Looking forward
The future of the SSM and banking in the Eurozone

EMEA Centre for Regulatory Strategy

Deloitte Banking Union Centre in Frankfurt

Contents

Executive summary	**2**
Banking Union and the SSM: the journey so far	**3**
The future of supervision in the SSM	**6**
The future shape of banking: disruptive innovation and the Banking Union	**9**
Conclusion	**14**
Contacts	**15**
Endnotes	**16**

Executive summary

One year on from the start of the Single Supervisory Mechanism (SSM), the European Central Bank (ECB) continues to develop and embed its supervisory approach. In May, Deloitte's paper 'Getting to grips with the new regime',[1] explored the issues arising during this period of change, and identified the areas that banks should focus their efforts on as they adjusted to the new regime. There remains much to do, but the progress made so far has been good.

This paper takes a longer-term view. Even as they continue to tackle near-term challenges, many banks are asking what the SSM will look like in the future, and what the implications will be for their business models, and for the banking industry more broadly. Regulation is now very much a strategic consideration for banks, and the approach that supervisors take – and how banks respond – are particularly important.

The future

Predictions are inherently uncertain, but there is plenty of information that can be used to piece together a view of the future. First, look at the SSM and the Banking Union. What still needs to be done to realise the vision that the ECB set out at the start of the journey? How will the development of the other elements of the Banking Union affect the SSM?

Amongst the features expected are more intrusive supervision, but greater consistency; potentially less recognition of a bank's individual circumstances; higher expectations in terms of regulatory management; greater emphasis on business models and stress testing as the focus of supervision; and less supervisory guidance. Cross-bank thematic reviews will also be used increasingly as part of a broader move emphasising peer groups and supervisory benchmarking.

Disruptive forces

Second, it is important to look at the wider context in which the SSM operates, both as part of a global regulatory network, and in managing the large number of legislative initiatives that are re-shaping the regulatory landscape for banks. What will be the effect of competition and the changing shape of the banking sector on supervision in the SSM? New entrants to banking and innovation in banking products, in particular through technology, will affect opportunities for all banks and pose challenges for supervisors.

Deloitte recently joined with the World Economic Forum to conduct a large study of the future of financial services. The purpose was to understand how disruptive innovations are reshaping the business of financial services as it exists today. Alongside the changing regulatory landscape, rapid technological change and shifting consumer preferences were identified as key disruptive forces.

To understand these factors further from the perspective of an SSM bank, this paper looks at the broader regulatory environment for banks; competition and innovation; and the macroeconomic (and social and political) environment.

Managing change

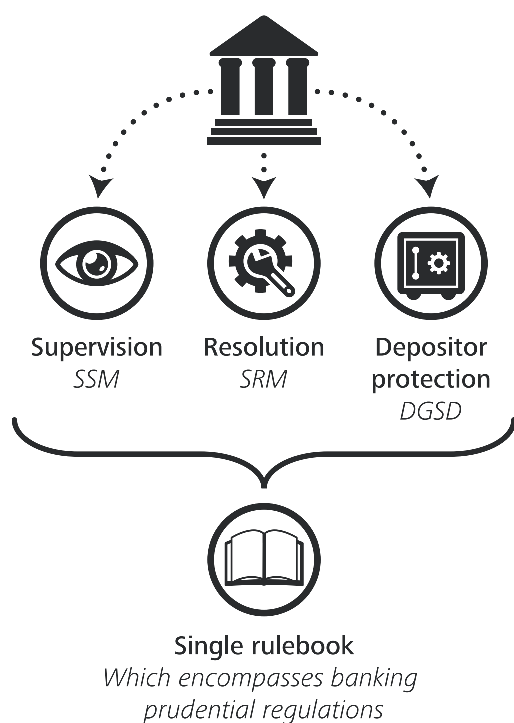
Banks need to consider the strategic implications of these changes, and take a holistic view of all of the factors in order to be successful. These changes will necessitate careful planning by the board, and determination to take action. There are also important implications for supervisors. Even if their objectives remain fixed, how they seek to achieve them and prioritise between them should reflect the changing environment, and how banks are responding to it. While the SSM will have an important influence on banking in the Eurozone in 2020, it is not the only such influence. And if the SSM is to be effective, it too will need to change with the times.

Regulation is now very much a strategic consideration for banks, and the approach that supervisors take – and how banks respond – are particularly important.

Banking Union and the SSM: the journey so far

The infographic on the following page summarises the journey to the Banking Union.

The Banking Union spans three pillars: supervision (the SSM), resolution (the Single Resolution Mechanism, SRM) and depositor protection (through the revised Deposit Guarantee Scheme Directive, DGSD), underpinned by the development of a Single Rulebook (encompassing banking prudential regulations).



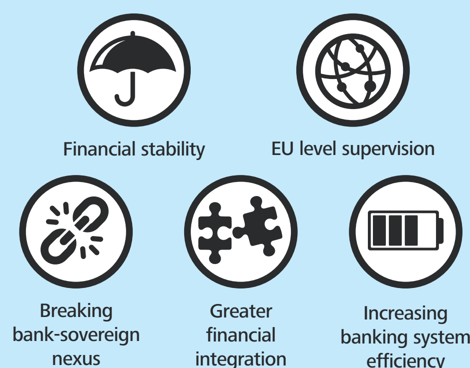
Progress has been made on the commitments that underpin the Banking Union, in particular, the SSM, is established both institutionally and operationally. The SRM is due to become operational from the beginning of 2016. On depositor protection, however, the ambition – at least in the near term – has changed, as the prospect for immediate agreement on a single deposit insurance scheme across the Banking Union has diminished.

