EUROPEAN CENTRAL BANK

BANKING SUPERVISION

The Legal Framework of the SSM – Pillar 2 vs. Pillar 1?

Séminaire AEFR -

Impact de la Surveillance sur la Régulation Bâle III

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Disclaimer

The views expressed in this presentation do not necessarily represent the views of the ECB and the SSM.

Supervision is determined by relevant Union and national law

ECB decisions and actions are governed by many different laws

- Regulations (including national legislation exercising options)
- Directives → national law implementation
- Delegated/Implementing Regulations (RTS/ITS)

Beyond Single Rulebook – common supervisory approach/ culture:

- EBA Guidelines
- EBA Opinions
- EBA Q&As

Micro-prudential supervision as part of a broader legal and institutional framework

Many prudential supervisory decisions need to be taken having regard to other areas of supervision

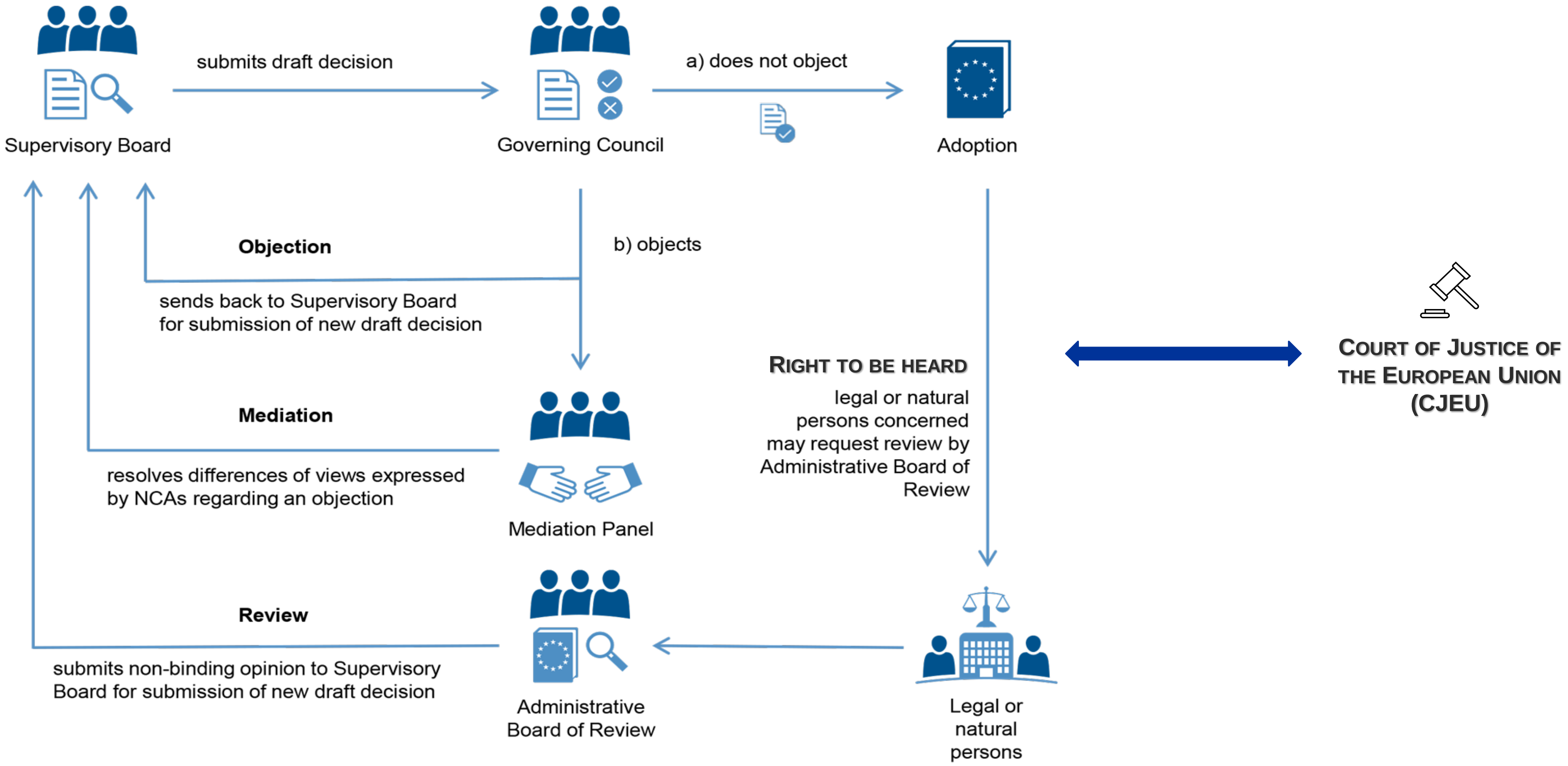
Institutional

Legal

- Single rule book is backbone of SSM work
- Remaining areas of necessary harmonisation
- Still differences in less harmonised areas which are relevant for banks, such as corporate law and consumer protection
- Supervisory powers often depending on national laws (CRD implementation and national discretions, national powers)
- Cooperation agreements for sharing information and collaboration in place

Supervisory decisions are taken following due process

Multi layer decision making ensures that different perspectives are duly reflected in every supervisory decision



Which supervisory decisions are we taking?

