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The view from industry
2017 Deloitte Banking Union Supervision Survey

BU CF Deloitte Banking Union Centre in Frankfurt

CENTRE *for* REGULATORY STRATEGY EMEA

Survey approach and key results

Deloitte's annual Banking Union Supervision survey asks banks about their experiences of the Single Supervisory Mechanism (SSM) and the changing supervisory and regulatory landscape. The insights enable banks to benchmark their strategies for responding to the SSM and understand best practice, and provide supervisors and policymakers with a clear industry perspective.

This year our survey examined in particular how supervisory relationships have continued to evolve; the organisational impact on banks; and technical issues regarding supervisory activities and regulations, as borne out by the Supervisory Review and Evaluation Process (SREP) and on-site inspections (OSIs). The results of the survey highlight in part the continuation of trends observed last year, as supervisory processes have matured and banks have refined their supervisory engagement strategies. At the same time much remains in development, not least because of the growing importance for banks of supervisory actions as the regulatory framework stabilises.

This paper sets out highlights from the survey and puts them in the context of broader developments – in particular, through the lens of the supervisory approach, business model analysis (BMA) and supervisory priorities for the year ahead – three topics that we keep coming back to in our conversations with clients.

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

Key messages from survey participants

01/Impact

- Half of survey participants report that their supervisory spending has increased by more than 50% on average over the first two years of the SSM
- Supervisory priorities have driven targeted investment in operations across a number of areas, most prominently governance
- Data requests continue to be a particularly significant draw on resources and distraction for management
- Progress still needs to be made in establishing a level playing field

02/Relationship

- More than 60% of survey participants are satisfied or very satisfied with their supervisory relationship
- Coordination on messaging and policy between supervisory teams though is felt to need improvement, as are the clarity and timeliness of supervisory communications

03/OSIs

- Most survey participants considered themselves to have been well-prepared for inspections
- From the perspective of survey participants, supervisors' planning, resourcing and operations for OSIs could be improved
- The ECB's draft guide on OSIs and internal model investigations published after the survey was completed will help with this

04/SREP

- The continued low interest rate environment is by far the most significant factor affecting banks' business models. Focusing on profitable products and increasing cost efficiency are seen as the main drivers for restoring or increasing profitability
- Despite positive developments in supervisory relationships, survey participants think there is insufficient transparency about the results of the SREP, and significant uncertainty about supervisory BMA

For this second edition of Deloitte's Banking Union Supervision Survey, more than a third of banks directly supervised by the European Central Bank (ECB) participated.

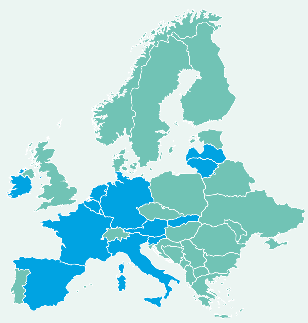
The survey was carried out between February and May 2017.

Target banks

All directly supervised SSM banks within the Eurozone

Participating banks

45 directly supervised **institutions** spanning 13 out of 19 **Eurozone countries**

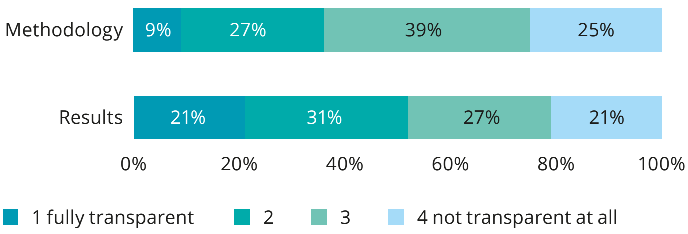


Countries that participated in the survey

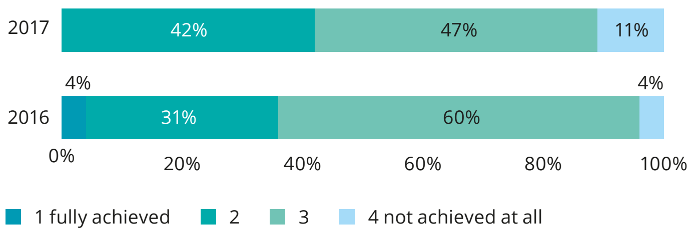
1 'Interview with Agora', Danièle Nouy, Chair of the Supervisory Board, ECB, February 2016, https://www.bankingsupervision.europa.eu/press/interviews/date/2016/html/sn160213.en.html

