn, the capital requirements of the countercyclical buffer can be lowered again in order to support lending to the real economy.

The European Systemic Risk Board (ESRB)[1] also plays an important role in terms of macroprudential policy. The supreme decision-making body of this EU board, the

1 The ESRB is responsible for all EU member states and the entire financial system. The SSM is responsible for participating member states and banking supervision only.

General Board, consists of the President and the Vice-President of the ECB, the governors of the national central banks of the member states, a member of the European Commission, the Chairperson of each of the three sectoral European financial supervisory authorities (the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA)), and the Chair of both the Advisory Technical Committee (ATC) and the Advisory Scientific Committee (ASC) of the ESRB. The General Board also has members without voting rights, namely one high-level representative per member state of the competent national supervisory authorities and the President of the Economic and Financial Committee (EFC). While the ESRB has no powers of its own in connection with the use of macroprudential tools, it is able to issue warnings and recommendations to the European Union as a whole, individual member states, the European supervisory authorities (ESAs)[2] and the national supervisory authorities in order to address systemic risks.[3] In future, this means that the ECB may also be a recipient of ESRB recommendations, which it will take into account in fulfilling its supervisory functions.

2 EBA, ESMA and EIOPA.
3 For more information on the tasks and composition of the ESRB, see Deutsche Bundesbank, Financial Stability Review 2010, pp 124-125.

decision thereon lies solely with the ECB, provided the branch in question is a branch of a significant institution. Otherwise, responsibility falls to the supervisory authorities in the home member state. However, in both cases, notification of intent must first be submitted to, and reviewed by, the supervisors in the home member state.

Exercise of the freedom to provide services

The exercise of the freedom to provide services, ie the provision of (bank) services across national borders without establishing a branch abroad, is governed, in principle, by a uniform procedure throughout the EEA, regardless of whether a country is an SSM member or not. Any credit institution domiciled in an EEA country that wishes to carry out its activities in the territory of another EEA country for the first time is required to notify the supervisory authorities in its home member state which activities from the "List of activities subject to mutual recognition" (see Annex I of CRD IV) it wishes to carry out. The interaction between this requirement and the SSM Framework Regulation gives rise to the following special situation. If the credit institution's home country is a non-SSM EEA member state and the host country is an SSM member state, the host country's powers will always lie with the ECB. The outcome of this is that the activities of a non-SSM credit institution in the SSM area are always viewed from a European angle.

SSM's impact on the composition and activities of supervisory colleges

The SSM will also radically transform the composition of the colleges of supervisors which are presently responsible for the effective prudential supervision of cross-border banking groups. These colleges were set up for banking groups with subsidiaries or significant branches in different EEA countries, making them the first port of call for the consistent application and enforcement of European supervisory rules and guidelines. Their main task is the coordinated planning and execution of key prudential activities both during ongoing supervision and in crisis situations.[12] The launch of the SSM will not do away with this arrangement as such, but some aspects will be refreshed. The participation of the ECB and national supervisory authorities in colleges of supervisors is set out in Articles 8 to 10 of the SSM Framework Regulation. Supervisory colleges in which all the members are supervisory authorities of significant supervised entities from the SSM will be replaced by JSTs. Under the new regime, then, supervisory colleges will be convened only if (a) at least one national supervisory authority from a non-SSM country is involved in the supervisory college by way of a parent undertaking under its supervision, or a subsidiary or a significant branch of the group in question, or (b) the supervised entity is a banking group which consists exclusively of less significant banks in the SSM area for which the relevant national supervisory authorities retain prudential responsibility in a college of supervisors.

Supervisory colleges will remain a key instrument under SSM

The core task of supervisory colleges – where they continue to exist – will not be affected by the launch of the SSM. They will continue to be a key instrument for the supervision of cross-border credit institutions – a function which was re-emphasised and consolidated through the implementation of the CRD IV package, where legally non-binding basic principles for the operational work of supervisory colleges were replaced by binding EBA technical standards, which made them not only directly applicable law, but also fleshed them out in greater detail.

Staffing and funding

Recruitment of staff for the SSM

SSM forces ECB to increase staffing levels significantly

The assumption of supervisory responsibility under the SSM means that the ECB will need to expand its staffing resources significantly. The ECB plans to recruit roughly 770 staff for its SSM prudential activities, plus around 200 support staff (eg in the areas of IT, legal, HR, control and audit). It already became clear at the preparatory stage that close and constructive cooperation between the ECB and the national supervisors would be vital for the SSM to achieve its aims. With this in mind, the Bundesbank is contributing more than just its operational expertise to the process of setting up the SSM. In April 2013, the Bundesbank began sending staff to the ECB to provide direct assistance in getting the SSM up and running. The ECB began advertising the new posts early in the fourth quarter of 2013.

Staffing challenges

English now much more important in day-to-day work

The supervision of significant SSM banks in the future JSTs and on-site inspection teams (OITs) will introduce an entirely new cooperative set-up and present a number of staffing challenges. For instance, in future staff from different countries and supervisory authorities,[13] each accustomed to operating in their own national supervisory cultures and under different employment conditions, will need to work across national borders. English is set to become significantly more important than hitherto as a working language in day-to-day communications.