A response to the financial crisis

The Banking Union emerged from a commitment by the European Commission, the European Council and the European Parliament to respond to a range of post-crisis challenges by enhancing financial integration in the Eurozone. The first plans for establishing the Banking Union were published by the Commission in September 2012.[2]

The objectives of the Banking Union broadly cover five deliverables:[3]

- Contributing to financial stability in the European Union (EU);
- Ensuring pan-EU supervision of the banking sector;
- Breaking the nexus between banks and sovereigns;
- Promoting greater financial integration; and
- Increasing the efficiency of the banking system.



The SSM formally opened for business on 4 November 2014. For months before, supervisors and banks prepared for the transfer of prudential supervisory responsibilities from national competent authorities (NCAs) to the ECB, including via the Comprehensive Assessment, which included a thorough review of the quality of bank assets.

The scope of the SSM covers authorisation and micro prudential supervision, and joint responsibility for macro prudential supervision of credit institutions in participating EU Member States – currently 19. The ECB has ultimate responsibility for the supervision of all banks in these countries, and direct responsibility for the supervision of larger, 'significant', banks. Conduct supervision remains the responsibility of national supervisors.

Banking Union and SSM to date | State of play

Banking Union

Roadmap to a Banking Union
September 2012
The European Commission set out plans for completing the Banking Union

Pillars of the Banking Union
SSM
SRM
DGS
Single Rulebook

Objectives and deliverables for the Banking Union set
Financial stability
EU level supervision
Breaking bank-sovereign nexus
Greater financial integration
Increasing efficiency of the banking system

2012

The Banking Union project gears up

A cornerstone of the Single Rulebook delivered
July 2013
The European Commission's proposal for revised capital requirements, the so-called CRD IV package which implemented the Basel III agreement into EU law, entered into force

2013

The journey begins

Progress on other elements of the Banking Union
April 2014
The European Parliament adopted BRRD and DGSD

2014

SSM

SSM legislation proposed
September 2012
The proposed SSM Regulation conferred broad supervisory powers and tasks to the ECB

SSM: Organisation and structure
Directorates General (DGs)
Microprudential Supervision I and II to focus on the direct and day-to-day supervision of 'significant' banks
DG Microprudential Supervision III in charge of indirect supervision of 'less significant' banks
DG Microprudential Supervision IV to perform cross-bank supervision and provide specialised expertise

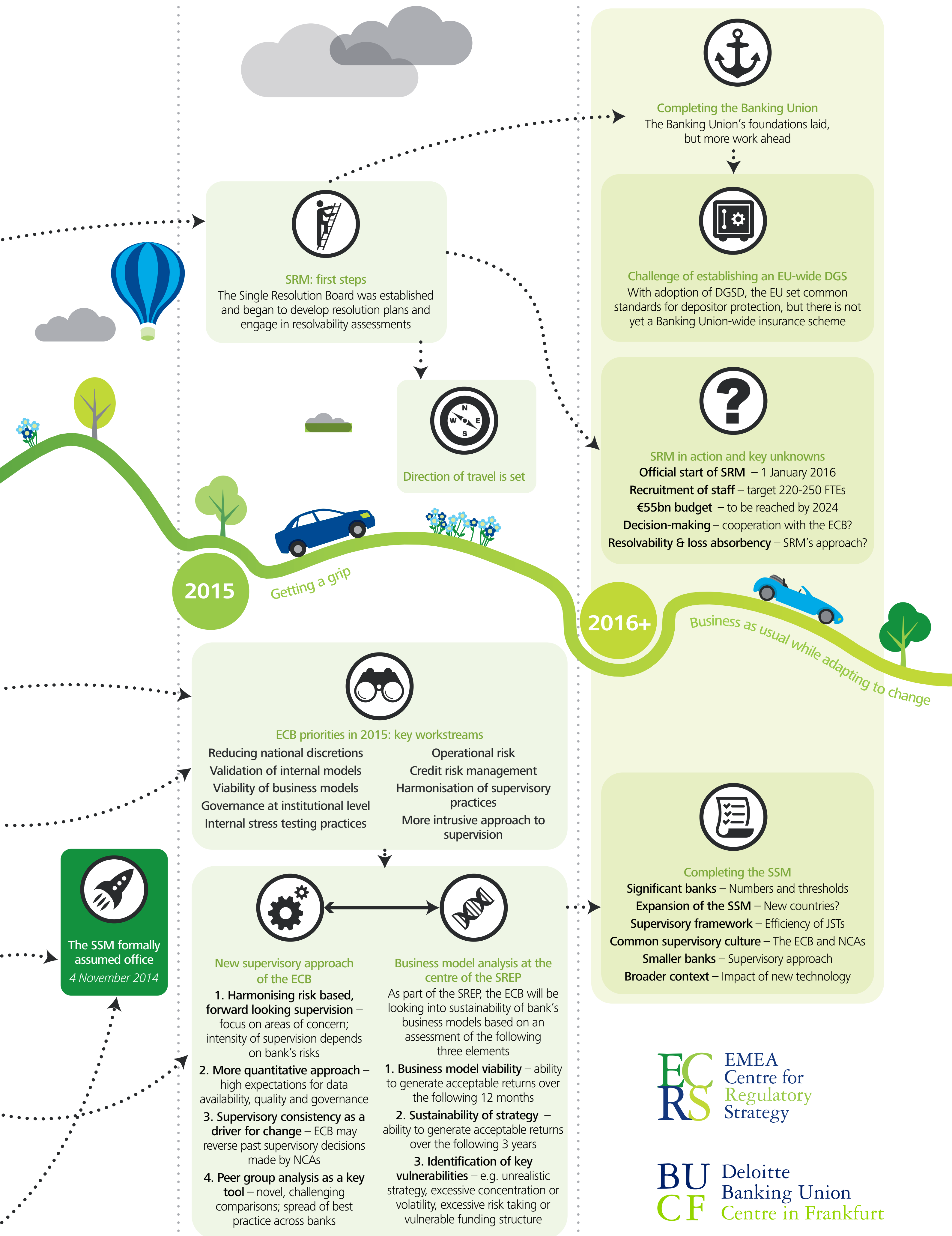
The SSM's first steps
October 2013
The SSM Regulation entered into force
November 2013
The Comprehensive Assessment started
November 2013
Leadership appointed:
Danièle Nouy, SSM Chair, assumed office