Evolution of the supervisory approach

During the 2016 SREP, conducted by the ECB, did you feel that there was sufficient transparency in terms of the methodology used and the results it produced?



Two years after the ECB took control as Eurozone banking supervisor, to what extent do you think that the level playing field has been achieved?



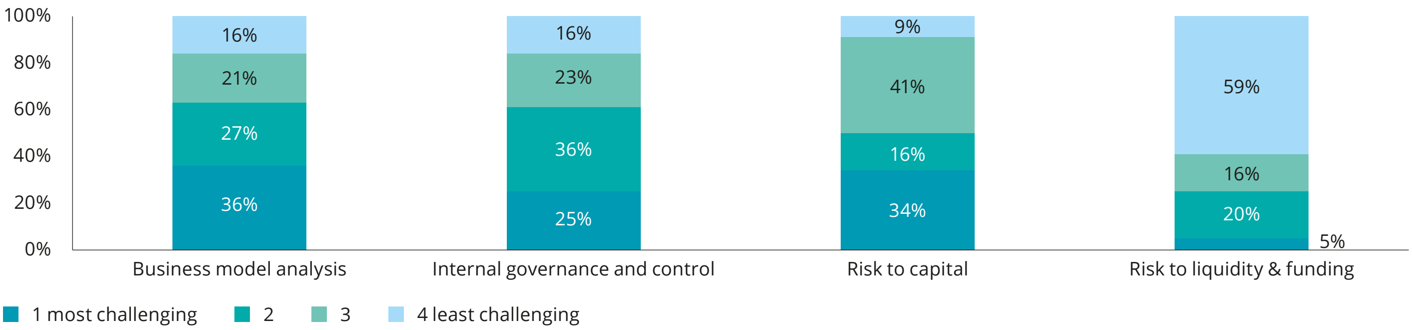
Reflecting on the evolution of supervision in the SSM over the past year, it is tempting to conclude that not much has changed. Survey participants report that the supervisory approach continues to lack transparency and consistency. That is despite relationships with supervisors – a key communications channel - having stabilized. Banks wonder if the much-heralded level playing field will become a reality .

Much has changed though. The reality is that the SSM is faring better against higher industry expectations. The ECB has made significant strides in clarifying its expectations on key topics – through bilateral discussions between banks and Joint Supervisory Teams (JSTs), publications and speeches – and supervisory processes have matured. Perhaps most notably, the ECB has made changes to how it implements the SREP, against the backdrop of a broader discussion about the process at the European Union (EU) level. The split of the SREP capital requirement into a Pillar 2 Requirement and Pillar 2 Guidance is intended to improve comprehensibility. Further, the ECB has worked on its qualitative approach and is consulting on its multi-year plan on SSM guides on the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP)[2], which provides details of what the ECB expects from annual submissions.

Of course, there remains more to do. Banks are hoping that there will be more clarity around supervisory methodology and also for other topics such as stress testing and risk data. Only 9% of survey participants think that the SREP methodology is sufficiently transparent, while only 21% judge the SREP results to be sufficiently transparent. The relatively more favourable response on transparency of results may reflect improvements in disclosures in SREP letters, whilst aspects of the underlying process remain challenging to understand. The ECB is though ultimately likely to be reluctant to provide more insight into its methodology, in order not to encourage banks to game the approach. However, unless banks fully understand why their capital requirements are being increased, their ability to remedy the supervisory concerns which gave rise to them will be limited.

