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2016 Deloitte Eurozone banking supervision survey

Assessing the state of the Banking Union

July 2016

EMEA Centre for Regulatory Strategy

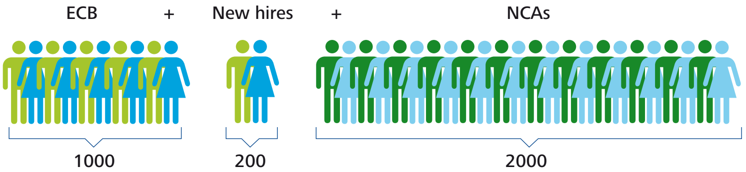
Deloitte Banking Union Centre in Frankfurt

The state of the Banking Union
Deloitte's survey on banking supervision

The Single Supervisory Mechanism (SSM) is now firmly established as a key part of the European Banking Union. Since it opened for business in November 2014, the SSM has continued to grow, both in scope and influence. It now has over 3000 supervisors at the European Central Bank (ECB) and local regulators, and 129 banks are directly supervised by the ECB. There remains though much for the ECB and national competent authorities (NCAs) to do to develop and embed the new supervisory approach. Many of the changes being introduced are significant and challenging for banks.

To be able to plan effectively it is important for banks to understand the impact the new supervisory regime is having across the region, and to benchmark their experiences and current practices against peers. For this reason Deloitte[1] launched its **Eurozone banking supervision survey**. The goals of the first survey were to monitor and analyse progress in terms of relationships, organisational impact, and technical issues regarding the new supervisory activities and regulations. This paper highlights the key results of the survey.[2]

Supervisors in the SSM



Number of banks under direct supervision

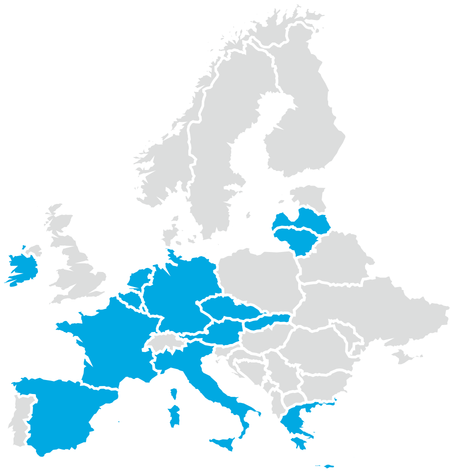
The survey was carried out between January and March 2016. It focussed on banks' experiences with the SSM and its impact on their organisations

Target banks

All directly supervised SSM banks within the Eurozone

45 directly supervised **institutions**

covering **16** out of 19 **Eurozone countries participated**



Countries that participated in the survey

Asset size, € billions	Number of participating banks
<30	11
30-100	18
100-500	10
> 500	6

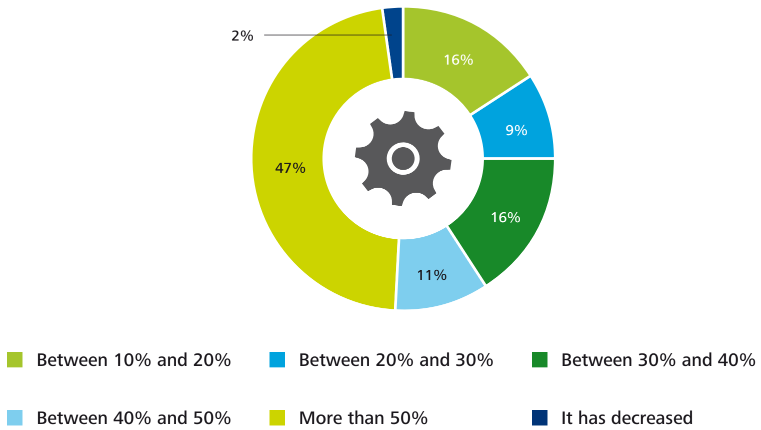
1 The survey was carried out by the Deloitte Banking Union Centre in Frankfurt and the participating member firms of DTTL. This summary report was prepared by Deloitte LLP, UK member firm of DTTL.
2 Note that due to rounding, some of the percentage figures for survey responses on the following pages sum to more than 100.

The state of the Banking Union
Assessing the SSM and its impact on Eurozone banks

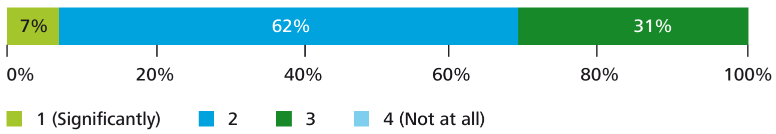
Impact

Many banks still have projects underway to tackle shortcomings identified following the financial crisis, including through the ECB's 2014 comprehensive assessment exercise. Eurozone banks are also still struggling with profitability and return on equity, due to a combination of macroeconomic conditions and more stringent regulatory capital requirements. New requirements from supervisors have added to cost pressures in the short term.