The SSM will be "intrusive", "tough" and "fair"
Danièle Nouy, SSM Chair

SSM: a lot of luggage on board
Immediate challenges for SSM leadership included:
Supervisory approach, data and analytics, and talent

Supervision of significant banks under the SSM
122 banking groups designated as 'significant' and supervised by the ECB-led joint supervisory teams (JSTs) that also involve representatives from local NCAs

Results of the health check
The Comprehensive Assessment of the largest banks in the Eurozone revealed:
13 banks failed the assessment with a combined shortfall of **€9.47bn** (adjusted for the capital raised in 2014)
The asset quality review identified almost **€48bn** in asset revaluation adjustments


Completing the Banking Union
The Banking Union's foundations laid, but more work ahead
Challenge of establishing an EU-wide DGS
With adoption of DGSD, the EU set common standards for depositor protection, but there is not yet a Banking Union-wide insurance scheme
SRM: first steps
The Single Resolution Board was established and began to develop resolution plans and engage in resolvability assessments
Direction of travel is set
SRM in action and key unknowns
Official start of SRM – 1 January 2016
Recruitment of staff – target 220-250 FTEs
€55bn budget – to be reached by 2024
Decision-making – cooperation with the ECB?
Resolvability & loss absorbency – SRM's approach?
2015
Getting a grip
2016+
Business as usual while adapting to change
ECB priorities in 2015: key workstreams
Reducing national discretions
Validation of internal models
Viability of business models
Governance at institutional level
Internal stress testing practices
Operational risk
Credit risk management
Harmonisation of supervisory practices
More intrusive approach to supervision
Completing the SSM
Significant banks – Numbers and thresholds
Expansion of the SSM – New countries?
Supervisory framework – Efficiency of JSTs
Common supervisory culture – The ECB and NCAs
Smaller banks – Supervisory approach
Broader context – Impact of new technology
The SSM formally assumed office
4 November 2014
New supervisory approach of the ECB
1. Harmonising risk based, forward looking supervision – focus on areas of concern; intensity of supervision depends on bank's risks
2. More quantitative approach – high expectations for data availability, quality and governance
3. Supervisory consistency as a driver for change – ECB may reverse past supervisory decisions made by NCAs
4. Peer group analysis as a key tool – novel, challenging comparisons; spread of best practice across banks
Business model analysis at the centre of the SREP
As part of the SREP, the ECB will be looking into sustainability of bank's business models based on an assessment of the following three elements
1. Business model viability – ability to generate acceptable returns over the following 12 months
2. Sustainability of strategy – ability to generate acceptable returns over the following 3 years
3. Identification of key vulnerabilities – e.g. unrealistic strategy, excessive concentration or volatility, excessive risk taking or vulnerable funding structure
ECRS
EMEA Centre for Regulatory Strategy
BUCF
Deloitte Banking Union Centre in Frankfurt

The future of supervision in the SSM

What will the future be like in the SSM? The seeds have already been sown. The vision for the SSM described by Danièle Nouy, Chair of the Supervisory Board – for tougher, more harmonised supervision – will take several years to implement and will be an iterative process. The influence of the other components of the Banking Union, in particular the SRM, and Single Resolution Board (SRB), will add to the demands on banks.

There will be additional influences from developments in supervision outside the Eurozone, and through the response of supervisors to the changing shape of the banking sector. The SSM operates in a global context. The ECB has a major influence on the EU regulatory and supervisory agenda, and it has become one of the key supervisors globally and will influence other global regulators as well as being influenced by them. The ECB is lead supervisor for nine Global Systemically Important Banks (G-SIBs) and host supervisor for the Eurozone operations of another eight.

