

European Banking Union

Overview of the proposed changes



The European Parliament (EP) voted on 12 September 2013, in favour of the Regulation setting up a Single Supervisory Mechanism (SSM) in the Eurozone.

The outcome of this legislative process, which formally began exactly one year ago with a proposal from the European Commission (EC), is the transfer of prudential regulatory powers from Eurozone national authorities to the European Central Bank (ECB).

As a result, approximately 130 of the Eurozone's biggest banks will be directly supervised by the ECB. The ECB will also be responsible for the overall oversight of prudential supervision in the Eurozone. Non-Eurozone EU member states can opt-in to the SSM.

What was discussed on 12 September 2013?

In reality, agreement on nearly all aspects of the SSM was reached in the trialogues between the EP, the Council and the EC in March this year.

The EP's final Plenary vote was however postponed until 12 September 2013, due to MEPs' concerns that the existing accountability mechanisms of the ECB were insufficient, particularly in order to maintain the separation between the ECB's monetary policy function and its newly acquired supervisory role.

In the lead up to EP vote, an institutional agreement between the ECB and the European Parliament was reached to address these concerns. The key terms of the agreement are reported to be:

- The ECB must submit the most important information from the minutes of the Board of Supervisors to the European Parliament;
- If the Governing Council of the ECB rejects a decision of the Board of Supervisors, the President of the European Parliament or the chairperson of the relevant committee must be informed;
- The Chair of the Single Supervisory Mechanism must be appointed by the

Parliament and the Council. The Parliament can initiate the dismissal of the Chair;

- The vice chair (a member of the ECB Governing Council) must also be approved by the Parliament;
- The ECB has to answer oral and written questions by the European Parliament. If certain points need to be kept confidential, in camera discussions are possible;
- If the Parliament initiates inquiries the ECB has to cooperate as for a committee of enquiry. This makes scrutiny much easier for the Parliament; and
- The ECB must inform the Parliament about supervisory activities regularly.

This summary was made available in a press release from the Greens/European Free Alliance.

Initial assessment

On 12 September 2012, the European Commission published its proposals for a single supervisory mechanism (SSM), a key element of the proposed banking union ("the Union"). The core of the SSM will be the transfer of all responsibilities and powers for the authorisation and prudential supervision of credit institutions (i.e. banks) in the Eurozone to the European Central Bank (ECB).

The ECB's objectives will be to promote the safety and soundness of credit institutions and the stability of the financial system. National competent authorities (NCAs), i.e. banking supervisors in the Eurozone, will continue to have a significant role in carrying out a wide variety of operational prudential supervisory activities, and will remain responsible for conduct of business supervision.

However, the ECB will be firmly in charge and will ultimately be able to instruct NCAs. Precisely how activities and tasks will be divided between the ECB and NCAs will have to be determined, although the documents published today contain some useful examples of the types of activity that may fall to NCAs.

It will remain open to other non-Eurozone Member States to "opt in" to the SSM, provided they undertake to comply with ECB acts and instructions.

The responsibilities of the European Banking Authority (EBA) will remain essentially unchanged. It will be responsible for the single rulebook which will apply across the EU as a whole.

In addition, it has now also been tasked by the Commission to prepare a single supervisory handbook – a "how to do it" manual for supervision across the EU.

The ECB will co-ordinate the input of the SSM countries into the EBA which we assume means that the SSM will speak and vote as one. The EBA's governance arrangements will be changed to reflect this new reality and provide safeguards for both the Union and non-participating Member States.

There are no new proposals on Deposit Guarantee Schemes or resolution in today's announcement.

However, in its **roadmap document**, the Commission has signalled its intention to bring forward a proposal for a single resolution mechanism for the Union which would enable credit institution resolutions and co-ordinate the application of resolution tools within the Union.

As expected, these are far-reaching proposals which will fundamentally change the balance of responsibility for banking supervision within the Eurozone.

Inevitably, the initial focus will be on the political debate and negotiation that will follow – very quickly, if the Commission's ambition of having the proposed Regulation agreed by the end of the year is to be realised.

