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From a single banking rulebook to a single supervisor, and beyond

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Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

Ladies and Gentlemen,

I am very happy and honored to be with you today. Let me warmly thank Concetta Brescia Morra and Banca d'Italia, especially Alessandra Perrazzelli, for their invitation.

I believe this event marks the start of a series of SSM 10-year celebrations, and I find it very fitting that it takes place in Rome, which has played such an important role in the European construction -two treaties were signed here- to which the Banking Union and its Single Supervisory Mechanism (SSM) bring a new key milestone. The SSM has greatly benefited from prominent Italian figures, such as Tommaso Padoa-Schioppa and many others. I vividly remember a thought-provoking piece from Lorenzo Bini Smaghi I had to brief my superiors about in… 1997 which was already arguing for the European Central Bank (ECB) to take on direct banking supervision in the Economic and Monetary Union (EMU)! I would also like to pay tribute to the many Italian colleagues involved in the preparations and launch of the SSM, to Banca d'Italia and the ECB. Today, I am not coming from Paris where the European Banking Authority is now located, nor from Frankfurt, the SSM headquarters where I used to work before, but from London where I attended an EU-UK dialogue yesterday. Very clearly, all roads lead to Rome!

We have just heard Elisabeth McCaul from the SSM making the analogy of arts and painting. Other previous speakers commented on the recent success of the word “mechanism”. I would like myself to reflect for a moment on “architecture”, for which Rome is also an excellent source of inspiration.

Let me first share with you a trip down memory lane and start with a quick retrospective.

As we know, the SSM is a massive achievement. It was launched in record time and has greatly benefited from the ECB which was both its incubator (it was itself born from the Bank for International Settlements (BIS)) and its new home. But it is fair to remember that this could also be done thanks to the efforts of many in the preceding decades. In fact, it has been a much longer - and at times bumpy- road to EU banking regulation and supervision since the first banking directive of the Council in December 1977.

Do not worry, I am not planning to cover 45 years of financial integration. Let me just take you back to 2001 and the Lamfalussy report, which was a key step in this journey to the European financial architecture as we know it today. This report proposed regulatory reforms to make the regulatory process faster and more efficient. It recommended a wider use of regulations as they are directly applicable in all Member States compared to directives (still a modern debate as we have seen more recently with the discussions about anti-money laundering), and proposed a new type of EU bodies, called the ‘level 3’ committees of national supervisors, including the Committee of European Banking Supervisors (CEBS).

CEBS was established in 2004. Its mandate was to advise the European Commission on EU banking legislation, to contribute to consistent implementation of EU legislation, and to promote convergence of supervisory practices and supervisory cooperation.

This was a very serious step forward in converging supervisory practices. In a nutshell, with a very small staff, it managed, within a few years, to establish a common reporting framework for banks and introduced the role of supervisory colleges – we will see later how useful this proved for the SSM. But only a few years later, in August 2007, a global financial crisis started, culminating with the failure of Lehman Brothers in September 2008. It then became clear that the European supervisory models and approaches were, to a large extent, ill-equipped to keep up with financial globalisation, with integrated and interconnected financial markets linking financial institutions across borders. The crisis exposed weaknesses in the areas of cooperation, coordination, and the consistent application of EU law, and a certain degree of mistrust between national supervisors in times of crisis.

On the other hand, the great financial crisis quickly set in motion a process of reforms which would last for a decade and fundamentally transform our approach to the regulation and supervision of banks. In February 2009, a report prepared by a group of wise men led by Jacques de Larosière recommended a brand-new regulatory agenda, stronger coordinated supervision across financial sectors, and effective crisis management procedures. It highlighted the need to complement microsupervision with a macro-prudential approach, to develop effective warning mechanisms, and to enhance the cooperation between supervisors with common decision-making processes.

In practice, after solid negotiation, this led to the establishment of the European Systemic Risk Board (ESRB) and the morphing of the three sectoral level-3 committees into fully fledged European Supervisory Authorities (ESAs), including the European Banking Authority (EBA) established in January 2011.

