Cyril Roux: The new regulatory and supervisory roadmap for Europe

Address by Mr Cyril Roux, Deputy Governor (Financial Regulation) of the Central Bank of Ireland, at the Banking Union Conference, Dublin, 23 June 2014.

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Good morning. My thanks to the Irish Banking Federation for inviting me to address this distinguished audience. It is my pleasure to be here with you.

The last few decades have seen countries going back and forth between conducting banking supervision within or without central banks. But one thing remained constant: the domestic nature of supervision. To coordinate supervision within the EU, we have established in the past two main mechanisms: home host arrangements, and colleges of supervisors, in charge of Joint Risk Assessment Decisions. The SSM is a very big step beyond these two mechanisms for cooperation: as the name implies, we are now putting in place a unified banking supervisor in the eurozone. Creating an international banking supervisor spanning 18 countries and trillions of assets is unprecedented. It is the most significant change ever made in European banking supervision. As the other two pillars fall into place, it forms the basis of the European Banking Union, which is arguably the main European project of our time.

We have just heard from Danièle Nouy the operational challenges and opportunities presented by the Single Supervisory Mechanism as seen from the ECB, so I will share with you how we at the Central Bank prepare for the implementation of SSM on 4 November this year.

I will provide you with an update on the work we are doing to transition to this new regime of supervision, how it impacts upon the way we will organise ourselves and what it means for Irish banks.

Our transition to SSM

We have established a programme of work to prepare for implementation of SSM in the Central Bank – this project is called Project Europe.

This the most significant project currently in progress in the Central Bank.

It involves eleven divisions across the bank, from HR to Banking Supervision and IT to Legal and Enforcement, among others. They work together under 23 separate work streams to ensure that we are prepared for 4 November.

So what are we working on precisely?

We revise our internal governance, reporting and decision making processes.

We develop a Supervisory Board briefing process akin to that of the Governing Council.

We are preparing to change our divisional structure in banking supervision

We plan, devise and roll out training for all staff involved in SSM

We update all our publicly available material on banking supervision and enforcement.

We upgrade the receipt, validation and transmission tools of supervisory and statistical data

We revise our fitness and probity regulations and our internal workflow around same.

We support the Department of Finance in its drafting of transposing legislation.

In so doing, the establishment of the SSM provides us with the opportunity to improve and strengthen our tools and procedures so that we can be an even better supervisor. Our aim is not only to ensure that we will have completed all preparatory tasks in support of the ECB's preparations but also to make the necessary organisational changes to allow us to deliver on our supervisory mandate ever more effectively.

In doing so we seek to ensure that we are giving full expression to the aims and objectives of the SSM – not the mere implementation of the minimum required to be compliant with SSM methodologies and structures.

But of course, we cannot do this in isolation.

We have recently had the pleasure of hosting a series of visits by senior management of the SSM in recent weeks, and we are also looking forward to the visit of Danièle this afternoon.

In April, we were visited by Dr Korbinian Ibel who is the Director General in charge of DG IV of the SSM, which, among other tasks, is in charge of developing the SSM policies and methodologies and ensuring that all national supervisory authorities apply the SSM rules and procedures consistently, for significant and less significant institutions alike.

We held a series of meetings with colleagues from different divisions, including our risk division. Our risk based approach to supervision which was introduced by the Central Bank in 2011 has been considered in detail when devising the SSM approach of judgment based, forward looking supervision that Danièle has described. As she already indicated, the system which will be used by the SSM will be based on the PRISM system that we currently use. This software will be adapted to the SSM methodology.

More recently, in early June, we welcomed Stefan Walter and Ramon Quintana, Directors General of DG I and DG II of the SSM, with their Deputies, for another fruitful day of meetings and engagement which some of you will recall being involved in.

This afternoon, we will introduce Danièle to the Banking Supervision team and also to the wider Project team which includes colleagues from a variety of divisions including our policy and risk divisions, HR, IT, Statistics, Enforcement and Legal. We will host a town hall style meeting with all staff affected by the changes brought about by SSM. This is a fantastic opportunity for our staff to ask questions directly to the Chair.

The Central Bank of Ireland has made and continues to make a significant contribution to the SSM, at every level.

Like my fellow eurozone peers, I take part every fortnight in supervisory board meetings chaired by Danièle, with Patrick Brady as my alternate, while Derville Rowland and Joe Gavin represent us in the Legal Committee of the ECB when it meets in SSM composition.

Other ECB committees address IT, data, HR and Communication issues for the SSM. In banking supervision matters, we also contribute to many more technical meetings that take place in Frankfurt and around Europe at an ever increasing pace.

We also contribute to the staffing of the SSM. 200 staff from authorities all over Europe have been seconded to the SSM to date; 11 are from the Central Bank of Ireland and we hope to increase that figure. This is indicative of our commitment to the success of the single supervisory mechanism.

Comprehensive assessment – update

Of course, in parallel with all of these change projects, is the Comprehensive Assessment.