In this document we focus instead on providing a summary of the proposals (see below) and on the main practical issues and challenges, of which we have identified six:

Giving the ECB responsibility for prudential supervision of all credit institutions in the Union is a necessary step in creating the SSM.

But it is not in itself sufficient, if the SSM is to correct the "supervisory failings" that have eroded confidence in the EU banking system.

A single supervisor requires a common and consistent supervisory culture, approach and risk assessment framework to be in place across the SSM, encompassing both the ECB and the NCAs.

This process of convergence of supervisory practice to produce real consistency will take years rather than months.

The full benefits that the SSM is intended to deliver to policymakers, taxpayers and the industry will emerge gradually as this process is completed.

The division of tasks and activities between the ECB and the NCAs needs to be developed.

This is hardly surprising at this early stage, but the helpful practical examples given in the papers need to be clarified as soon as possible and it would be a very positive first step if the ECB and NCAs engaged the industry in this debate.

To add to an already complex picture, NCAs will remain responsible for conduct of business and anti-money laundering supervision.

As we know, there is no clear line between prudential conduct and conduct of business in certain areas, such as governance, and there will almost certainly be some overlap.

Agreeing clear and practical co-ordination arrangements will therefore be essential.

The EBA will have a vital role in producing the single rulebook for the EU as a whole and for ensuring consistency of its interpretation and implementation inside and outside the Union.

Changes will be made to its governance and voting arrangements in order to assist the EBA in this regard. Notwithstanding these safeguards, the ECB/SSM will come to exercise a very powerful, possibly dominant, role in EBA policy-making.

The Commission proposes giving the ECB the power to impose significant financial penalties on credit institutions for breaches of the rules.

It is silent on procedural safeguards, including rights of representation and appeal. These will need to be put in place in due course.

The proposals have little new to say on resolution, although the Commission has indicated that it will bring forward proposals for a single resolution mechanism to co-ordinate resolution activities.

The role and nature of this mechanism will be critical to ensuring effective crisis management and resolution proceedings.

The details, when they emerge, need to answer decisively the question of which body is ultimately in charge in a crisis.

The ECB will fund its supervisory activities by a levy on credit institutions.

It is possible that some of these additional costs may be offset by reduced fees levied by NCAs. However, it seems unlikely that a new layer of supervision can be added without some net increase in costs to the industry.

More positively, the ECB will be required to publish a separate budget and accounts for its supervisory function, which will introduce useful transparency.

Today's proposals provide all credit institutions in the EU with ample food for thought. The ambitious implementation timetable, the expected raft of documents on how the new regime will work in practice and the forthcoming proposal on the 'missing link'

(i.e. single resolution mechanism) will further add to firms' 'to-do' lists.

It is thus essential that all those affected start assessing the potential impact of these proposals on their operations and their supervisory relationships as soon as possible.

Summary of key proposals

Membership and scope

At the heart of the SSM is the proposal to designate the ECB as the body responsible for specific tasks concerning the prudential supervision of credit institutions which are established in Member States whose currency is the euro (currently 17) Member States whose currency is not the euro are allowed to participate in the SSM and will be able to enter into "close (supervisory) cooperation" with the ECB, subject to meeting specific conditions.

The ECB will carry out supervisory tasks assigned to it in Member States with which it is in close cooperation, and the NCA of that Member State will have to abide by ECB guidelines and requests.

Authorisation

Applications for authorisation are to be submitted to a relevant NCA which determines if it meets conditions for authorisation in national law.

If the application meets national criteria, the NCA proposes to the ECB that the ECB should grant authorisation. ECB will then determine whether the application meets the provisions of EU law and grants authorisation if they are.

Authorisation may be revoked either at the initiative of the NCA or the ECB.

Rule and policy making

Policy and rules will continue to be made by the EBA with a strong commitment to a single rulebook.

The EBA will now be able to exercise its powers and tasks with respect to the ECB as well, which has been designated a "competent authority" for this purpose (in addition to NCAs).

The ECB will co-ordinate and “express a common position” of the Eurozone Member States for matters falling under its scope when they participate in the Board of Supervisors (BoS) and the Management Board of the EBA.