Through the adoption of binding technical standards and guidelines, the EBA was to contribute to the creation of a European Single Rulebook in banking as well as to promote convergence and harmonisation in supervisory practices across the EU. It was to foster supervisory cooperation in going concern and in crisis situations, and to assess risks and vulnerabilities through novel instruments like supervisory stress-tests.

But in 2010-2011, the euro area was already wrestling with a new financial crisis -the sovereign debt crisis- which led to serious disruption and instability in the banking system. In view of this crisis, the EBA conducted a capital stress-test exercise in 2011 to assess banks' capital needs and restore confidence in the markets as part of a broader European stability package. This was, however, not enough; bolder steps were needed. In June 2012, European leaders came together and decided to make faster progress towards completing the EMU. Shortly after, as Governor Visco reminded us, they swiftly agreed to establish a Banking Union relying on a single supervisory mechanism (the SSM), a single resolution mechanism (SRM) and a common deposit insurance framework. The SSM came into being in late 2014.

Since then, the SSM has been responsible for the prudential supervision of the banking sector in the euro area and, later in Bulgaria and Croatia which entered into close cooperation agreements. As previously highlighted, the SSM was a game changer. But it was not exactly a big bang in the sense that it did not come out of nowhere. This somewhat long detour to explain how several preceding initiatives and experiences (including that of the ESAs) have prepared the minds and paved the way to the SSM, contributing to its lightning-quick start between 2012 and 2014. I had the privilege of being involved in a number of these steps, especially the latest ones, from different perspectives: participating in the EBA's working structures as a national authority and then as an ECB representative, contributing to the preparations for the SSM and then joining it at the ECB, and now working at the EBA.

So, let me now share some personal views on how the CEBS and the EBA helped kickstart the SSM, how the SSM helped advance their convergence agenda, and where we stand now.

For its launch, the SSM could immediately draw on a solid contribution from the EBA and its CEBS predecessor.

The SSM preparations were built on four existing building blocks: a Single Rulebook, common reporting, cooperation structures, and a supervisory stress-testing framework.

The Single Rulebook

Since its inception, a key task of the EBA has been to establish a Single Rulebook, that is, a truly uniform and integrated set of rules applicable to all banks operating within the European Union. This consists primarily of technical standards directly applicable in all Member States and is complemented with guidelines in less harmonised areas where direct European rules are not (yet) an option (such as where national company or insolvency laws need to be accommodated). The latter provide another source of convergence as authorities need to declare whether they comply or not. Relying on harmonised rules is indeed critical for a single European supervisor - how could one understand that banks facing similar risks be treated differently just because they happen to have their headquarters in different Member States? I will come back to this.

Still in the context of this Single Rulebook, the EBA introduced a pragmatic approach through a questions and answers (Q&As) tool, by which banking supervisors and financial institutions can ask for clarifications on the applicable EU rules when facing complicated -most often very practical- issues. Finally, the EBA embarked on the drafting of a single supervisory handbook for supporting the day-to-day activities of supervisors, but this proved to be long-lived with the start of the SSM.

Let me pick one example which was of direct relevance for the SSM at its start. As part of its convergence mandate, the EBA was tasked by the Capital Requirements Directive (CRD) to develop guidelines on common procedures and methodologies for the supervisory review and evaluation process (in short, the “SREP Guidelines”). The objective was to have a common language for structuring the assessment of the risk profile of a bank, and to express any additional ("pillar 2") requirements in the form of capital, liquidity, or qualitative measures. This has been a relative slow and difficult process since 2011 due to some reluctance from national supervisors to part ways with their preferred practices - I very well remember as I was involved in these discussions!