While the SSM is still evolving, other global regulators are changing their regimes and influencing the debate. The vision for supervision in the SSM will need to evolve, reflecting developments in best practice.

The scale of these challenges should not be underestimated. Refinement will need to be made to (for instance) the details of the supervisory reviews. Over time the ECB will develop its supervisory risk appetite framework, which will further inform supervisory strategy.

The remainder of this section explores the factors driving supervisory outcomes in more detail. Before banks anticipate the implications of these for strategy, it is important to understand what other factors will influence the evolution of banking over the next few years, as set out in Section 3.

Forecasting the future

The SSM is expected to demonstrate the following features:

Greater emphasis on business model analysis and stress testing within the supervisory assessment

Guided by the Supervisory Review and Evaluation Process (SREP) framework – guidelines on how supervisors across the EU should conduct their assessments of the prudential risks and financial resilience of banks – supervisory conversations will increasingly centre on business models. Fully articulating the business model and business strategy, mapping out the implications across business lines and functions and ensuring a thorough and consistent understanding across the business will be important in meeting supervisors' expectations and in managing the supervisory relationship. Following the example of the US and the UK, supervisory stress testing will become an important adjunct to this approach[4]. Supervisors will assess the near-term sustainability and medium-term vulnerabilities of the bank, and use this to focus their approach.

More intrusive supervision, but greater consistency

The increase both in the number of rules and in the intensity of supervision will not abate, and banks within the SSM, as outside, will need to manage this. A potential benefit will be greater consistency of rules and their application. This will make it easier to operate in different jurisdictions within the Banking Union, simplifying the task of dealing with different national regimes. To date, the ECB has embarked on the task of examining critically the options and national discretions provided for in EU rules, as well as increasing consistency of the regulatory models used by banks. Cross bank thematic reviews and peer group analysis will contribute to the drive for consistency.

Less accommodation of individual bank idiosyncrasies

All of these changes are important, but in the short-term they may continue to be overshadowed by the need for both supervisors and the supervised to bed down the new system, in particular the cross-bank components designed to provide a sector-wide view and enhance consistency. On the one hand, a greater emphasis on proportionality should ensure that the requirements for banks reflect factors such as size, geography or complexity of business model. At the same time, the drive for consistency will reduce or remove provisions that have in the past been made to accommodate the specific circumstances of banks, certainly when these have been applied inconsistently between countries.

Higher expectations in terms of regulatory management

The number of regulations, their complexity and their interconnectedness will drive many banks – not just the largest – to invest in enhanced regulatory management and compliance monitoring. That investment will reduce supervisory-driven remediation work in the medium term, and will enable banks to tackle requirements more strategically. Banks will be expected to be able to demonstrate on an ongoing basis that they are compliant with regulations, and be ready for detailed reviews be they of models, processes or technology. Reviews will consume banks' time and resources. Although that effort will not reduce, it will stabilise as the regulatory change agenda matures.

Less guidance

The ECB has provided very little external guidance on its supervisory approach. Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, has said the ECB is not going to provide more guidance because it does not want banks to optimise their behaviour to meet only the letter of the SSM regime. Instead, banks will be left to make their own judgements.[5]

Over the past year progress has already been made to bring the vision for the SSM to life.

Supervisory approach

After the Comprehensive Assessment was completed and the ECB took over responsibility for supervision in the Eurozone, the new supervisory approach started to be rolled out, supervisory inspections began, and new data, such as those data requested for the 'short term exercise' (STE)[6] were gathered. These activities informed the ECB's own first SREP. The SSM SREP will be further developed – in design and implementation – over time. For example, the quantitative models used to develop the preliminary SREP score are not yet finalised, and deep-dives into specific areas of supervisory interest are expected to become the norm.

Next, and perhaps most important, harmonization of individual capital and liquidity adequacy assessments (ICAAPs and ILAAPs) over the next couple of years is expected. Both differ significantly across the Eurozone with respect to the degree of freedom granted to banks and the level of documentation required, be it a formal report to the supervisor or only internal documentation. Both are important components of the SREP assessment and the ECB is likely to provide further internal guidance to make the supervisory approach more consistent across JSTs.

The vision for the SSM described by Danièle Nouy, Chair of the Supervisory Board – for tougher, more harmonised supervision – will take several years to implement.

Sector and peer group analysis

If general areas for concern are identified by the ECB, targeted, cross-bank reviews will be its 'weapon of choice' to tackle the issues. This approach helps establish a supervisory benchmark against which improvements can be specified. Investigations related to risk appetite and governance, cyber risk and leveraged finance have already been seen in 2015 and further supervisory activities are expected in the coming year.

Regulatory models

The ECB has planned a sector-wide review of internal models used by banks under its supervision, which will last at least until 2019. Banks will be facing this review at a time when models are changing anyway due to other regulatory initiatives including changes to prudential capital and liquidity requirements, and revised accounting rules, and resources are scarce. Work by the European Banking Authority (EBA) and the Basel Committee on Banking Supervision (BCBS) on the future of the internal ratings-based approaches will be conducted in parallel to the ECB's review. Implementation of the changes requested by the EBA will affect the same departments, IT systems, processes and methodologies that are under close scrutiny by the ECB. Therefore, banks will need to align internal initiatives closely and plan strategically to cope with them in the most efficient way. In the best case, the ECB and EBA will be closely aligned, but conflicts between both initiatives could arise, with additional uncertainty for the sector.