In order to conduct all required activities and reporting by the ECB during the first year, how has your annual spending on supervisory activities and engagements increased (excluding supervisory fees)?



To what extent has the new supervisory approach enhanced the overall quality of banking supervision?



Almost half of the banks in our sample reported that their **supervisory expenditures had increased** by more than 50% (excluding the supervisory fee), in order to be able to conduct all the activities and reporting requirements.

The new supervisory approach was also described by 42% of participants as **"very different" from the previous one**, and by an additional 29% as "different". Implementing these changes is costly both in terms of direct financial impact and the demand on staff and management teams.

All survey participants though agreed with the statement that the new approach had to a greater or lesser extent **enhanced the overall quality of banking supervision** across the Eurozone.

The state of the Banking Union
Impact on business model and SREP

SREP

The European Banking Authority's (EBA) 2014 guidelines on the Supervisory Review and Evaluation Process (SREP) process require supervisors to perform business model analysis. This topic remains a key area of focus for supervisors and banks.

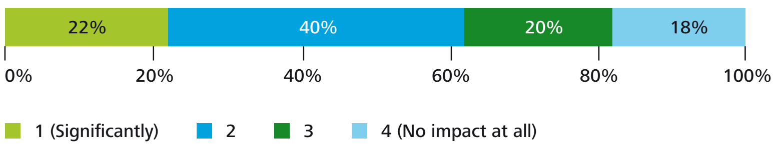
Banks have in the past expressed concerns that a focus on business models might lead to **interference by supervisors in strategic decision-making** – although supervisors have been robust in pushing back against the assertion. Around a fifth of survey respondents reported that the SSM **had significantly impacted strategic decision-making**, with an additional 60% reporting they felt an impact, even though it was not considered to be significant.

Other components of the SREP – capital, liquidity and internal controls – are also being scrutinised more closely. Consequently, **on-site inspections and ongoing supervisory activities** have resulted in detailed feedback and follow-up work for a number of the banks involved.

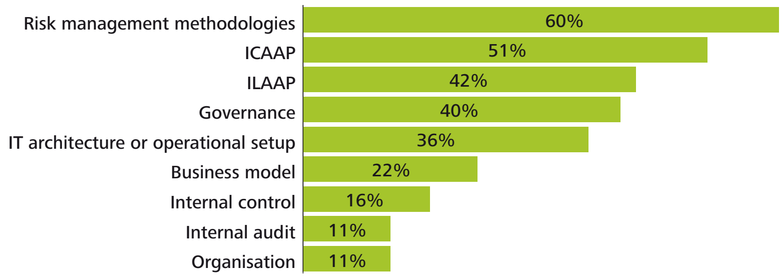
In response to the findings of the 2015 SREP, many banks have **considered making changes to their risk management methodologies, Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP),** and **Governance**. There was though relatively little time to ensure changes were reflected in time for the 2016 SREP: ICAAPs and ILAAPs were due to be submitted by the end of April. It is more likely the changes being made will affect future results, giving banks time to consider more carefully what to do.

The ECB will conduct a **horizontal review of banks' profitability drivers** over the next two years. To support that it will extend its Short Term Exercise (STE), including by adding a section on the profitability forecast exercise. Here, performance will be examined both in absolute terms and relative to peers, with an increasing **focus on peer-group analysis**. There is more work for banks to do here: whilst around half of the banks in our survey had conducted a SREP self-assessment, only a few (12%) had attempted a peer group analysis as part of this self-assessment.

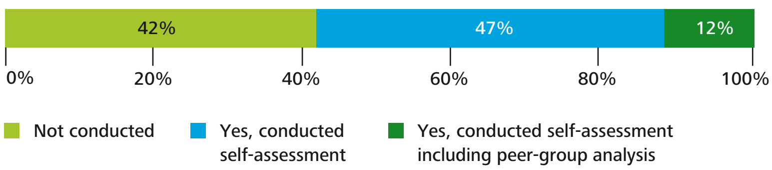
To what extent has the new supervisory approach impacted strategic business decisions taken by your bank?



In which area might your bank implement changes in order to prepare for the 2016 SREP process?



In 2015, has your bank conducted a self assessment of SREP readiness and outcomes?