In the Autumn of 2012 and beginning of 2013, with the need to be ready for a quick SSM start, the picture changed radically. It was also often the same people who were also involved in the SSM preparations and the immediate benefits of the lengthy SREP Guidelines discussions suddenly became obvious. We could measure the usefulness of the knowledge already accumulated and that of the SREP framework that was surfacing. This allowed to finally reach an agreement in June 2014, and the SREP guidelines were adopted a few months later, in December 2014. They provided a strong foundation on which the SSM could swiftly develop its internal (and much more detailed) SREP methodology for a consistent supervision of the 130 significant institutions coming from 19 different Member States under its direct supervision.

Harmonised supervisory data

A second building block for the SSM was found in the area of data. Besides a single set of rules and supervisory review process, a single supervisor also needs truly comparable and reliable data from the entities it supervises. In December 2005, CEBS issued guidelines establishing a standardised consolidated financial reporting framework - FINREP. Then, in January 2006, it launched a common reporting framework (COREP) for the new solvency ratio to be calculated by credit institutions and investment firms. When the EBA replaced CEBS, it rolled out technical standards for a harmonised

FINREP and COREP supervisory reporting, which became directly applicable in all EU Member States in 2014. This provided a standard set of data and benchmarks to supervisors for carrying out their analyses, which came in handy for the SSM at its start.

Cooperation structures

When setting the SSM, EU legislators could also build on supervisory cooperation practices which had been successfully tested in the preceding years. Just as the ESAs are governed by their Boards of Supervisors, the SSM's decision-making body is its Supervisory Board, which also gathers the officials responsible for banking supervision within the SSM countries.

Furthermore, when drafting the SSM supervisory manual, it became immediately clear that the approach of supervisory colleges would form an excellent basis for the future SSM supervisory teams. College members coming from all relevant authorities involved in the supervision of a banking group would meet on a regular basis – typically quarterly - for a large bank, share their risk assessments and prepare a joint decision on the adequacy of the capital of that bank. Promoting an effective and efficient functioning of the EU supervisory colleges has been an important task for the EBA which it had taken over from the CEBS, developing common standards for the joint risk assessments and capital decisions, and promoting best practices.

With this in mind, we coined the concept of the Joint Supervisory Team - or "JST". This would be the equivalent of a college in terms of the authorities involved in the supervision of a given banking group but with a much more functional approach: experts would work together on a day-to-day basis as opposed to meeting from time to time and would be placed under the leadership of ECB staff instead of the staff of the home country authority. The size and composition of the JSTs would be proportionate to that of the banking group and of its various national operations. Important in this was the word "joint", to insist on the necessary close cooperation between the ECB and national competent authority (NCA) parts of the SSM.

There was, however, one further inspiration that was not retained by the SSM. The ESAs were used to develop their work through standing committees which provide a link between the technical work of their experts in subgroups or task forces and their decision-making bodies. We thought that having something similar, involving medium or senior officials from competent authorities one level below the Supervisory Board, could also facilitate the work of the latter and produce further cohesion. We proposed to call this a GRAM – for Group Risk Assessment Meeting. The SSM chose not to adopt this. One day, maybe, they will reconsider!

Stress tests

Supervisory stress-tests were introduced by the US Federal Reserve in 2008 during the global financial crisis as a way of checking systematically for potential areas of risks in banks' balance sheets, to provide transparency and restore confidence. To bring a forward-looking dimension to the SREP and identify the risks banks might be exposed to, the EU CRD also required competent authorities to stress test the institutions under their supervision at least annually. Similarly, the EBA was mandated in its founding regulation to carry out regular EU-wide stress tests to assess the resilience of financial institutions to possible but hypothetical future adverse market and economic developments.

A first EU-wide stress test was carried out by CEBS in 2009 on a sample of 22 major EU cross-border institutions representing 60% of the EU banking sector assets. In 2011, the EBA took over the role and continued to run such exercises on a bi-annual basis. The outcome of the latest stress test exercise was published in July 2023 and covered a sample of 70 banks representing 75% of the EU banking sector assets.

Before its operational start in November 2014, the SSM had to run a comprehensive assessment, which included an asset quality review and a stress-test. Here, the EU-wide stress-test "technology", which had been developed in previous years proved again very helpful. Definitions harmonised by the EBA's Single Rulebook in 2014 in areas like non-performing exposures and debt forbearance could also be used for the asset quality review, which was conducive to reaching comparable outcomes.

