Sabine Lautenschläger: The SSM after one year

Keynote speech by Ms Sabine Lautenschläger, Member of the Executive Board of the European Central Bank, at the IIF (Institute of International Finance) Colloquium on European Banking Union, Frankfurt am Main, 18 November 2015.

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Sylvie, David, ladies and gentlemen,

Looking at the programme for tomorrow, I see you will have an interesting day full of valuable insights and discussions about

- banking union as well as capital markets union,
- their current and potential effect on banks,
- the establishment of the Single Resolution Board, and
- the activities of the Single Supervisory Mechanism (SSM) in particular.

It is a pleasure to be here this evening to set the stage for this upcoming conference. I welcome this opportunity to reflect on some of the messages the Single Supervisory Mechanism learnt during its first year of operation. (And I promise my comments will not be too long or too exhaustive – the main course is still in front of us, after all).

On our first anniversary, we received a lot of praise! At the same time, a few of our stakeholders expressed some understandable wishes and called for improvements.

Let me first of all thank all those who praised us – you will not be too surprised that I would briefly like to look back on some of the achievements for which we were praised before I consider the room for improvement.

Let me recall what the SSM is all about: the SSM was the result of one of the biggest financial crises in the last hundred years. Our task is to contribute to a safe and sound banking system in the euro area and thus to contribute to national, European and global financial stability. We are asked to ensure a level playing field across national borders. We aim to counter supervisory arbitrage and promote equal treatment. Our assignment is to establish a euro area supervisor which:

- is objective and fair, with no home bias,
- acts effectively, efficiently and pre-emptively,
- brings together experience and knowledge of regional and European markets and of supervisory parameters,
- monitors European and global developments,
- identifies risk trends and finds quickly mitigating measures, and
- contributes to setting European and global standards.

The SSM is one of the world's largest supervisors. We supervise 123 significant banking groups in 19 countries, including nine out of the current 30 global systemically important banks identified for 2016. We are also responsible for the effective and consistent function of the SSM, which includes overseeing about 3,500 less significant institutions. The total assets under SSM supervision amount to more than €26 trillion. SSM supervision is conducted by thousands of supervisors across Europe, most of whom work for the 26 national supervisory authorities.

The last 12 to 18 months were marked by a whole series of measures, including:

- recruiting more than 1,000 ECB supervisors and support staff;

- setting up central supervisory infrastructures;
- carrying out the comprehensive assessment and translating the results into supervisory actions;
- developing and implementing the SSM's legal and methodological framework;
- setting up the Joint Supervisory Teams and establishing a consistent and standardised database;
- identifying key risks within Europe's banking sector, drawing up our strategic plan for 2015 and planning our supervisory activities accordingly;
- enhancing our supervisory methodology further, in particular regarding the Supervisory Review and Evaluation Process (SREP);
- harmonising supervisory approaches and perspectives, going beyond options and national discretions;
- gaining an overview of the 19 national banking sectors with their 3,500 less significant banks; and
- conducting day-to-day supervision of the 123 banking groups with 1,100 directly supervised banks.

All in all, in our first year of operation we have laid the foundation for tough and fair supervision. And I am satisfied with the results we have achieved. But as some of the well-wishers pointed out on our anniversary, there's still room for development and improvement.

We must remain vigilant, because banking supervision means keeping our eyes open for trouble – yes, we are paid to worry!

The second year of the SSM will also see a lot of fine-tuning of our supervisory approach and methodologies. We will establish further administrative practices for specific topics relating to the banks' governance, risk management and internal controls. We will deepen our understanding of national specificities in banking sectors and national legal bases as we have to determine how much scope we have for harmonisation.

Let me now focus on one particular wish that was repeatedly expressed in the run-up to our anniversary: enhanced transparency regarding the SSM methodologies and concepts, in particular regarding SREP.

We take transparency seriously. It is closely related to accountability and communication. We need to communicate and be in a dialogue with a number of counterparts: individual banks foremost, other key stakeholders involved in banking supervision, such as banking associations or auditors, Parliaments, and, last but not least, the general public.

From the outset the SSM has actively managed its communication with these different stakeholders. A few weeks before the SSM officially started, we published a guide describing our approach to supervision and the key features of our organisation.

We stated upfront that we would comply with the EBA guidelines on SREP, which provide a fairly detailed approach to how the banks' risk profiles should be assessed.

Since the beginning of 2015, we have started having regular meetings with banking associations in order to answer their questions and explain our modus operandi.

Supervisory teams have intensified their dialogue with banks on their risk profile, and how it is reflected in the respective SREP decisions: we have not only explained where they stood but we have also given them an idea of the benchmarking we used for calibrating the SREP ratio. As those decisions were being finalised, the communication was stepped up at all levels. More recently, the ECB President, the Supervisory Board Chair and I shared publicly some information about the overall impact of SREP decisions.

So, all in all, I believe that in its first year of operation the SSM has been a supervisor which has maintained a dialogue with all the stakeholders concerned.

Now there are also challenges associated with transparency and communication. The right level of transparency has to be found.