The Management Board will always include at least two Member States which do not participate in the SSM.

EBA decisions concerning regulatory matters (binding technical standards, guidelines and recommendations, decisions to reconsider restrictions on financial activities) and budgetary matters will continue to be taken by the BoS by a qualified majority of its members.

Voting on action in emergency situations will also remain unchanged (taken by simple majority).

Settlement of disputes and disagreements

The EBA's powers have been amended to allow it to address binding decisions to the ECB on action on settlement of disagreements.

Decisions on breaches of EU law and settlement of disagreements will be considered by a new independent panel of experts, consisting of a Chairperson and two members (one each from Member State participating and not participating in the SSM) appointed by the EBA BoS from its voting members.

Decisions proposed by this panel are considered as adopted unless rejected by the BoS by a simple majority, but only if it includes at least three votes from each of the participating and non-participating Member States in the SSM.

Supervision

Prudential supervision of credit institutions will transfer to the ECB. The ECB will carry out its tasks within a SSM which will include NCAs.

The supervision of conduct, anti-money laundering responsibilities and the supervision of third country credit institutions establishing branches/providing cross-border services within a Member State will remain with the NCA.

The ECB will assess acquisitions and disposals of holdings in credit institutions.

The ECB will monitor compliance against capital requirements, large exposure rules, liquidity and leverage rules, own funds requirements and public disclosure obligations.

Where provided for in EU Acts, the ECB will have the power to set higher prudential requirements and apply additional measures to credit institutions.

The ECB will be able to impose additional capital buffers including a conservation buffer and a countercyclical buffer and monitor compliance against them.

The ECB will carry out supervisory stress tests.

Supervisory powers will extend to governance arrangements, systems and controls and Pillar 2.

Not only will the ECB be the consolidated supervisor for parent credit institutions established within the Union, but it will also participate in consolidated supervision of groups outside of the Union.

The supervisory responsibilities of a NCA for a credit institution in a Member State outside the Union which establishes a branch/provides cross-border services within the Union will transfer to the ECB.

The ECB will participate in relevant supervisory colleges, including those for credit institutions outside the Union which operate a branch/provide cross-border services within the Union.

The EBA will be tasked with devising a single supervisory handbook to complement the single rulebook.

Investigation

To perform investigations the ECB will have the power to request information from credit institutions, financial holding companies (including mixed financial/activity holding companies); persons involved in the activities of any of these institutions; third parties with outsourced responsibilities; or persons otherwise “closely connected” with the institutions.

The ECB will have also the power to interview these institutions and persons and to examine their books of record.

All entities and persons outlined above may be subject to an on-site inspection including inspection without prior announcement.

Enforcement

The ECB will have powers to impose sanctions which are aimed at being “effective, proportionate and dissuasive”.

The ECB may fine credit institutions for breaches of directly applicable Union Acts up to twice the amount of profit made/losses avoided or up to 10% of total turnover in the preceding year.

Where the entity being fined is a subsidiary of a parent undertaking, the fine will be calculated on the basis of the total annual turnover of the ultimate parent undertaking.

In cases other than those outlined above, the ECB may require NCAs to impose sanctions if it deems it necessary for the performance of its supervisory tasks.

Resolution

The ECB will have the power to carry out early intervention actions as defined in EU law including coordination with the relevant authorities.

The ECB will have a role to play in cross-border crisis management groups and resolution colleges.

A single resolution mechanism will be created (by a separate legal bill) with responsibility for resolution of banks and to coordinate the application of resolution tools for credit institutions within the Union. Additional crisis management and resolution responsibilities could be given to such a mechanism.

It is not envisaged that a single resolution fund will be created.

Governance and resourcing

The proposal recognises the need for the ECB to be held accountable for its decisions given the wide-ranging powers it will acquire. In addition to being bound by general rules on due process and transparency, it will be accountable to the European Parliament and the Council of Ministers.

Due to concerns around conflicts of interest the ECB will need to ensure that supervisory

activities are carried out in full separation from its monetary policy functions.

