BANKING UNION

The new framework of supervision and regulation





Agenda

- I. Banking Union
- II. Single Supervisory Mechanism (SSM)
- III. Single Resolution Mechanism (SRM)
- IV. Deposit Guarantee Schemes (DGS)
- V. Challenges for the European Financial System







debt crisis

in 2010

2015 | June

Needs Reduce Increase the interdependence solidity of between the **Financial** Eliminate the banking sector discrepancies crisis in European and sovereigns in the banking 2007 Member sector Standardise States' prudential supervision rules criteria **European System of Financial Supervisors (ESFS*)** ✓ Opacity of financial European Systemic Risk Board ESRB) Sovereign European Banking Authority(EBA)

✓ Dispersal of supervisory

structures

imbalances

✓ Macroeconomic

Banking Union

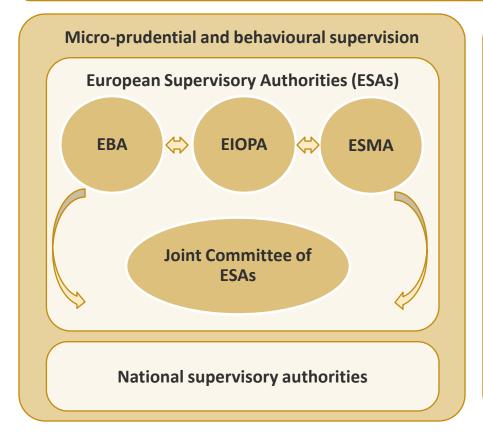


- 3 pillars:
 - √ Single Supervisory Mechanism
 - ✓ Single Resolution Mechanism
 - ✓ Deposit Guarantee Scheme
- More transparent systematic enforcement of the same rules for supervision, recovery and resolution of banks
- Deeper supranational integration in the financial sector under centralised supervision
- More concerted, timely, efficient action for banks experiencing difficulties with a view to protecting taxpayers' money

- **Occupational Pensions** Authority(EIOPA)
- European Securities Market Authority (ESMA)
- > Joint Committee of European Supervisory Authorities (ESAs)
- National supervisory authorities 2011



European System of Financial Supervisors (ESFS)



Macro-prudential supervision

European Systemic Risk Committee

- **≻ECB**
- **➤** National central banks
- **European Supervisory Authorities (ESAs)**
- **European Commission**

National supervisory authorities

President of the Economic and Financial Committee





Single Supervisory Mechanism



 Consisting of the ECB and national competent authorities (NCAs)

(SSM)

- Directly and indirectly supervises around 3,600 banks
- Classifies credit institutions as significant or insignificant. The former are under the direct supervision of the ECB, and the latter under the direct supervision of the NCAs
- Its bank supervision is effective and intrusive in order to guarantee stability, soundness and protection of the banking sector
- HQ in Frankfurt

Banking Union

Single Resolution Mechanism (SRM)

- Handles the centralised, organised, coordinated management of the resolution of credit institutions and mitigates the risks to the stability of the financial systems of the Banking Union Members States
- Reduces interdependence between the banking sector and sovereigns
- Creates a supranational mechanism for funding resolution
- HO in Brussels

Deposit Guarantee Scheme (DGS)



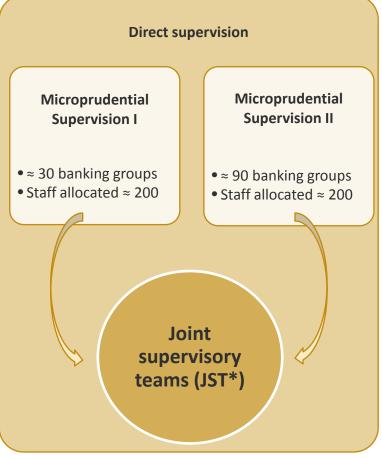
- Protects depositors from the effects of the insolvency of a credit institution
- The publication of the DGS Directive in 1994 and the revisions that followed as were designed to harmonise national frameworks for deposit guarantee schemes
- In the 2014 revision, the Directive enshrined the role of assisting the DGS to the funding of resolution of credit institutions
- The plan to create a common European deposit guarantee scheme has no implementation date as yet