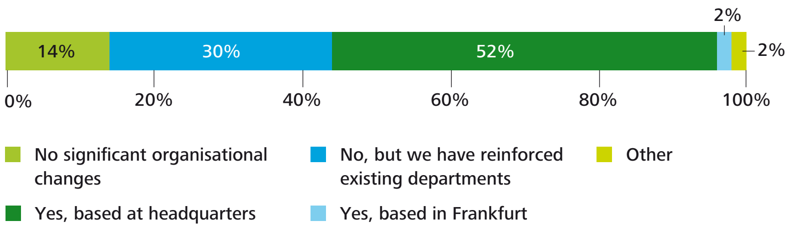
How the ECB's expectations evolve in this respect will be important. Banks will need to **invest more time in conducting their own peer group analysis**, including the development of an approach that starts with the identification of peers and the identification and gathering of relevant information, and ends with reporting of the results. This requirement poses certain challenges to banks in terms of data availability and methodology. The approach must be developed carefully, and customised to each bank's individual circumstances.

The state of the Banking Union
Current progress and relationships

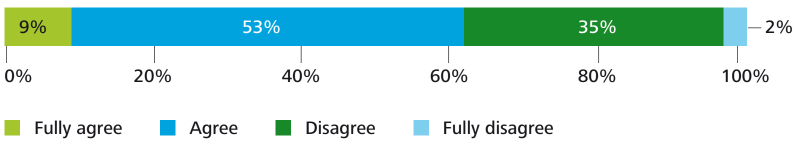
Relationship

The establishment of the SSM has not only triggered large organisational changes at the ECB, but has also necessitated changes to the way banks operate their supervisory relationship. The impact of the new supervisory regime goes beyond the supervisory approach and the new SREP methodology.

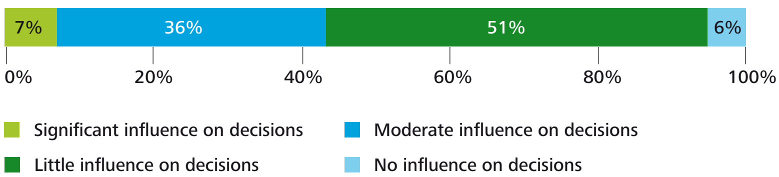
Has your bank established a dedicated team to deal with the SSM?



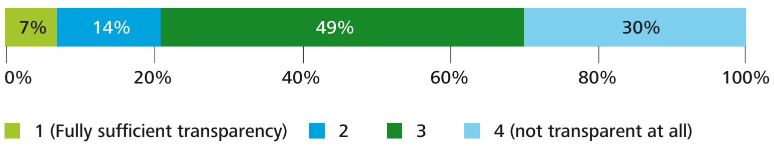
Will the SSM break the link between banks and home country supervisors by eliminating national biases?



In your experience, how influential is the NCA in the supervisory decision-making process?



During the first SREP conducted by the ECB, did you feel that sufficient transparency on methodology has been applied?



More than half of the banks in our survey **had established a dedicated team to manage their interaction with the SSM**, and another quarter had reinforced existing departments. These teams manage communications and coordinate supervisory activities within their group. The benefits of this approach in managing the SSM relationship are clear, but to be effective the team needs to be able to marshal technical and management resources across the group. Banks often find it more difficult to make this a reality.

The relationships established between banks and their Joint Supervisory Team (JST) were considered robust in most cases, at both the Board and technical-expert levels. Collaboration between the ECB and NCAs was also considered to work well during common procedures and on-site inspections. That said, collaboration will remain a key challenge going forward given the inherent difficulty in coordinating across multiple organisations and jurisdictions. Equally, it will be important to invest in establishing a strong framework in order that it remains robust in times of stress.

However, the SSM is still evolving. The new regime and supervisory approach will need to be **fine-tuned over the coming years**, with most of the participants in our survey expecting this process to last between two to five years. Lack of **transparency for banks during the SREP** is a particular concern. Banks also reported that the respective roles of the JST, NCA and Directorate General Micro-prudential Supervision IV (DG IV) – responsible for horizontal and specialised tasks – at the ECB are not always clear, with banks sometimes **receiving what appear to be overlapping requests** from different groups. To overcome this, an **ongoing dialogue** between the JST and its counterparts in DG IV is important. As the owner of the SSM methodology, DG IV has already started the dialogue with the industry; going forward it will be essential to strengthen the exchange. Furthermore, the SSM will likely come under pressure to issue more guidance in the form of standards or best practice observations, to enable banks to better plan for and meet supervisory expectations, as well as to help further harmonise practices.