As we have just seen, the SSM did benefit from quite substantial convergence and preparatory work when it started. But how did that unfold after it had become operational?

On the whole, the SSM gave a massive boost to the convergence of supervisory practices that is part of EBA's mandate.

Despite some 20 years of harmonisation in banking regulation in the EU, despite the contributions from the CEBS and the EBA, the truth of the matter was that supervisory methods and cultures were still diverse when the SSM started. Various degrees of intrusiveness, of reliance on quantitative vs. qualitative information, different approaches to risk assessment, especially whether it should be bank- or supervisory-led (some supervisors stood for various shades of Internal Capital Adequacy Assessment Process – ICAAP - France preferred its "ORAP", others used combinations!), and whether additional capital requirements should be determined by a holistic or risk-by-risk approach.

The creation of the SSM *de facto* led to a harmonisation (or even unification) within the Banking Union. It allowed for instance to harmonise a very large number of options and discretions which had been conferred to competent authorities by the banking legislation, which the ECB decided to exert itself. On the other hand, there was now the risk of having a 'two-speed' process between those supervisory authorities within the SSM and those outside the SSM. Against this backdrop, the EBA refocused its convergence work aimed at ensuring convergence between these two groups.

Going back to the rulebook, the start of the SSM and the entry into force of the SREP guidelines in 2014 brought mediations between competent authorities on their capital decisions to a halt. Until then, when a joint capital decision could not be agreed within a supervisory college, the EBA could be called to impose a solution if all conciliation attempts had failed - a 'binding mediation' approach which had been controversial during the legislative discussions. Early mediations had set the tone that disputes could not go unresolved. They had tackled ring-fencing issues, highlighted the different domestic risk assessment and calculation methodologies, and reinforced support for a true harmonised decision-making process through colleges following the SREP guidelines. The SSM would internalise most home-host disagreements making mediations unnecessary.

The organisation of banking supervision had also remained rather diverse. This was the case from an institutional point of view, with a whole range of structures including stand-alone, integrated or twin peak supervisors, some of them being integrated within the national central banks and others being separate. There was also a lot of diversity with regards to very practical issues: the size of the supervisory teams, the profiles and career paths of the supervisors, reliance on off-site or on-site supervision, to name a few. While the SSM had little effect on the national institutional set-up, it had a direct impact on the practical organisation of supervision and helped foster a solid common supervisory culture within its members.

Looking at the impact of the SSM on banking reporting and data, despite the harmonisation brought by COREP and FINREP, many national supervisors had kept collecting large amounts of data sets for different -always excellent of course!- purposes. The SSM did not disappoint here: to feed its SREP methodology it first added its own Single Purpose Exercise, which continued as a Short-Term Exercise which has remained in place over the years. It also embarked on other data collections in formal (as shown by the FINREP solo ECB regulation) or less formal ways.

On the other hand, the SSM also did real efforts to streamline the data collections performed by its central teams and those of its national competent authorities. It was a true catalyst to further converge reporting requirements. And single supervision, by applying a harmonised Pillar 2 process, removed the need for maintaining different reporting templates for different competent authorities. Aware that reporting is meaningless if the quality of the data is questionable, the SSM also focused a lot on improving banks' data aggregation and reporting capabilities.

Regarding cooperation structures, the SSM led to a change in the composition and dynamics of supervisory colleges for banking groups operating in the euro area. Many colleges simply ceased to exist in 2014 since all the entities of the banking groups they were supervising were now under the direct supervision of an SSM JST. The total number of supervisory colleges in the EEA thus declined from 95 colleges in 2014 down to 68 colleges in 2015. Colleges of supervisors, however, are still needed for cross-border banking groups with a presence in both SSM and non-SSM countries, and the EBA keeps participating in a number of those.