Work of JSTs will follow a matrix structure …

Future cooperation within the SSM will challenge both the Bundesbank and the staff involved to embrace an entirely new set of working methods. Staff across various locations will join forces to collectively exercise ongoing supervision over significant banks, collaborating in the JSTs much like a virtual team would do. The JST coordinator from the ECB will use a matrix structure to set the supervisory requirements, while the respective Bundesbank super-

12 See also Deutsche Bundesbank, International cooperation in the area of ongoing banking supervision, Monthly Report, December 2009, pp 47-57, available online at www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly_Report_Articles/2009/2009_12_banking_supervision.pdf?__blob=publicationFile.
13 The term supervisory authority in the section dealing with staffing matters refers to both supervisory authorities in the narrower sense of the term and central banks performing tasks in the area of banking supervision.

ior will be responsible for staff policy-related matters and general framework conditions for the Bundesbank team members.

… and present new challenges to all participants

It will take some time to formulate a definitive response to all the staffing challenges presented by the special and, in many respects, innovative collaborative and structural characteristics of the SSM, first and foremost the areas in which national conditions of employment are a significant factor.

Supervisory fees

ECB will levy an annual supervisory fee on banks from SSM countries

The cost of banking supervision by the ECB is to be borne by the supervised entities themselves. The ECB will, therefore, levy an annual fee on the credit institutions established in the participating member states pursuant to Article 30 of the SSM Regulation. The ECB's fees will cover the ECB's expenditure in performing the tasks conferred upon it by the SSM Regulation.

More detailed provisions on determining the total amount of the supervisory fee, calculating the amount to be paid by each supervised bank or banking group, collecting the annual supervisory fee and other procedural matters are addressed in the ECB regulation on supervisory fees.[14] The consultation documents on the ECB regulation on supervisory fees published in May 2014 comment on the individual aspects of this regulation.

Direct and pro rata indirect costs to be apportioned

The ECB will use the supervisory fee to apportion its direct costs for performing its operational activities in the four newly created Directorates General, the Directorate General Macroprudential Policy and Financial Stability, the Supervisory Board and the secretariat as well as *pro rata* indirect costs for shared services such as legal services, statistics, IT, HR and facilities. The SSM Regulation states that the supervisory fee must be cost-effective and reasonable for all credit institutions. To ensure that this is the case, the ECB will communicate with the NCAs before setting the final fee level.

Separate fees for significant and less significant banks

When setting the supervisory fee, the ECB will break down its annual costs into the categories "Supervisory costs for significant entities" and "Supervisory costs for less significant entities", with the costs in each category being apportioned to the institutions.

Fixed minimum fee and variable component

The ECB's supervisory fee in each category will consist of two elements – a fixed minimum fee component and a variable fee component. The minimum fee will generally be 10% of the costs in the category in question, divided by the number of institutions in that category. Owing to the special situation that the three largest credit institutions in each participating country are regarded as significant, irrespective of their actual size, the minimum fee component will be halved for the smaller significant institutions with total assets of €10 billion or less. The variable fee component will be calculated as 50% of the following fee factors: the institution's total assets (TA), and its total risk exposure (TRE) as an appropriate indicator of the risk profile.

ECB can only confirm exact figures for refundable supervisory costs in 2015

The ECB will be unable to confirm the exact amount until 2015, but its preliminary calculation suggests that the ECB's expenditure for its prudential activities will come to roughly €40 million for November and December 2014, with a projection of around €260 million for 2015. Of these total costs of €300 million for the SSM's first accounting period, €255 million will be apportioned to significant banks and €45 million to the less significant ones. The ECB expects the supervisory fee to range between roughly €150,000 and €15 million annually for the directly supervised significant institutions, with the majority paying somewhere between €0.7 million and €2 million. As for the indirectly supervised less significant institutions, the annual fee will range from around €2,000 to €200,000, with the bulk of them set to pay between €2,000 and €7,000.

14 Publication of the ECB regulation on supervisory fees is scheduled for 20 October 2014.

Fee notices will be issued by the ECB each calendar year between 1 June and 31 August, with payment being due within a period of 35 days. The first fee notice will be issued in 2015. It will cover the fee period of November/December 2014 as well as the advance payment for 2015.

Outlook

Europe's Single Resolution Mechanism

SRM to augment SSM shortly

With the SSM in place, the Single Resolution Mechanism (SRM) will be the second pillar of the banking union.[15] Alongside the SRM, a European Single Resolution Board (SRB) and a Single Resolution Fund (SRF) will be established, putting in place a uniform institutional framework for participating SSM member states that facilitates the resolution of credit institutions. It will thus bring liability and responsibility into alignment at the European level.

Bank levy under negotiation

The small print surrounding contribution payments to the SRF is still a matter of negotiations. The measurement of these contributions will be determined by way of a delegated act pursuant to Article 103 (7) of the Bank Recovery and Resolution Directive (BRRD) and a Council implementing act pursuant to Article 70 of the SRM Regulation. Judging by the draft versions of the delegated act, banks will each be required to pay a levy which essentially consists of a flat contribution plus an additional risk-adjusted contribution.