Supervision of less significant banks

It is not only the significant banks that have to deal with changes in supervisory approach and culture. Developing and rolling out the supervisory approach for less significant banks – smaller banks, not directly supervised by the ECB – is also on the ECB's agenda. The approach has to be calibrated for more than 3000 banks under indirect supervision, although the ECB does seem to make a distinction between around 100 high priority banks within that group and the rest. Input from supervisors in each country will be essential. Convergence of the supervisory approaches for significant and less significant banks will be an important factor to ensure consistent supervision. However, this has to be implemented carefully as smaller banks might not be able to handle the supervisory burden otherwise.

The SSM in the wider context

As has been noted, the SSM is only one building block of the Banking Union. In this context, resolution and resolvability planning will be a particularly powerful tool. (Under EBA SREP guidelines supervisors will assess banks against the risk to sustained viability. Hence more generally oversight of the banks is shifting towards a stressed-scenario perspective.)

From 1 January 2016, the SRB will become the ultimate resolution authority for the Banking Union. It will be responsible for operationalising the SRM and ensuring proper implementation of the EU Bank Recovery and Resolution Directive (BRRD), in particular by drawing up resolution plans and taking decisions relating to resolution for all 'significant' banking groups, any other banks directly supervised by the ECB, as well as for cross-border groups.

Most notably, the SRB will have powers to impose structural, financial or other operational changes to banks which are deemed unresolvable, or where there are impediments or obstacles to resolution. The SRB will also be responsible for determining banks' bail-in-able debt requirements (referred to as MREL, 'minimum requirement for own funds and eligible liabilities'), thereby giving the SRB a direct interest in prudential regulatory issues. Additionally, the SRB has a variety of powers, including the ability to request information and conduct on-site visits.

Trigger events for resolution are defined along with early intervention mechanisms and require close liaison with supervisors. It will take time for these new arrangements to be fully fleshed out.

Banks already faced recovery and resolution planning requirements under the BRRD. The SRB, however, will bring its own perspective on how to achieve resolvability and set MREL requirements. Having a single institution taking decisions for banking groups across the Banking Union should deliver a greater degree of uniformity across the region. The SRB may also take the place of multiple national resolution authorities in crisis management groups and resolution colleges.

The future shape of banking: disruptive innovation and the Banking Union

Deloitte recently joined with the World Economic Forum to conduct a large study of the future of financial services.[7] The purpose was to understand how disruptive innovations were reshaping the business of financial services as it exists today. Alongside the changing regulatory landscape, rapid technological change and shifting consumer preferences were identified as key disruptive forces.

Before determining how to respond to the future shape of the SSM, it is important for banks to take into account these other forces, and to understand how they will shape the banking sector – and in turn the shape of the SSM and priorities of the ECB. A bank's strategic response needs to consider all the forces together; tackled in isolation banks may find themselves pursuing different initiatives in incompatible directions. There are also implications for operations, systems and controls, business model and governance.

The cost and complexity of the response will vary across banks according to their size and business model, so each bank needs to identify its own approach. How this plays out for Eurozone banks will depend on competition and consolidation, and on each bank's ability to respond. For all banks these factors feed into a broader profitability challenge.

Also important will be the response of the providers of key infrastructure, such as payment systems, and of governments to accommodate some of the innovations (for example, moves to further promote the Single Market within the EU, such as the Capital Markets Union (CMU), will benefit "start-ups" as well as established banks). Experience will not be the same in all countries.

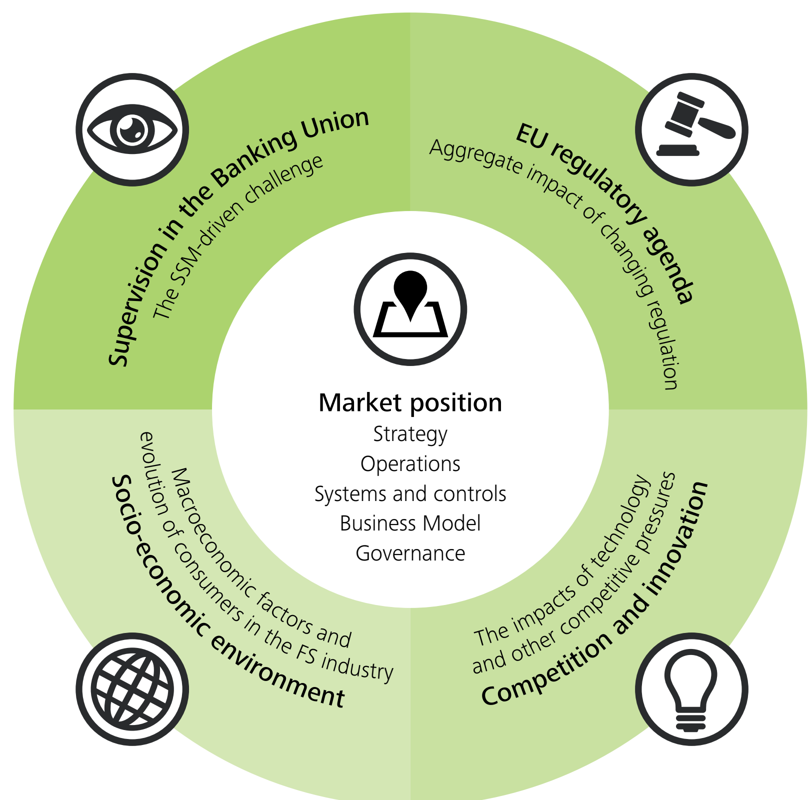
Disruptive forces

To examine this further consider the forces from the perspective of a bank in the SSM by looking at the following factors (summarised in Figure 1):