Finally, when it comes to stress-testing practices, the SSM has been a major contributor to the bi-annual EU-wide EBA stress-tests, which provides supervisors with a starting point for setting additional targets of capital ratios to banks (the "Pillar 2 Guidance", or P2G) and more generally help them identify vulnerabilities at banks using a common yardstick. Backed by the strength of the ECB teams for developing challenger models or performing quality assurance, the SSM helped bring the EU-wide stress-tests to the next level and make them a reference point for all stakeholders.

All in all, the SSM changed the scope of the EBA's convergence work. Thanks to the establishment and action of the SSM, actual convergence in many areas was achieved within a few years for a very significant part of the Union. This was naturally acknowledged in the annual convergence report produced by the EBA. The latter shifted its efforts and focused more on maintaining convergence between the SSM and supervisors from the rest of the Union, relying, for instance, on an annual European Supervisory Examination Programme (ESEP) for all, on peer reviews and on benchmarking exercises.

Where do we stand now? What should be the next steps?

We have now achieved a strong supervisory setup in the Union, and we see regulatory and supervisory actions complementing one and other. Regulation is developed in close cooperation with those who will use it in their day-to-day work. Supervisors can turn to the regulatory body for guidance and interpretation issues about the applicable legislation and rules. This ensures checks and balances. As regulators and supervisors are collaborating in many working structures, they can easily align and reach their respective objectives. There is also a continuum between rulemaking for supervision and resolution matters which converge at the EBA table. The EBA also ensures that there is an ongoing dialogue and cooperation between the integrated SSM supervisor and the supervisory authorities from the other member states.

A second strength of our current overall architecture is that it is quite a modern setup. Both the policy work and the ground supervision are carried out in the context of a truly European approach with multinational teams. True, the nature, composition, and intensity of the work of these teams reflect different needs and paces: while supervision requires large teams working together on an ongoing basis for continuous action, policy development and EU-wide risk analyses are developed through *ad hoc* modular teams gathering at regular intervals through a project approach depending on the urgency. This means that, again, there is complementarity, with quite some good capacity and agility embedded in this architecture.

Is all this enough? Not quite. For two reasons. Firstly, because while it is of course critical to have all the right ingredients and structures available, as we know, regulation and supervision are very much about executing. Arts rather than science? Or a bit of both!

Secondly, there are now new frontiers. Indeed, many topics going beyond and across the traditional boundaries of the financial sector. These include Environmental, Social and Governance issues, ICT transformation, data and reporting integration. Those do not stop at banking, they cut across. And banking activities themselves are not strictly contained within the regulated banking sector ("Rome is not in Rome anymore"). Recent important pieces of EU financial legislation reflect this. This is for instance the case of the Digital Operational Resilience Act (DORA) or the Markets in Crypto-Assets Regulation (MiCAR). The European Commission is also promoting a strategy for integrated reporting in the EU financial sector as a whole. Last but not least, the importance of the non-banking financial sector has taken new proportions since the global financial crisis.

Let me conclude.

Progress is undeniable and should be fully acknowledged. But we cannot declare ourselves satisfied – regulators and supervisors rarely are... The regulatory and supervisory framework that exists today is an amazing achievement compared to the situation in 2007. Recent episodes of financial and non-financial stress could be withstood thanks to the joint efforts from the industry and the public sector. European banks have significantly reduced their risks and strengthened their capital and liquidity positions. These shocks have also confirmed that having a harmonised regulatory framework and a strong supervision is critical. Notwithstanding this, as Jean-Claude Trichet, the former President of the ECB, liked to remind us, one should never get complacent but rather always remain vigilant.

So, now is the time to keep up with our efforts and make the system even more robust and efficient, to complete the goals and ambitions that were so evident 10 or 15 years ago, in the immediate aftermaths of the financial crises. This has to be done considering challenges that cut across and go beyond the financial sector. As a result, one may repeat the famous words of Sir Winston Churchill: "This is not the end. It is not even the beginning of the end. But it is perhaps, the end of the beginning." Thank you for your attention.