Banks need to clearly understand what shapes the supervisor's assessment so that they can better explain their situation and also have the right incentives to improve their risk profiles. But efficient supervision builds on a wide array of tools – quantitative as well as qualitative ones, including meetings, indicators based on reporting, on-site reports, market information etc. – and these tools need to be flexible enough to adjust to changes in the banks' situations and external developments. This is why our approach is holistic in nature and based on "constrained judgement", and is certainly not a mechanistic tool box that would automatically produce a capital number for each bank; it is not a "push-the-button" method! Banks should therefore not expect us to publish one anytime soon.

Regarding the general public, as often as possible we choose public consultation. This has been the case, for example, for the ECB regulation on the application of FINREP at the solo level and in respect of how we want to execute options and national discretions; moreover, the framework regulation, which sets the parameters for the working relationship between the national competent authorities and us, is publicly available.

But as I said, transparency is an important issue and that is why it will remain a regular item on the list of items to be worked on and accomplished in the next two to three years as our methods become more refined and holistic. When communicating with the public we also strive to show developments over time, covering several supervisory cycles and with a more comprehensive presentation of the national specificities. We plan not only to cover the more relevant topics of the supervisory universe but also to show the interconnectedness of different supervisory topics. We aspire to a kind of transparency which not only features abstract methods but which also shows the results of applying a consistent and holistic methodology to 123 banking groups – a methodology which of course will be anonymised but which will be meaningful in showing trends. This kind of presentation needs careful preparation and an underlying transparency concept; this kind of transparency needs time. And we still have to work on it.

SSM methodologies and transparency are related to the data requested by the SSM – one of the topics discussed in the last few weeks – and I am not talking about AnaCredit, as there are no supervisory requests in AnaCredit yet.

When talking about transparency, banks, associations and the public always want to compare individual banks or banks in different countries or banks with different business models. Everybody craves benchmarking; but to achieve good benchmarking comparable, standardised data are needed to avoid comparing apples with pears.

The SSM had to build up a database in order to adequately establish a basis for comparison, for benchmarking and for calibrating its decisions regarding significant banks. We indeed benefited from the EBA implementing technical standards on FINREP/COREP that provide a wealth of information, but we had to collect additional data for our pillar 2 SREP decisions.

Thus, we had to be tough on banks and on ourselves, too, to collect quantitative as well as qualitative information in a standardised way, as this is the only way to get an overview of banks in 19 countries which all had different reporting traditions. It was the only way, too, to work towards a level playing field. Such data collections are inevitably subject to adjustments over time to keep them aligned with the banks' changing risk profiles and activities.

In the spirit of transparency, let me briefly shed some light on how we set our priorities according to the tasks given to us and the risks emerging, and on our planning and execution cycle.

In the summer of each year, we start the preparatory work by conducting a top-down annual risk stocktaking exercise together with the ECB's financial stability experts as well as colleagues from the national competent authorities. Additionally, we assess changes in the regulations and bring in supervisory insights via a bottom-up approach. In evaluating these three areas we ensure that risk orientation is taken into account when setting our strategic goals.

The results of these analyses provide input into the strategic planning that we call supervisory priorities, which are decided upon by the Supervisory Board and Governing Council in November; these priorities are operationalised via the Supervisory Examination Programme.

Independent of our strategic planning and the usual supervisory cycle and topics, there are the priorities set by others, by international groups and fora which are interested in interacting with a single euro area supervisor. There are many, very useful, large European and global initiatives such as the EBA stress tests or other requests to be met or questionnaires to be filled in by my SSM colleagues.

Operationalising supervisory activities for 123 banking groups with 1,100 banks presents a considerable challenge. Some of these activities are legally determined; some are based on external demands by international fora. They may also arise from the applications of banks or be the result of our work on identified emerging risks.

I am still quite satisfied with the priorities we have set. This year our focus was on business models and profitability, as one might expect from a new supervisor needing to get its own fresh view – in particular when banks have to adjust their business model to a low interest environment and stricter regulatory requirements. We also conducted an initial review of the banks' governance, focusing on the organisation and composition of bank managements and we got a first impression of the banks' handling of cyber risk and data integrity.

All three topics will have follow-ups in the coming years to give us deeper insights.

Next year we will intensify and deepen our work on the viability of business models and profitability drivers by analysing not only at firm level but also across business models. In 2016 we will do a thematic review to assess compliance with the BCBS principles for effective data aggregation and risk reporting. Additionally, we will focus on the banks' treatment of non-performing loans and on the transition to IFRS 9. And we will follow up on the implementation of the SSM stance on options and national discretions to monitor the banks' quality of capital. With regard to methodology, we plan to develop our SREP methodology for liquidity risk.

With the priorities set now, we will start to draw up the 2016 working plan for each banking group in detail. This will happen in December; thus banks will have to wait for at least another month to get an insight into what kind of supervisory activities (for instance thematic meetings, onsite inspections or surveys) are relevant for the interaction with their supervisor in 2016. But one thing is for sure: 2016 will be a busy year for euro area banks as well as their supervisor.

As I do not want to keep us any longer from enjoying our dinner, allow me to briefly conclude. What remains is my wish for next year: on the second anniversary, I hope that one or two of the same well-wishers will repeat their praise! I am convinced that the SSM staff at the national supervisory authorities and at the ECB will continue their excellent work, as they have been doing in 2015, and that we should be even further down the road of becoming a truly European supervisor – one which can contribute, to the greatest degree possible, to a safe and sound banking system in the euro area and one which ensures a level playing field. And I also hope that we will have implemented our plan and thus fulfilled this year's wish for greater transparency.