In addition, while JSTs have stabilized and banks' meetings with them have became more frequent over the past year, banks perceive there to be some problematic differences between formal and informal communication. While banks can sometimes wait months for formal communication e.g. the final results of OSIs or approval for model changes, informal communications can be much faster, but by definition less certain as the outcome can be changed as a result of the ECB's internal challenge process. Banks would value a more coordinated and tailored approach across the ECB, in particular between policy and supervision teams.

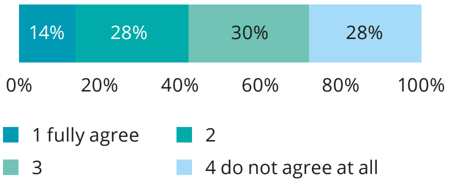
Which pillar of the SREP assessment was most challenging for your organisation in terms of effort and resources (staff and management)?



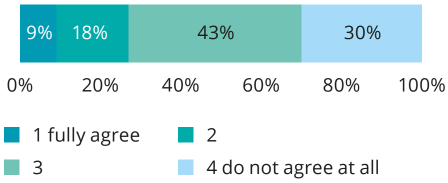
2 'Multi-year plan on SSM Guides on ICAAP and ILAAP', letter from Daniele Nouy, Chair of the Supervisory Board, ECB, February 2017, https://www.bankingsupervision.europa.eu/ecb/pub/pdf/170220letter_nouy.en.pdf

Business model analysis

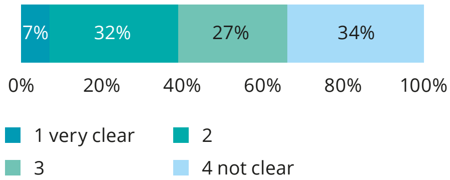
Do you think that the SSM's supervisory activities are putting you under pressure to adapt your business model beyond changes which the Board would make in any case?



To what extent do SSM requirements and requests play a role in driving adjustments to your business model?



Are SSM business model expectations communicated in a clear and understandable manner?