- **Changing regulatory landscape** – supervisory requirements in the SSM alongside the broader regulatory environment for banks;
- **Rapid technological change** – competition and innovation, being facilitated by the reduction in barriers to entry and evolution of the 'art of the possible' delivered through technological change; and
- **Shifting consumer preferences** – the socio-economic environment, and the implications for the demand for and consumption of banking services.

These forces will play out against the backdrop of the potentially significant effect of market consolidation, resulting in a much more integrated banking market.

Figure 1: Factors affecting the banking sector in Europe



The previous section considered the first factor, supervisory requirements, the ambition to establish a forward-looking, judgement led regime, and the expectation of more focused, intrusive supervisory intervention. Two consequences in particular, the greater emphasis on the viability and sustainability of business models, and less recognition potentially of individual circumstances, will have a direct effect on strategy. The changes to the supervisory relationship may also affect decisions on governance and organisational structure for banks.

While the regulatory landscape is evolving, the banking sector is changing as well. The number of banks under direct supervision in the SSM may grow over the next years due to new entrants joining, and consolidation in the sector. Certainly the share of bank assets under direct ECB supervision will increase.

Over the next few years, the effective reach of the SSM will expand, as unresolved aspects of its approach are addressed, such as its work on smaller banks, its approach to consistency (uniformity versus no 'one size fits all') and peer groups, and what forward-looking supervision looks like in practice. This in itself is a huge body of work, and as it is completed it will catalyse further change for banks. It is also conceivable that over time the remit of the SSM might widen, although currently no such changes are planned.

While the regulatory landscape is evolving, the banking sector is changing as well. The number of banks under direct supervision in the SSM may grow over the next years due to new entrants joining, and consolidation in the sector. Certainly the share of bank assets under direct ECB supervision will increase.

Regulatory environment

The numerous regulations developed in the aftermath of the financial crisis are driving fundamental changes in the way that banks operate.[8] The regulations are affecting strategic business decisions about markets, clients and products, legal structure, data, and technology. Beyond the direct costs of compliance, the regulations – in particular when considered in aggregate – will translate into significant additional costs of doing business.

The regulatory cornerstones of the Banking Union and other regulatory developments lay a foundation for **better capitalised, more resolvable banks**, removing the cost to taxpayers of bank failure and ensuring that consumer deposits are protected. These regulations are substantial, but they are not the only examples of regulatory change that banks need to navigate.

As the final elements of the EU capital requirements regime ("CRD IV package") are finalised (including, for example, the leverage ratio and liquidity requirements), banks have already started to assess the effects of the multiple regulatory constraints on their business models. Coupled with loss absorbing capacity requirements for resolution purposes, these different pieces of the puzzle fit together in a complex fashion, leading to substantial costs of implementation and optimisation programmes.

In the meantime, new reviews have already been added to the pipeline, including changes to the standardised approach and Risk-weighted Assets (RWA) framework, at both the BCBS and the Banking Union level. Some of these changes are potentially very material, especially for credit risk. Those will require greater investment in data analytics systems, and also adjustments to business models and strategy. Since any EU legislative proposals to respond to developments in Basel will take time, banks may face a new round of regulatory re-design just as they finally implement the Basel III requirements.

The European Commission's **capital markets and conduct initiatives**, whilst not directly in the domain of the Banking Union, have been gaining prominence for Eurozone banks and their national supervisors over the past months. A set of regulations and initiatives focused on derivatives and shadow banking are set to change the landscape in capital markets, and as a result, affect competition and profitability.[9]

Increasing regulatory focus on retail conduct issues, driven by the **consumer protection agenda**, provides an opportunity for banks to consider more than just compliance-driven changes in their operations and invest in improving customer experience. This will also help them to address competitive pressures from both peers and FinTech disruptors. The latter specifically take advantage of technological advances and win against legacy systems and old-fashioned solutions offered by many banks. With EU policy now aimed at stimulating growth, the CMU once established will open new sources of financing for businesses, so that banks may face even greater competition in their lending activities.

Coupled with loss absorbing capacity requirements for resolution purposes, these different pieces of the puzzle fit together in a complex fashion, leading to substantial costs of implementation and optimisation programmes.

By 2020, Eurozone banks will, in aggregate, have spent billions of euros on compliance with EU regulations and embedding these in business models. The volumes of new regulatory reporting will require banks (as well as supervisors) to have appropriate data capabilities. The winners will be those who will be able to use these drivers to build up competitive advantage by re-jigging their businesses, investing in "re-inventing" themselves and thinking (at least) two steps ahead.