Ideally, the calculation method would need to ensure that credit institutions share the cost of future banking crises in line with their contribution to systemic risk. It is particularly important in this regard that adequate account be taken of both the individual bank's risk profile and the principle of proportionality, which dictates that small, low-risk institutions should contribute less to the SRF, relatively speaking, than their large, systemically important counterparts.

Comprehensive assessment

SRM not to cover legacy debts that came into being on national watch

The European SRF established under the SRM is not designed to cover SSM institutions' legacy debts, that is to say, capital shortfalls that are already evident in banks' balance sheets. Any such existing capital shortfalls arose while institutions were still being overseen by national supervisors, and therefore also need to be closed at the national level. That is why the comprehensive assessment (CA) of significant credit institutions, an exercise provided for in Article 33 (4) of the SSM Regulation, is a crucial step in the preparatory work for the SSM. The CA is reviewing the quality of bank assets as at 31 December 2013. In addition to this asset quality review (AQR), the ECB, liaising with the EBA, is also performing stress tests which simulate potential scenarios in order to gauge their impact on the institutions' stability. The scenarios consist of a baseline scenario simulating a typical macroeconomic path over a three-year horizon and an adverse scenario in which the economy is assumed to follow a particularly unfavourable and unlikely, yet conceivable, path.[16]

Tools for addressing capital shortfalls identified by the CA

The ECB, liaising closely with the EBA and national authorities, is currently carrying out the CA. The results will be released on 26 October 2014, just over a week before the ECB assumes responsibility for the direct supervision of significant banks. If the CA finds that an institution has a capital shortfall, that institution will be given two weeks to submit a capital plan detailing how it intends to go about covering that shortfall – by raising capital in the markets, say. Institutions will be given either six months (for shortfalls arising under the AQR or the baseline scenario) or nine months (for shortfalls

15 For further details on the SRM, its set-up and its funding structure, see Deutsche Bundesbank, Europe's new recovery and resolution regime for credit institutions, Monthly Report, June 2014, pp 31-55, available online at www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly_Report_Articles/2014/2014_06_recovery_resolution_regime.pdf?__blob=publicationFile.
16 The ECB's website provides detailed information on the CA at www.ecb.europa.eu/paym/sepa/html/index.en.html.

arising under the adverse scenario) to implement their capital plans. Should the institution be unable to cover its capital needs by itself, the authorities of the relevant member state will have to step in. If necessary, this path might also lead to the resolution of the institution in question. Since responsibility for addressing legacy debts lies with national authorities, the member state in question can, in principle, exercise discretion in the tools it chooses to use for this purpose. However, the European legislation governing public assistance must be adhered to in this respect. This legislation requires losses to first be absorbed by shareholders and subordinated creditors before a recapitalisation using public funds is allowed.[17] Although the BRRD resolution toolkit will probably not be transposed into German law before 1 January 2015, this condition can already be met in Germany by virtue of the transfer order instrument (section 48a *et seq* of the Banking Act) which can, if necessary, be deployed in combination with the establishment of a bridge bank. In Germany, the restructuring fund financed through bank levies and the tax-financed Financial Market Stabilisation Fund (SoFFin) are available as backstops for external funding. However, consistency with the principle that investors should be the first in line to shoulder the risks and losses involved in their investment can be assured only if SoFFin is tapped as a last resort. If the CA identifies any need for action at German credit institutions, Germany is well prepared to face the challenges this will entail.

Conclusion

The banking union, of which the SSM is a supporting pillar, is an important and necessary complement to European monetary union. Above all the banking groups which operate multinationally in Europe's highly integrated financial markets need to be overseen by a similarly interconnected, pan-European supervisory mechanism based at a central supervisory authority.

The SSM will replace the existing, purely national banking supervisory set-up in the euro-area countries and, *in toto,* will open up an entirely new chapter in supervisory practice. A relatively short preparatory phase has seen the legal, institutional and organisational groundwork being put in place to ensure that the changeover on 4 November 2014 will be as seamless as possible.

High hopes surround the launch of the SSM. By shifting the perspective away from a national approach towards an overarching European view with a uniform administrative practice, the SSM regime has the potential to improve the competitive environment in Europe's banking market.

It is crucial for NCAs to be involved every step of the way. The SSM should be regarded as the supervisory mechanism of the ECB and the NCAs, which interact and assume tasks and functions in a cooperative manner. Not only does this mean that NCAs' particular insights into national markets and banks can be tapped; it also prevents moral hazard resulting from different supervisory practices, combined with the risk of domestic banks being afforded preferential treatment.

The banking union will be able to get off to a successful start only if the currently existing burdens and risks of the significant banks which are to be supervised directly by the ECB in future have been identified and catalogued beforehand. Even though the CA represents a huge administrative effort for both the banks involved and banking supervisors, the process of thoroughly evaluating credit institutions, and then remedying any problems it brings to light, is a crucially important step towards underscoring the credibility of the SSM.

17 See also the Banking Communication from the Commission, available online at eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52013XC0730(01).