Statutory Permissions

National law, CRR, CRD

National powers
- e.g. mergers, change of statutes

Common procedures
- Qualifying holdings
- Banking authorization

CRR permissions
- e.g. internal models, waivers

CRD permissions
- e.g. FHC authorization, Fit and Proper (FAP)

Permission

Permission with Conditions or Obligations

Rejection

Revocation Withdrawal

Pillar II Powers

Article 16(1) SSMR

(a) Breach of relevant Union law

(b) Likely breach of relevant Union law

(c) Risk not covered and managed

Tools such as:

- Capital: Additional own funds
- Plan: Present a plan
- Process: Improve processes
- Restriction: Restrict business
- Removal: Removal of board members

Enforcement and Sanctions

Article 18 SSMR

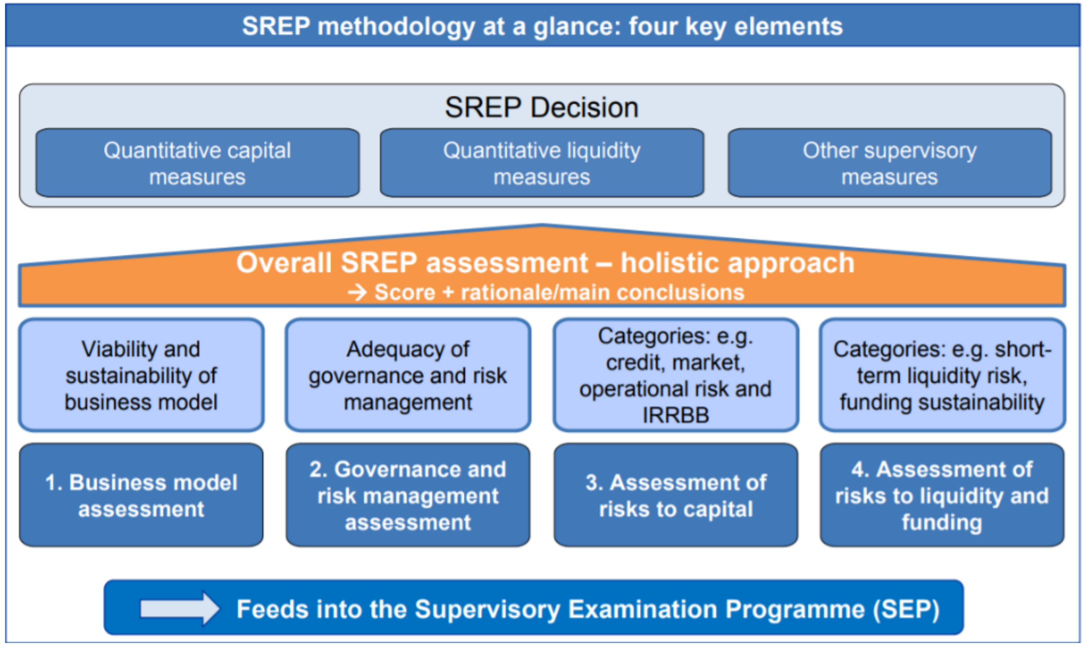
Direct ECB Sanctions — Article 18(1) & (7): Breach of directly applicable Union law + ECB regulation/decision

Sanctions via NCA — Article 18(5): Cases not covered by Article 18(1)

Enforcement via Periodic Penalty Payments — Regulation (EC) No 2532/98

Rule based vs. principle-based requirements

- EU legislation sets minimum capital / own funds requirements for all banks operating in the EU. These requirements are referred to as **Pillar 1 requirements** and cover in particular credit risk, market risk and operational risk (including internal models) and capital definitions
- **Pillar 2 Requirements (P2R)** are a **bank-specific** capital requirements which apply in addition to Pillar 1 requirements. Supervisors need to cover risks which are underestimated or not covered by Pillar 1, based on a firm-specific process, examining the risks of individual banks (blanket minimum requirements for specific risks are not allowed).



- ➢ Need for convergence and predictability of supervisory action promotes detailed regulation
- ➢ Existing regulation is heavily rule based. This can promote check the box and template-based supervision.

The ECB strives to provide ex-ante guidance on how the regulatory framework will be applied

ECB ensures transparency towards banks and markets:

- ECB Regulations (OND)
- Guides (e.g. OND, climate risks)
- Letters
- Expectations

These are consulted with industry, and coupled with various outreach initiatives

→ Transparency and predictability of supervisory actions is key in any supervisory activity while preserving flexibility to react to institution specific situations

Some illustrative challenges in the current supervisory architecture

- Fragmentation: Is the current legal and institutional framework facilitating the establishment and supervision of a pan European group?

  Example: different treatment between domestic and cross border liquidity and capital waivers but also different frameworks for conduct promote domestically funded and tailored business models

- Level playing field: National options will lead to different outcomes across countries

  Example: differences in process in FAP assessment might lead to unlevel playing field with regards to the appointment and evaluation of key board members (ex ante vs. ex post assessment)

- Which definition of proportionality? (institution or risk based?)

  Example: treatment of Small and non complex institutions. Comprehensive assessment of risks of an individual institution and wider implications regarding resolvability and impact on other institutions

- How to achieve judgment <u>and</u> consistency?

Regulation key in empowering supervisors and ensuring level-playing field

- Regulation sets the framework for the exercise of supervisory powers, but also determines the structure and resilience of the European banking market
- Important to ensure that this framework remains fit-for-purpose, also to deal with present challenges (ESG, digital, geopolitical risks) => maintain the ability to react to new risks
- Regulatory amendments to the EU BANKING Package should help to:
  - Empower supervisors to more risk based supervision
  - Increase the capacity of supervisors to ensure a greater level-playing field
  - Allow for a more effective and efficient discharge of supervisory functions
- Ultimately, this will also benefit the industry as it allows for more targeted, effective, and efficient supervision.