Single Rulebook

SSM Supervisory Manual



Organisational structure: 4 general directorates and 1 back office



Indirect supervision

Microprudential Supervision III

- Institutional and sectoral supervision
- Control of supervision and NCA relations
- Analytical and methodological support
- Staff allocated≈ 80

Horizontal supervision

Microprudential Supervision IV

- Analysis of risk in the SSM
- Guaranteed quality of supervision
- Supervision policies
- Execution and sanctions
- Crisis management
- Internal models
- Staff allocated≈ 250

Secretariat

Secretariat of the Supervisory Board

- Decision-making policy
- Decision-making process
- Staff allocated ≈ 30

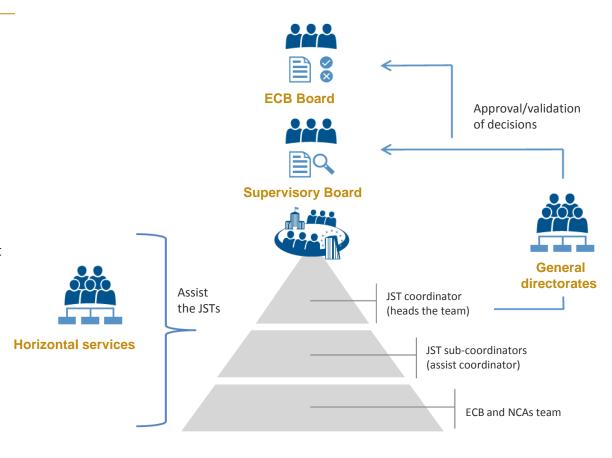
Source: ECB





Direct supervision: joint supervisory teams

- A JST is set up for each significant banking group
 - Each JST includes members of the ECB and NCAs (not only from the group's country but also from other Member States)
 - ✓ It is headed by an ECB coordinator
 - ✓ The size of each JST depends on the nature, complexity, scale, risk profile and business model of the institution in question
- They exercise permanent supervision of significant banking groups
- They implement decisions of the Supervisory
 Board and the ECB Board related to their remit
- They develop and implement a supervision plan for each significant credit institution

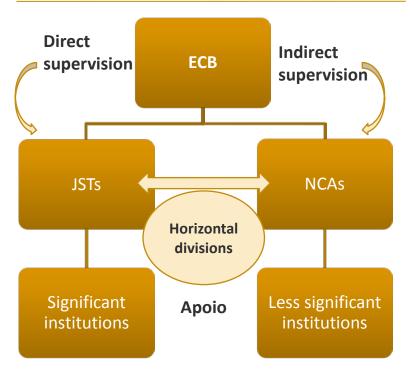


Source: ECB





I. Sharing competences in the SSM



II. Criteria for determining significant status



Source: ECB





2013

- Preparation of the Comprehensive Assessment
- Creation of SSM Regulation and SSM Framework Regulation
- Initial draft of the Supervision Manual
- Formation of committees and working groups made up of NCAs members
- Design of organisational structure, supervisory model and information reporting model

2014

- Classification of significant (120) and less significant institutions
- Appointment of President, Vice-president and Directors-General; recruitment of experts for SSM
- Formation of JSTs and their first meetings with banking groups and NCAs
- Preparation of capital and liquidity decisions in SREP (Supervisory Review and Evaluation Process)
- Comprehensive Assessment; Development of additional regulations, methods and processes

2015

- Publication of the EBA Guidelines for the SREP and consequent implementation of the Short-Term-Exercise for the
 120 banks directly supervised in 2015 and 2016
- Formation of a working group to review national options and discretions
- Design and start of indirect supervision

Detail next 3 pages







Supervisory Review and Evaluation Process (SREP)

I. Methodology

Feasibility and sustainability of the business model

Suitability of internal control and governance system

Suitability of capital requirements

Suitability of liquidity/ funding requirements



Overall assessment of institution Score from 1 (low risk) to 4 (high risk)