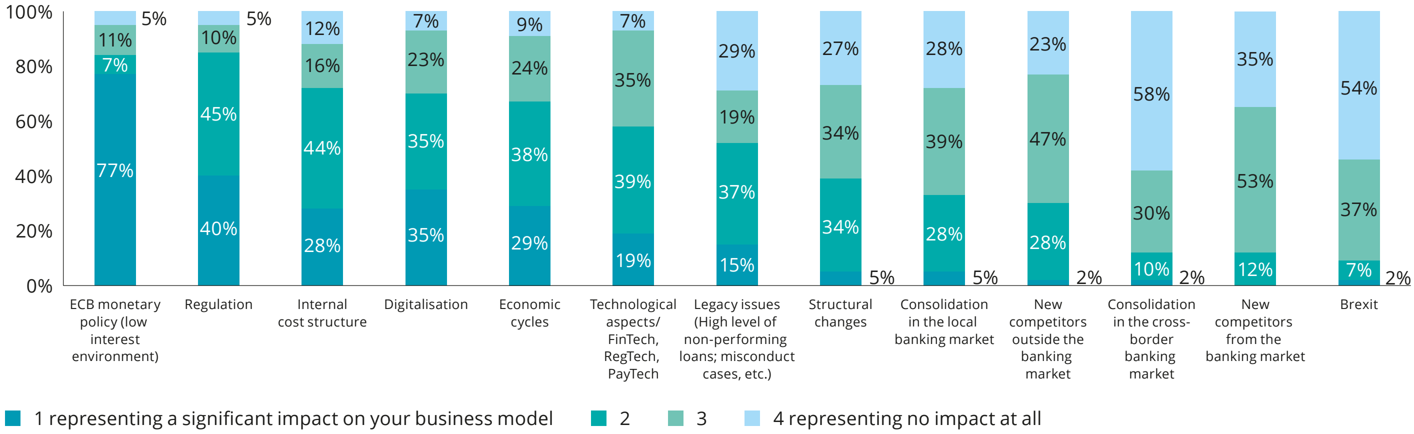


Supervisory BMA has been a priority for the ECB since the beginning of the SSM. Three years on, we often hear about an increase in the intensity of supervisory scrutiny of business models and it is a topic currently mentioned regularly in speeches by the ECB Supervisory Board. Supervisors are exploring in particular banks' ability to generate their cost of capital, against the backdrop of protracted low/negative interest rates and disruption from new technologies ('Fintech'), and the challenge of responding to the UK's withdrawal from the EU ('Brexit'). There is a stated expectation that the Eurozone banking sector needs to consolidate[3], although the mechanism for making this happen remains unclear.

That level of activity suggests banks should be very focused on understanding their business through the lens of supervisory BMA, in particular whether they are outliers in the quantitative horizontal analysis. Any concern though that supervisors will try to intervene, and tell banks how to run their business is probably unfounded. In fact, the SSM approach has remained rather quantitative, and as a result banks are asking themselves if and when BMA will become more influential in the supervisory process. The majority of survey participants (61%) find expectations on BMA unclear or difficult to understand. Overall, banks do not report much pressure to change their business strategy or their approach to managing their business model in response to supervisory activities. Only 14% of survey participants are definitely planning such changes, while 28% are considering them. The perceived lack of potency of BMA as a 'lever' for supervisors may be addressed, in particular as follow up discussions with supervisors become more frequent.

That is not to say that banks are not themselves focused on challenges to their business model. The impact of the low interest rate environment is considered to be the key driver of any change to business models. Survey respondents, however, ranked both competition from outside the banking market and Brexit at the lower end, with only 2% considering each to have a significant impact on their business model. 28% ranked new competition from outside the banking sector second and another 12% ranked new competition from the banking sector second. The fact that the perception – or prioritization – of issues appears to diverge between banks and supervisors reflects differing perspectives. That banks and supervisors' perceptions differ so much when it comes to the priority topics may prove problematic and aligning these different perspectives may have to become a priority in its own right.

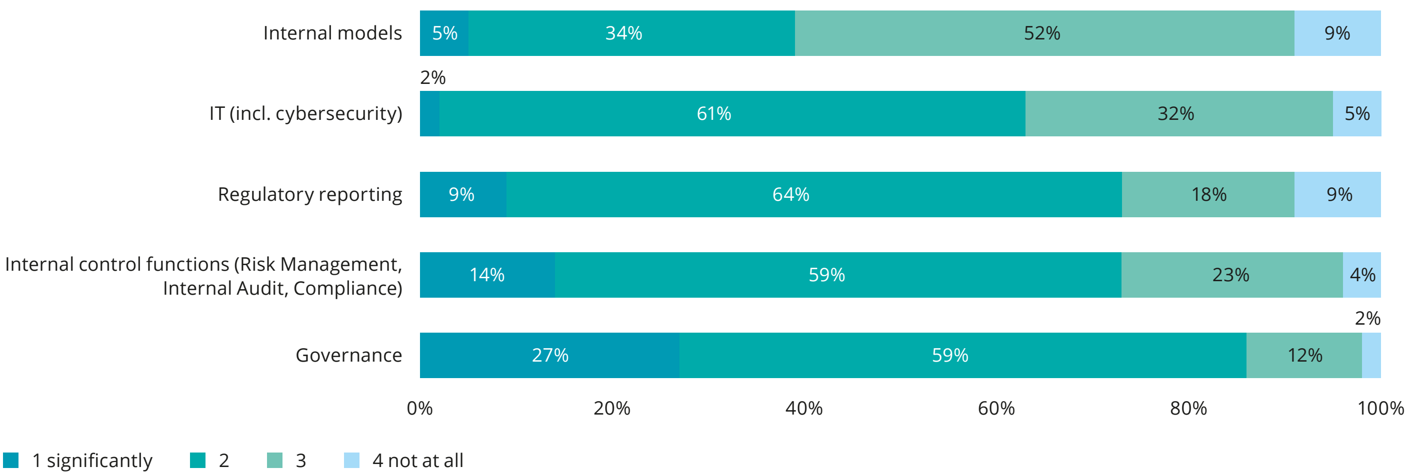
To what extent do the following factors affect your business model?