The ECB must exercise its supervisory responsibilities in full independence from Union institutions and governments.

A new supervisory Board will be created and comprise representatives of the ECB and NCAs (including those who have established close cooperation with the ECB). It will have a chair and vice-chair who will be elected from the ECB Governing Council for a non-renewable term of no more than five years.

A new Steering Committee will be formed by a subset of Board members.

The Chair of the EBA and European Commission will be observers on the Board but will have no role on the Steering Committee.

The ECB will levy a supervisory fee on the credit institutions it supervises, which will be proportionate to the risk profile of the firm. This will form a separate ECB budget whose detailed accounts will be published annually.

NCAs will second staff to the ECB.

Timetable and transitional provisions

The ambition is for the Regulation to be agreed in the coming months and to enter into force by 1 January 2013, with the ECB to assume full powers by January 2014 at the latest.

The ECB reserves the right to start carrying out its responsibilities before January 2014, in particular for institutions which have requested or received financial public assistance.

For all other credit institutions, ECB supervision will be phased in: on 1 July 2013 for systemically important Eurozone credit institutions; on 1 January 2014 for other credit institutions.

The first group will be determined on the basis of cross-border activity and size, covering at least 50% of the Eurozone banking sector as at 1 January 2013. The list will be published before 1 March 2013.

From 1 January 2013, the ECB will have the power to request information from NCAs of participating Member States. This information will be used to inform the ECB's view on the credit institutions which should be included initially.

Until implementation of the Capital Requirements Directive IV and the accompanying Regulation and changes to the Financial Conglomerates Directive the ECB will exercise its powers over the credit institutions within scope through instruction to the existing NCA.

The Regulation allows for the 'grand-fathering' of existing credit institutions so that they can carry on their business without reapplying for authorisation.

NCA's will need to provide the ECB with a list of currently authorised credit institutions (i.e. beyond the anticipated first cut of credit institutions within scope) together with a report on their supervisory history and risk profile.

Review

The impact of SSM will be specifically examined in the forthcoming review on the functioning of the European Supervisory Authorities (ESAs), which will be published by the Commission at the beginning of 2014.

In addition, a holistic review of the SSM and its impact will be published by 31 December 2015, and will address the functioning of the ECB within the European System of Financial Supervision (ESFS), the effectiveness of independence, accountability and governance arrangements and the interaction between the ECB and the EBA.

Next steps

Following the entry into force of the SSM Regulation, the ECB formally begins relevant preparatory work:

- One aspect of this preparatory work is the appointment of an SSM Supervisory Board. This body will then be tasked with key decisions on the operationalisation of the SSM.
- The ECB will have a minimum of one year since entry into force to take over supervisory responsibilities.
- However, the SSM regulation does have a provision enabling the EC, the EP and the Council to delay the go-live date if deemed necessary.
- A priority for the ECB will be to conduct an Asset Quality Review (AQR) of the banks it will directly supervise.

The SSM is only one of the pillars of the Banking Union. Following the SSM agreement, attention will now increasingly turn to the Single Resolution Mechanism (SRM), proposed by the EC on 10 July.

Contact



Vincent Gouverneur
Partner – EMEA Investment Management Leader
vgouverneur@deloitte.lu



Martin Flaunet
Partner – Banking & Securities Leader
mflaunet@deloitte.lu



Raphaël Charlier
Partner – Audit
rcharlier@deloitte.lu



Basil Sommerfeld
Partner – Operations & Human Capital Leader
bsommerfeld@deloitte.lu



Benjamin Collette
Partner – Strategy & Corporate Finance Leader
bcollette@deloitte.lu

Deloitte is a multidisciplinary service organisation which is subject to certain regulatory and professional restrictions on the types of services we can provide to our clients, particularly where an audit relationship exists, as independence issues and other conflicts of interest may arise. Any services we commit to deliver to you will comply fully with applicable restrictions.

About Deloitte Touche Tohmatsu Limited:

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, 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.com/lu/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte has in the region of 200,000 professionals, all committed to becoming the standard of excellence.