Additional capital needs

Over supervisory needs (qualitative)

II. Implementation

- 2015/2016: around 120 directly supervised banking groups
- Information gathering (DG IV)
 - ✓ Reports from ICAAP and ILAAP (annual)*
 - Short-Term-Exercise: quarterly templates of quantitative data (credit, operating, market risks, interest rate, sovereign, liquidity and concentration risks and profitability projection chart)
- Calculation of score for each block (DG IV)
- Capital and liquidity assessment (JSTs):
 - ✓ Regulatory capital and liquidity (CRR/ CRDIV)
 - Challenge of banks' internal capital and liquidity estimates (ICAAP, ILAAP, peer groups)
 - ✓ Forward looking / stress testing analysis
- Final decision on supervisory measures







National options and discretion

I. Framework

Over 100 options...

Capital requirements
Regulation (CRR)

Capital Requirements
Directive IV (CRD IV)

... that can be exercised by:

Competent authorities (BdP)

Member States

... to meet the specificities of each country.

Options cover a variety of issues of two main types

- Capital requirements
- Liquidity / Leverage requirements
- Limit on major risks
- Credit risk
- Capital buffers

Phase-in

or

Permanent

II. ECB action

Assessment of importance of options = €125 bn of additional capital needs

- Inconsistent application of options can:
 - ✓ Result in discrepancies in quality of capital
 - ✓ Jeopardise the level playing field between European banks
 - ✓ Put the correct operation of the Banking Union at risk
- When the SSM goes into operation, the ECB will revise different national options in two phases in 2015:
 - 1. Classification of options on the basis of their criticality and possibility of change
- 2. Final decision on options to be dropped, maintained or altered



SSM - Supervision (4/4)



2015 | June

Implementation of indirect supervision

SSM

Microprudential Supervision III

Supervision Control and NCA Relations

- Point of contact with NCAs
- Cooperation with NCAs
- Supervision of NCAs' approaches to guarantee their quality and consistency, based on the principle of proportionality (under DG IV)

Institutional and Sectoral Supervision

- Monitoring banking subsectors and institutions in particular
- Assessment of possibility of ECB taking over direct supervision
- On-site inspections in articulation with DGV IV

Analysis and Methodological Support

- Development and updates of methodology for classifying institutions and :
 - oSREP
 - o Risk assessment system (RAS)

Microprudential Supervision IV

 Articulation with DG III divisions in guaranteeing quality of supervision, proportionality and local inspections

- Monitoring of status of less significant institutions (LSIs)
- Exchange of information and personnel between NCAs and between them and the ECB

• Regular reports on LSIs

- Draft decisions with a material impact on the LSIs and dismissal of members of the board of directors
- Periodic ex-post information on measures taken

Planning of supervision under superintendence of DGIII

Direct supervision

Less significant institutions

Next step: review of classification of High Priority
 LSIs in each country



Goals of Single Resolution Mechanism

- √ To harmonise resolution processes for credit institution within the Banking Union
- √ To create a mechanism for funding supranational resolution
- √ To guarantee that supervision and resolution are exercised at the same level
- √ To align interests and ensure the sharing of losses in the resolution de banking groups that do cross-border business
- √ To foster impartiality in decision processes and limit the risks of possible indulgence by local supervisors
- √ To give preference to cross-border solutions rather than strictly national ones
- √ To reduce interdependence between the banking sector and sovereigns

Purpose of resolution measures

- ✓ Ro ensure the continuity of financial services essential to the economy
- √ To prevent serious effects on financial stability
- √ To safeguard the interests of taxpayers and the exchequer and minimise use of extraordinary public financial support
- √ To protect depositors whose deposits are guaranteed by deposit guarantee systems
- √ To protect funds and assets held by credit institutions on behalf of their customers