You will all be more than aware that the ECB launched the Comprehensive Assessment in November of last year. In fact, some of you here today are heavily engaged in the exercise. This project, which is a kind of entrance examination for all significant credit institutions, includes an Asset Quality Review (AQR), Stress Test and Supervisory Risk Assessment.

The AQR is a point-in-time examination of a bank's assets and will result in the determination of provision adequacy and, as the case may be, identification of capital requirements. The

Stress Test builds on the AQR by providing a forward-looking view of banks' shock-absorption capacity under prescribed macro-economic scenarios and constraints.

We are well advanced for the AQR exercise. This has involved the examination of credit and market exposures, for both on and off-balance sheet exposures, covering all material asset classes. It will result in more than 50 per cent of assets by risk weight being reviewed by national competent authority teams. For us, this means having engaged auditors to review over 4,000 credit files and resultant collateral valuations. We have covered not only the three largest Irish banking groups but also large subsidiaries of foreign banking groups, be they headquartered elsewhere in the eurozone, in the UK or in the US.

The AQR has also resulted in completion by the Central Bank of Processes, Policies & Accounting Reviews, Level 3 Fair Value Asset Revaluations and Collective Model Reviews. The project organisation ensures a high level of quality assurance and it is intended that the results of the AQR will be fully integrated with the results of the stress test. Our recent Balance Sheet Assessment, conducted last year, is taken into account in the AQR and the determination of the results.

The approach to the stress test is as per the EBA methodology that was published in April and will be performed by the EBA and ECB in close co-operation. We are expecting the first submission of the constrained bottom-up results at the end of the month.

Why not publish the results now, or afford you a sneak preview? Because the first sets of preliminary results may well turn out to require a lot of validation, consistency checking, supervisory dialogue, integration and rework before we can all stand behind them.

The next four months will see a period of challenge, quality assurance, integration of the AQR results and finalisation. The results will then be published by the EBA for all banks in their sample. For those banks that are also part of the SSM, it is expected that results of the Comprehensive Assessment will be published thereafter – recognising the unique integration of AQR results into the forward-looking stress test capital requirements.

Significant credit institutions and the "Joint Supervisory Team"

Danièle has taken us through, in some detail, the operational challenges and opportunities which go hand in hand with the SSM. One of focus point of supervision in the SSM of the significant institutions are the Joint supervisory teams or JSTs, that is to say teams comprising ECB and national central bank staff who will work together in the ongoing supervision of each significant institution.

A JST Coordinator will lead the JST and will be based in the ECB. The JST co-ordinator will be supported by our current team leaders and the line supervisors working with them

The JST coordinators will be responsible for the planning and execution of the annual supervisory programmes and the coordination of communication with their institutions. They will also make proposals for formal decisions to the Supervisory Board, and monitor the implementation of such decisions.

This will apply to the banks currently subject to the Comprehensive Assessment (AIB, BOI, PTSB, UBIL, BOAML). As these banks differ in size and complexity, they will be supervised in 4 different divisions in the SSM; two of these divisions are in DG I and two in DG II.

Except for the JST coordinator in Frankfurt, JST members for these banks will be from our Banking supervision directorate led by Sharon Donnery and working here at the Central Bank. The day to day work, the on-site inspections and most of the supervisory engagement will continue to be performed by Sharon's teams.

For the JSTs to become effective and operational there will obviously have to be much dialogue, cooperation and information sharing. Some of this information sharing has commenced but the process is at its infancy and JSTs are only now becoming formed.

JST coordinators for Irish banks will come soon to Dublin to meet with Central Bank staff, learn about these institutions, their risk profiles and current issues. They will also meet with the institutions that they will be directly responsible for.

You can expect to hear from your new supervisory team shortly.

Less significant institutions

While the significant institutions undergo this change to their supervisory personnel, the other less significant institutions, or "LSIs", which we supervise will continue to be supervised directly with us here in Dublin. We will not adopt this JST structure for them.

When we talk of less significant institutions I would like to make the point that it does not mean lower risk or, less important. In fact, very often smaller institutions may carry more risk insofar as systems, controls and governance are concerned but the impact of that risk crystallising is not as significant on the EU wide financial landscape. Yet these institutions are often essential to the provision of services to the economy, consumers, business or to other sectors.

We will continue our direct supervision of these less significant institutions. We will retain the responsibility for supervision but the ECB will have oversight, through DG III led by Mr Jukka Vesala. This will ensure a harmonised approach and consistency of quality.

What will change is that, just like for significant institutions, we will move away from our current PRISM engagement model as we will now supervise in accordance with the SSM Supervisory Manual. The IMF, in its Report on the Observance of Standards and Codes (ROSC), issued in the beginning of this year, invited the Central Bank to review its supervisory engagement and its mix of onsite and offsite supervision for Medium Low and Low Impact banks. The fund recommended that the analysis of regulatory returns should be strengthened as well as greater focus on testing and sampling of risk management processes.

It is very important for us that we continue to supervise to the highest international standards of best practice. We will therefore be reviewing our supervisory engagement model for these banks in tandem with the ECB this year in order to address these findings and take action as necessary.