3 'Interview with Mannheimer Morgen', Sabine Lautenschläger, Member of the Executive Board and Vice-Chair of the Supervisory Board, ECB, July 2017, https://www.bankingsupervision.europa.eu/press/interviews/date/2017/html/ssm.in170729.en.html

Future priorities for the SSM

To what extent do you think that your bank has improved / the operations of your bank have improved in the following areas over the last year?



At the start of 2017 the ECB set out its supervisory priorities: business models and profitability drivers; credit risk, with a focus on non performing loans (NPLs) and concentrations; and risk management. Survey participants report that they have made significant investments over the past year in operations aligned to areas of supervisory scrutiny. Most notable is the extent of investment in governance, which ranked second highest in terms of number of inspections as reported by the ECB in its latest annual report on the SSM. It also could be interpreted as a response to the ECB's thematic review on risk governance. Banks seem to be rather reactive than proactive in that sense. Given the amount of new regulation they have to implement, this is a pragmatic approach. The danger though that this will backfire some day in terms of falling short of supervisory expectations in a particular area remains.

Looking forward, these topics are likely to remain key, but the aspects that supervisors focus on will evolve. Most importantly, work on business models will focus on Brexit preparedness. The ECB is closely monitoring planning by banks with operations in the UK, as well as banks relocating operations to the Eurozone. The ECB has to ensure that the banks it currently supervises have adequate plans in place to be able to continue operations without major disruption. For banks moving to the Eurozone, the ECB needs to handle more authorizations, and the number of banks to be supervised will increase. Given the attention on Brexit and the resources required, it remains to be seen how far the ECB will be able to progress other efforts (even with its stated intention to increase resources). Brexit will stretch its resources and the ECB will potentially need to be more selective as to which initiatives to push forward and to reconsider timelines.

The Targeted Review of Internal Models (TRIM) program has picked up and the in-depth on-site review cycle has started. The program is up and running for all risk types in scope with the key objectives to reduce the variability of risk-weighted assets (RWAs) stemming from internal models, to improve the consistency among banks' methodologies and to restore the credibility and adequacy of capital requirements. The work on NPLs, IFRS 9 implementation and risk governance is also proceeding. Elsewhere in the Banking Union, the resolution cases during 2017 have provided important lessons for the SSM and Single Resolution Mechanism, and will drive changes to supervisory and resolution approaches over the coming months .

We also expect to see more work on topics such as cyber risk and outsourcing. Both have become more prominent on the EU supervisory agenda.

"So, I can't give you a number, but hopefully we will increase our staff already this year, and for sure next year, in order to cope with the wave of authorisations, licensing, qualified holding procedures and internal model approvals."
Sabine Lautenschläger[4]

4 'Interview with the Financial Times', Sabine Lautenschläger, Member of the Executive Board and Vice-Chair of the Supervisory Board, ECB, July 2017, https://www.ecb.europa.eu/press/inter/date/2017/html/ecb.in170704.en.html

Responding to the Banking Union challenge

The Deloitte Banking Union Centre in Frankfurt (BUCF) was established to respond to the new 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. It works closely with Deloitte's Single Resolution Mechanism team based in Brussels. The Deloitte Centre for Regulatory Strategy is a powerful resource of information and insight, designed to assist financial institutions in managing the complexity and convergence of rapidly increasing new regulations.

If you wish to discuss the survey results, please contact your local Deloitte representative, or contact the survey team directly via **BUCF_survey@deloitte.com**. You can find out more about the BUCF from the website **www.deloitte.com/de/de/pages/financial-services/topics/banking-union-centre.html**.

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