Main guidelines in resolution

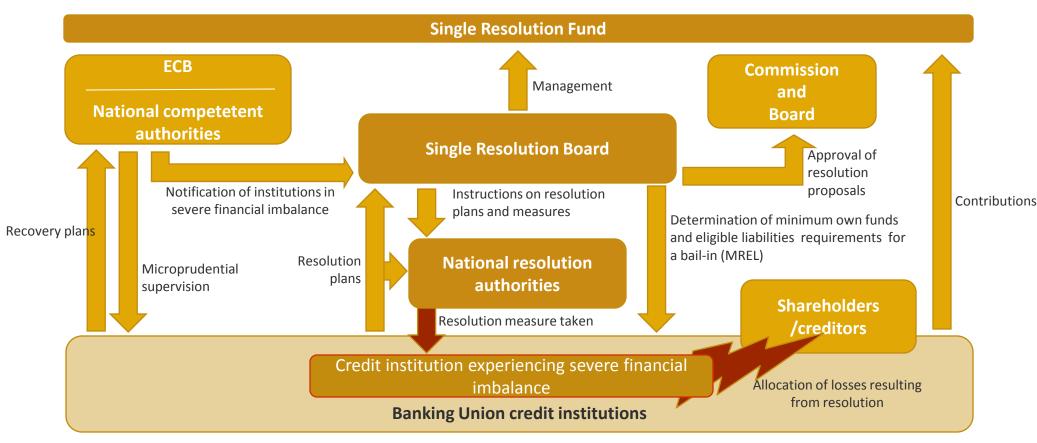
- ✓ The shareholders of the credit institution being resolved bear the main losses of the institution
- ✓ Its creditors then bear the institution 's losses on an equal footing on the basis of a scale of their credits
- ✓ No shareholder or creditor can bear a loss o more then s/he would bear if the institution went into liquidation (noncreditor worse-off)
- ✓ Depositors bear no losses on deposits guaranteed by deposit guarantee systems





How the Single Resolution Mechanism works

"The Single Resolution Board has been created to respond to the Eurozone crisis and establishes the second pillar of the Banking Union. By avoiding bail-outs and worst-case scenarios, the SRB will put the banking sector on a sounder footing - only then, can we achieve economic growth and stability" - Elke König, Chair of the Single Resolution Board







Timeline for implementing the main measures in the Single Resolution Mechanism

19 Aug 2014

Regulation of Single Resolution Mechanism (Regulation (EU) 806/2014 of 15 July came into effect

1 Jan 2015

Start of application of the Bank Recovery and Resolution Directive (Directive 2014/59/EU of 15 May)

<u>1 Jan 2015 – 1 Jan</u> 2016

Resolution plans drafted

(in accordance with Articles 8 and 9 of the do Single Resolution Mechanism Regulation)

As of 1 Jan 2016

The Single Supervisory
Board will go into full
operation with powers
and responsibilities for
resolution

31 Dec 2024

Minimum level of resources of Single Resolution Fund = 1% of total deposits guaranteed at all credit institutions in participating Member States



Centralised resolution power can go to the Single Resolution Board



Appointment of national reslution authorities



Information
gathering and
cooperation with
national resolution
authorities in
planning resolution



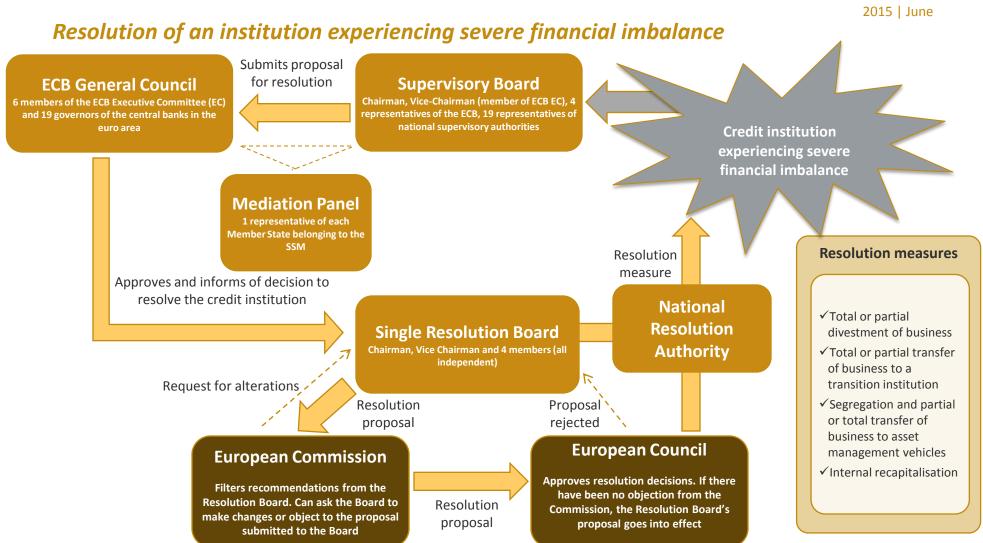
The actual date will depend on the date of ratification by all the Member States participating in the Intergovernmental Agreement on transfers and pooling of contributions to the Single Resolution Fund