Competition and innovation

Technology has become a powerful disrupting factor for the financial services industry and will increasingly shape banks' competitive positions. Customer experience, efficiency and security are the key challenges. Both retail and wholesale banks are facing competition from outside the traditional banking sector, as FinTech companies and alternative lenders have started to acquire market share due to their innovative solutions and adaptability. More broadly, competition across the Eurozone will be a driver for likely wide-ranging consolidation.

Rapid advances in technology, coupled with booming investment in the FinTech sector, have created a new generation of disruptive non-bank players in the financial services industry, not burdened by comparable supervisory or regulatory pressures and boasting faster, leaner and often more financially attractive services and products.

Deloitte's research with the World Economic Forum identified key innovation pressures on traditional business models across six areas of the industry.
For banks, the most important pressures relate to payments, deposits and lending, and capital raising. Economies of scale are likely to erode, with 'unbundling' of banking services, especially in payments, and fewer cross-subsidies. There will be a need either to withdraw from some business lines, or to partner with non-traditional players, innovating, or 'letting go' of some of their traditional businesses.

Data capabilities are crucial not only for delivering high-quality services, but also for building up customer knowledge essential for maintaining relationships and keeping up with changes in consumer tastes and needs. As a result banks may rely more on external providers to deliver online and mobile solutions in a timely manner.[10]

As banks make these changes, it will be essential to give appropriate focus to how to accommodate the needs of customers.

The emergence of accessible and efficient peer-to-peer lending and capital raising platforms is another example of new disruptive competitors for banks. Crowdfunding is seen by some as an alternative to low yields offered by banks on their deposit products. It has been on the rise across the EU and could benefit from CMU developments. Traditional banking channels will need to adjust to these shifting customer preferences and compete with alternative lending providers by offering more attractive products for consumers.

Until recently banks have invested relatively little in FinTech. In 2014 they accounted for around 20% of the $10 billion total invested,[11] a fraction of their aggregate regulatory compliance-related spending over the past years. This will not be sustainable if banks are to improve organisational effectiveness and deal with legacy systems. Smaller banks and new entrants have a certain advantage as they should be better equipped to turn around and upgrade their systems and be more flexible. All players will also need to invest in cyber security, which will be essential for running sound day-to-day operations.

There will also be regulatory challenges accompanying those innovations. These include both policy developments, such as the European Commission's plan for the Digital Single Market[12] and forthcoming Green Paper on retail financial services, and new regulations developed in response to the innovations made.

Not only do banks need to respond to this fundamental challenge, but supervisors will need to follow suit and understand the risks and opportunities these pose both for customers and for the banks they supervise. This is no less true for the ECB than others. Responding to the new competition will require banks to re-think their current product and service offering, including deciding on potential spin-offs or acquisitions, and investing in innovation in a targeted manner, focusing on a number of key areas. Banks need to focus on delivering fully virtual and cyber-safe services and operations that are able to cater to heightened customer expectations. Supervisors need to understand this new agenda and ensure they respond to it in the approach they take.

Socio-economic environment

It is tempting to think that the environment for banks is set only by technology and regulation – and by the opportunity to generate profits that results. It is clear though that other factors are important in setting the agenda, including the societal view of banks and banking, and the demand for banking services.

Deloitte's research with the World Economic Forum identified shifting consumer preferences as a disruptive force. One reason consumer preferences change at an industry level is the societal view of banking. Seven years on from the start of the financial crisis, there remains a debate as to the role and value of banking. The ascendency of alternative platforms to access financial services through technological innovation and the promotion of alternatives to bank sources of finance through the CMU initiative are ensuring alternatives are available, but the legacy of the financial crisis on public perceptions is an important factor in the viability of such alternatives.

Also important in changing the demand for services are demographic trends – an ageing population – and the continuation of the increasing financialisation of the economy. Although not dealt with in this paper, each of these is a significant issue that warrants careful consideration.

Successful banks will take account of such factors in their strategy, and accommodate a range of options.

Playback to the SSM

Even as the ECB transitions to business-as-usual supervision over the next few years, it will find that the profile and issues of the banks it supervises are evolving because of the disruptive forces that have been identified. The changing shape of the banking sector will play back to the Banking Union itself, forcing it to re-think approaches, priorities and focus.

For example, one of the key issues identified in the World Economic Forum report was that collaboration between regulators, incumbents and new entrants will be required to understand how new innovations alter the risk profile of the industry – positively and negatively. Another key question is how supervisors will take advantage of technological developments to change the way that they supervise banks. For them, too, the changes bring risks and opportunities.

The changing shape of the banking sector will play back to the Banking Union itself, forcing it to re-think approaches, priorities and focus.

Conclusion

Banks could take the view that as the new supervisory approach is developed and embedded, banking in the SSM will become "business as usual" – the supervisory relationship that they have always maintained, albeit with new protagonists. This paper has though argued for a different perspective. First, the aspirations of the ECB senior management team and of the politicians that created the SSM still have some way to run. Requirements that have been put in train will still take some time (perhaps years) before their full effect and implications are known.

Both regulators and the regulated need to remain attuned to the fundamental changes underway in financial services, which could well require both to alter their business models and ways of operating.