Let me also mention that, while there will be no JST for these banks, we expect that SSM staff or staff from other supervisory authorities may join us on inspections or as part of our supervisory work.

Organisational change at the Central Bank

The Central Bank will make organisational changes to reflect the SSM operations and to align with what you will experience in terms of interaction and communications.

As you all know the SSM has four Directorates, to which I have already referred: two for Significant Institutions, one for Less Significant Institutions and one for what are referred to as Horizontal Functions. The Horizontal directorate includes 11 different divisions containing functions that provide services across all supervisory directorates and one of these is the centralised management of on-site inspections.

We have given some consideration to how we should organise ourselves in the SSM and held discussions with SSM management and with other national supervisors. It is clear to us that we need to change our structure to accommodate the SSM structure:

- to create a very clear distinction between on site and off site activities;
- to facilitate the creation of clear linkages and relationships between the Central Bank and the SSM;

- to respond to quantitative analysis that are to become ever more prevalent
- to build reporting capability;
- to build the skills and capabilities of our staff and ensure their development and retention.

This implies a three way split, involving the creation of specific on-site inspection teams on the one hand, and on the other hand teams focused on the ongoing, off-site supervision of all banks. The introduction of separate on-site inspection teams that will be tasked with discrete inspection mandates and will be independent from the on-going supervisory work with an institution is new territory for the Central Bank. Currently we incorporate on-site work into our on-going supervisory work and do not have independent teams performing this work.

Combined with this, and in mirroring the SSM structure, we recognise the need also for a third horizontal division, which would comprise specialised teams on liquidity, credit, internal models, and the like.

We expect to change structurally in the coming months. We shall ensure that we build the necessary skills and capabilities of our staff so that we continue to deliver on our supervisory mandate post November.

Transition to SSM for institutions

What will this mean to you in terms of the engagement you will have with the SSM and with my teams at the Central Bank?

What will you need to do differently?

Obviously banks will now be part of a eurozone system of supervision, with the coordinator of the JST based in Frankfurt. Therefore, stakeholder engagement will be very important and increasingly demanding on institutions supervised by the ECB.

At a high-level, the individual risk elements of a risk assessment are largely consistent with the approach that we currently take to assessing the risks. However, many finer elements will change. The supervisory manual is more prescriptive than our current processes, and it provides greater linkage between individual risks and a quantitative outcome.

Final SREP decisions – including taking account of the Comprehensive Assessment – will likely be taken shortly after SSM commencement and within the construct of the new Joint Supervisory Teams.

Altogether the SSM approach will probably be more formal, with greater emphasis on a commonality of approach and treatment and on peer reviews. However I am sure I will not disappoint when I tell you it will not be less intensive!

The on-site inspections will be more prominent and more formalised with different aspects of the engagement led by different functional experts and possibly led by Heads of mission from a different national supervisory authority.

The horizontal functions in SSM will be providing special expertise to JSTs – identifying early focus points and trends by sector-wide analysis, ensuring consistency, adequacy and best practices; and, focusing supervisory action. To do this successfully the ECB will probably want to leverage the specialist capabilities of horizontal functions of NCAs. You may find that you will be engaging with teams from multiple supervisory authorities.

There will be a significant increase in the volume of data required to complete assessments, the use of key risk indicators, and the level of prescription within the assessment themselves (e.g. use of questionnaires in each of the risk categories). In general you can expect the requests for data to increase and therefore banks must continue to develop their data warehousing and analytics capabilities. There is a wide movement towards more granular data requests as this allows the supervisors to conduct their own analytics.

Non SSM tasks

While it is clear that a lot will change in the Irish Central Bank over the coming months, the supervisory priorities remain.

We will continue to focus on our overall strategic and statutory objectives – safeguarding stability, protecting consumers.

We will continue to supervise all credit institutions with respect to their compliance with non-prudential rules, including consumer protection and anti-money laundering, that fall outside the remit of the ECB and the SSM.

We will continue to strengthen our coverage of Anti Money laundering and to monitor compliance with the Criminal Justice Act through our specifically focused Anti Money Laundering Division.

We will also continue to be solely responsible for conduct supervision. Enforcing proper behaviour will continue to be a key focus for us at the central Bank, in particular the adherence to our Code of Conduct on mortgage arrears.

On that note, post programme monitoring of the Troika will continue throughout 2014 and beyond in relation to Ireland's progress in fixing its mortgage arrears crisis. It shall continue to be a top priority.

The high level of arrears weighs on Ireland's banking, acting as a drag on the economy, new lending and profitability.

Banks and borrowers need closure.

The targets that we set need to be achieved and banks must continue to progress resolutely to resolve this issue.

Conclusion

In conclusion let me emphasise that the successful implementation of SSM is a key priority for us at the Central Bank of Ireland. It is also an extremely exciting challenge.

Work is well advanced under Project Europe at this stage and I am confident that we will effectively accomplish the transition to SSM in time.

We look forward to working with our colleagues in the SSM and in the other supervisory authorities around Europe as we converge to a single mechanism of supervision, where we become one team of supervisors. This combination of skills and experience cannot but succeed.