The amount of the Single Resolution Fund is expected to reach 55 billion euros



SRM – Functioning and organisation (3/3)



DGS - Overview



Directive 94/19/EC

- Ensures protection of depositors throughout the European Union and obliges the Member States to introduce at least one deposit guarantee system
- Sets the minimum level of protection at 20,000 euros per depositor and per institution
- Establishes obligations of information by credit institutions to customers on deposit protection rules

Directive 2009/14/EC

- Amends the previous Directive
- Increases minimum protection to 50,000 euros and then to 100,000 as of 31 December
- Reduces deposit repayment time to a maximum of 20 business days
- Steps up obligation to inform and credit institutions must now inform customers if a financial instrument is not covered by the guarantee fund

Directive 2014/49/UE

- Amends Directive 94/19/EC
- Establishes a harmonised level of coverage of 100,000 euros, regardless of the Member State's currency
- Reduces the repayment time to 7 business days
- Harmonises DGS funding methods
- Fixes a minimum target of DGS financial resources at 0.8% of guaranteed deposits, which must be reached by 31 December 2024
- DGS now play a role of providing assistance in funding the resolution of banks

2015 | June

Funding of deposit guarantee systems

Ex-ante contributions (initial and periodic*)

If these prove insufficient...



Special contributions



Loans from gurantee systems of other EU Member States (maximum 5 years)



Loan from country's central bank and government (in latter case can be guarantees)

* By decision of the national guarantee system, payment of up to 30% of annual contributions can be replaced by irrevocable commitments to pay (collateralised by blue chip securities)



Sources:

- Website of Banco de Portugal https://www.bportugal.pt/
- Website of the European Banking Authority http://www.eba.europa.eu/
- Website of the European Commission http://ec.europa.eu/
- Website of the European Central Bank https://www.ecb.europa.eu/
- Website of the Single Supervision Mechanism (SSM) https://www.bankingsupervision.europa.eu/
- Website of the Single Resolution Board (SRB) http://srb.europa.eu/
- 2014 Annual ECB Report on supervision, March 2015
- Law 23-A/2015 of 27 March (transposing Directives 2014/59/EU BRRD and 2014/49/EU DGS)
- Decree-Law 157/2014 of 24 October (transposing Directive 2013/36/EU CRD IV) and Regulation (EU) 575/2013 of the European Parliament and of the Council (CRR)
- Regulation (EU) 1024/2013 of the European Parliament and of the Council conferring specific tasks on the ECB concerning prudential supervision of credit institutions
- Regulation (EU) 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the
 resolution of credit institutions and certain investment firms within the framework of a Single Resolution Mechanism and a Single Bank
 Resolution Fund
- The Deposit Guarantee Scheme Directives (Directives 94/19/EC, 2009/14/EC and 2014/49/EU)
- EBA Guidelines on the Supervisory Review and Evaluation Process (SREP), December 2014
- Fifth Report of the Joint Committee of ESAs on the Risks and Vulnerabilities of the European Financial System, May 2015
- Survey de 2014 do Centre for the Study of Financial Innovation (CSFI) Banking Banana Skins, April 2014