Second, banking and banking regulation are anyway undergoing significant change, which demands a proactive response from banks. Banks inside and outside the Banking Union face these issues, but the additional uncertainty about the SSM compounds the challenge for those banks subject to it. Moreover, the optimal response to supervisory requirements can only properly be judged by taking a broader view of regulation and other forces affecting the banking sector.

Finally, both regulators and the regulated need to remain attuned to the fundamental changes underway in financial services, which could well require both to alter their business models and ways of operating. Otherwise, in 2020 the public is likely to see both as stuck in the past, with the danger that they are seen as anachronistic and, ultimately, irrelevant.

Contacts

Francisco Celma
EMEA FSI Co-lead & FSI Leader Spain
fcelma@deloitte.es

Nick Sandall
EMEA FSI Co-lead
nsandall@deloitte.co.uk

EMEA Centre for Regulatory Strategy
Clifford Smout
Partner
csmout@deloitte.co.uk

Simon Brennan
Director
simbrennan@deloitte.co.uk

Katrin Budy
Manager
kbudy@deloitte.de

Kateryna Bobrova
Assistant Manager
kbobrova@deloitte.co.uk

Banking Union Centre in Frankfurt
Hans-Jürgen Walter
BUCF Leader
hawalter@deloitte.de

Dan Keeble
BUCF Partner, UK
dkeeble@deloitte.co.uk

Miguel Ángel Bailón
BUCF Partner, Spain
mbailon@deloitte.es

Ronald Koppen
BUCF Partner, Netherlands
RoKoppen@deloitte.nl

Nicolas Fleuret
BUCF Partner, France
nfleuret@deloitte.fr

Diego Messina
BUCF Partner, Italy
dmessina@deloitte.it

Bernard de Meulemeester
BUCF Partner, Belgium
bdemeulemeester@deloitte.com

Marijan Nemet
BUCF Partner, Germany
mnemet@deloitte.de

Martin Flaunet
BUCF Partner, Luxembourg
mflaunet@deloitte.lu

Alexandra Kostara
BUCF Partner, Greece
akostara@deloitte.gr

Oana Petrescu
BUCF Partner, Central Europe
opetrescu@deloittece.com

Colm McDonnell
BUCF Partner, Ireland
cmcdonnell@deloitte.ie

Miguel Morais
BUCF Partner, Portugal
mmorais@deloitte.pt

Endnotes

1 See Deloitte's previous paper on the SSM, 'Getting to grips with the new regime', May 2015, http://www2.deloitte.com/uk/en/pages/financial-services/articles/single-supervisory-mechanism.html.

2 See 'A Roadmap towards a Banking Union', a Communication from the European Commission to the European Parliament and the Council, September 2012, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012DC0510.

3 'Banking Union: meaning and implications for the future of banking', a speech by Vítor Constâncio, Vice-President of the ECB, at the Banking Union Conference organised by the Master in Banking and Financial Regulation, Navarra University, Madrid, 24 April 2014, https://www.ecb.europa.eu/press/key/date/2014/html/sp140512.en.html.

4 That said, Danièle Nouy recently made clear in an interview with Expansión newspaper that whilst the ECB might draw on the example of the US Federal Reserve's stress testing exercise, for the time being the approach was not suitable for European banks, https://www.bankingsupervision.europa.eu/press/interviews/date/2015/html/sn151013.en.html.

5 Comments quoted by Reuters in 'Bundesbank mahnt EZB zu mehr Transparenz bei Bankenaufsicht', http://de.reuters.com/article/economicsNews/idDEKCN0RW0XN20151002.

6 The STE is a quarterly reporting requirement developed by the ECB. It requires reporting by all significant institutions on all significant risks (credit, market, operational, interest rate risk in the banking book) as well as profit and loss information.

7 'The Future of Financial Services: how disruptive innovations are reshaping the way financial services are structured, provisioned and consumed', June 2015, http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Financial-Services/gx-fsi-wef-the-future-of-financial-services.pdf.

8 For an overview of regulations in development see, for example, 'Top 10 for 2015: Our outlook for financial markets regulation', http://www2.deloitte.com/uk/en/pages/financial-services/articles/regulatory-top-ten-for-2015.html.

9 See 'The CMU action plan: the long and winding road', http://blogs.deloitte.co.uk/financialservices/2015/10/the-cmu-action-plan.html.

10 'Cleared for takeoff', 2015, http://www2.deloitte.com/content/dam/Deloitte/ca/Documents/financial-services/ca-en-the-future-of-financial-services.PDF.

11 See 'Payments Disrupted: the emerging challenge for European retail banks', http://www2.deloitte.com/uk/en/pages/financial-services/articles/payments-disrupted.html.

12 See the European Commission's website for further information on the Digital Single Market, http://ec.europa.eu/priorities/digital-single-market/.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.co.uk/about for a detailed description of the legal structure of DTTL and its member firms.

Deloitte LLP is the United Kingdom member firm of DTTL.

This publication has been written in general terms and therefore cannot be relied on to cover specific situations; application of the principles set out will depend upon the particular circumstances involved and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this publication. Deloitte LLP would be pleased to advise readers on how to apply the principles set out in this publication to their specific circumstances. Deloitte LLP accepts no duty of care or liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

© 2015 Deloitte LLP. All rights reserved.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

Designed and produced by The Creative Studio at Deloitte, London. J1368.