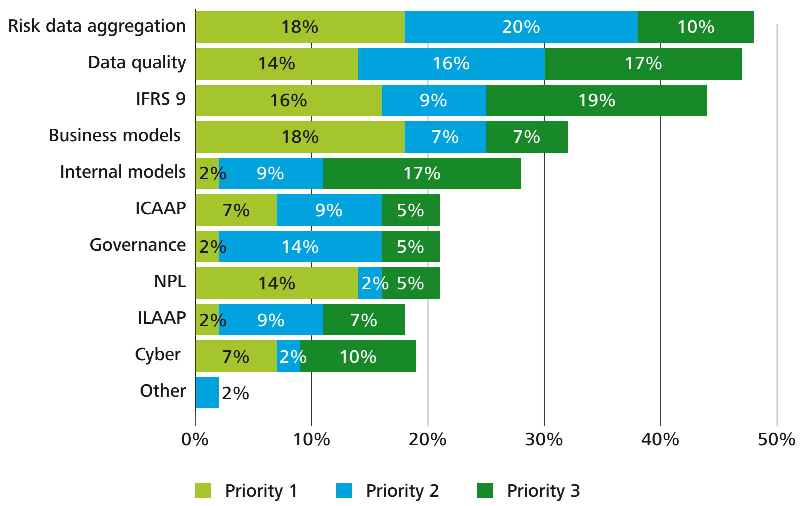
The state of the Banking Union
Future challenges for banks

Looking forward

Banks ranked risk data aggregation, data quality, implementation of IFRS 9 and supervisory assessments of business models as the most challenging aspects of the SSM's priorities for 2016. In the longer-term, as banks and supervisors adapt to the new regime, new challenges are expected to arise. Full implementation of new prudential ratios and greater consistency of internal models and standardised approaches were ranked as the most challenging activities for the future.

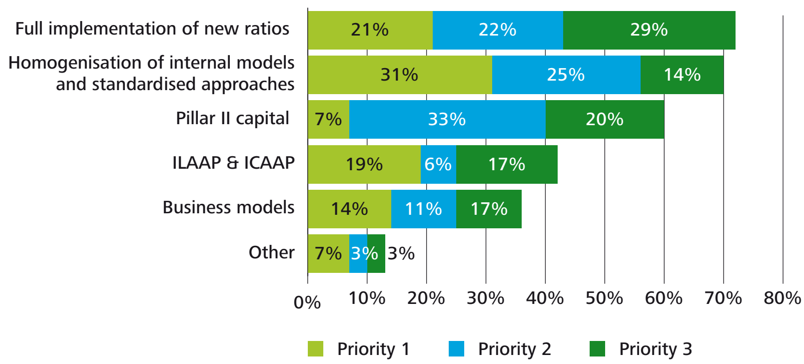
2016 Priorities in 2016

Which of the SSM's priorities do you expect to be the most challenging for your bank in 2016?



Priorities in the long-run

In the long run, which of the following aspects should be the most challenging for your bank regarding the SSM's future supervisory activities?



The focus on **risk data aggregation and data quality** is no surprise given legacy remediation work on data quality including from the comprehensive assessment exercise, the new standards for global and domestic systemically important banks introduced by the Basel Committee on Banking Supervision (BCBS), and the fact that banks remain unable to respond in a fully-automated way to data requests from supervisors. Given the systems and processes banks find themselves with though, comprehensive fixes to the problems are difficult to design and fund. A strategic solution will in many cases require a sustained, multi-year investment, as well as elements of an innovative technological solution. In the short term it is important for banks to communicate their strategy to supervisors clearly so as to minimise pressure to prioritise tactical fixes over longer-term investment.

Whilst supervisors are not responsible for accounting policies, the impact that changes such as **IFRS 9** will have on banks is important to prudential measures of risk, and in turn regulatory ratios and regulatory capital management. It also has knock-on implications for stress testing. For banks **IFRS 9** presents a significant implementation challenge, with new accounting methodologies to adopt and then feed through regulatory and risk management processes.

The supervisory assessment of business models picks up several of the same issues identified earlier in this paper. This analysis is not repeated here.

All of the issues identified though – both for 2016 and beyond – are important for supervisors as they work to build resilience in the longer term. Each bank will need to benchmark its capabilities across each dimension and on that basis prioritise its effort. **Where issues will remain supervisory priorities over several years, banks should be aware that supervisors' expectations will likely increase year on year.**

The state of the Banking Union
Responding to the Banking Union challenge

Deloitte's Banking Union Centre in Frankfurt (BUCF) was established to respond to the new supervisory landscape, and in particular to support firms locally to tackle the challenges, as well as to respond to their needs in the most efficient and effective manner. The Centre is supported by Deloitte financial services industry practices across the region. It works closely with Deloitte's Single Resolution Mechanism (SRM) team based in Brussels.

Deloitte's EMEA Centre for Regulatory Strategy (ECRS) provides analysis and insights on the forward regulatory agenda. The ECRS leverages regulatory specialists to monitor regulatory developments and provide an expert, objective perspective on opportunities and challenges for financial institutions.

If you wish to discuss the survey and obtain a more comprehensive overview of all results, please contact your local Deloitte representative, or contact the survey team directly via **BUCF_survey@deloitte.com**.

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