

www.pwc.de

***Experience with the Single
Supervisory Mechanism and the
development of the Single
Resolution Mechanism –
the perspective of an advisor***

May 2016

pwc

Agenda

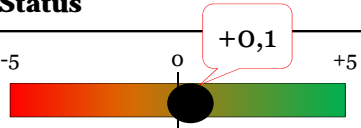
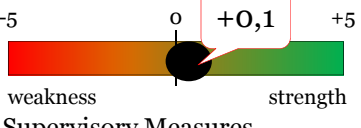
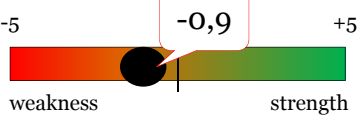
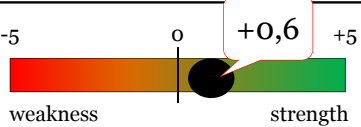
- 1. Single Supervisory Mechanism (SSM)**
- 2. The experience so far**
- 3. ECB's priorities for 2016**
- 4. Single Resolution Mechanism (SRM)**

SSM

1

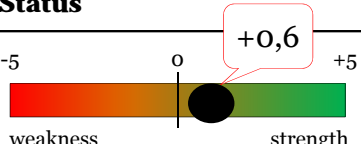
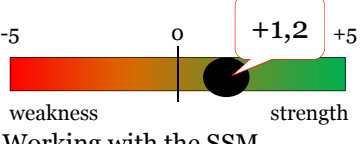
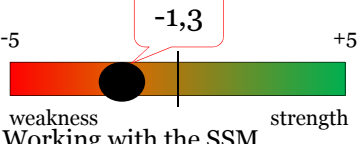
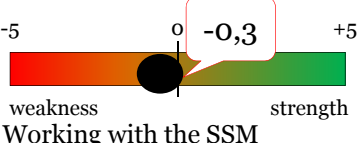
1. SSM

Feedback from the Banking Industry (1/2)

Status	Threats	Opportunities
 <p>Harmonisation Create a level playing field</p>	<ul style="list-style-type: none"> • Double burden of complying with ECB and NCA requirements • “One size fits all” approach could lead to a less diversified banking sector 	<ul style="list-style-type: none"> • Harmonisation is visible and making good progress over the first 15 months of SSM • Harmonisation of options and national discretions by the ECB should take different aspects in different countries into account
 <p>Supervisory Measures SREP</p>	<ul style="list-style-type: none"> • Lack of transparency, leading to results which are hard to interpret • Burdensome process, not proportionate to the size and complexity of an institution 	<ul style="list-style-type: none"> • Increased transparency of results to allow meaningful analysis by banks • Standard process which promotes fairness and consistency across supervised banks
 <p>Supervisory Measures Benchmarking & Peer Groups</p>	<ul style="list-style-type: none"> • Lack of transparency on what peer group banks have been assigned to • Banks being erroneously assigned to peer groups which do not reflect their activities 	<ul style="list-style-type: none"> • Increased transparency on peer group assignments • Allows banks across Europe to be accurately compared
 <p>Working with the SSM Communication with / by the SSM</p>	<ul style="list-style-type: none"> • Lack of transparency in SREP results 	<ul style="list-style-type: none"> • Increased access to supervisors to continue open and transparent dialogue

1. SSM

Feedback from the Banking Industry (2/2)

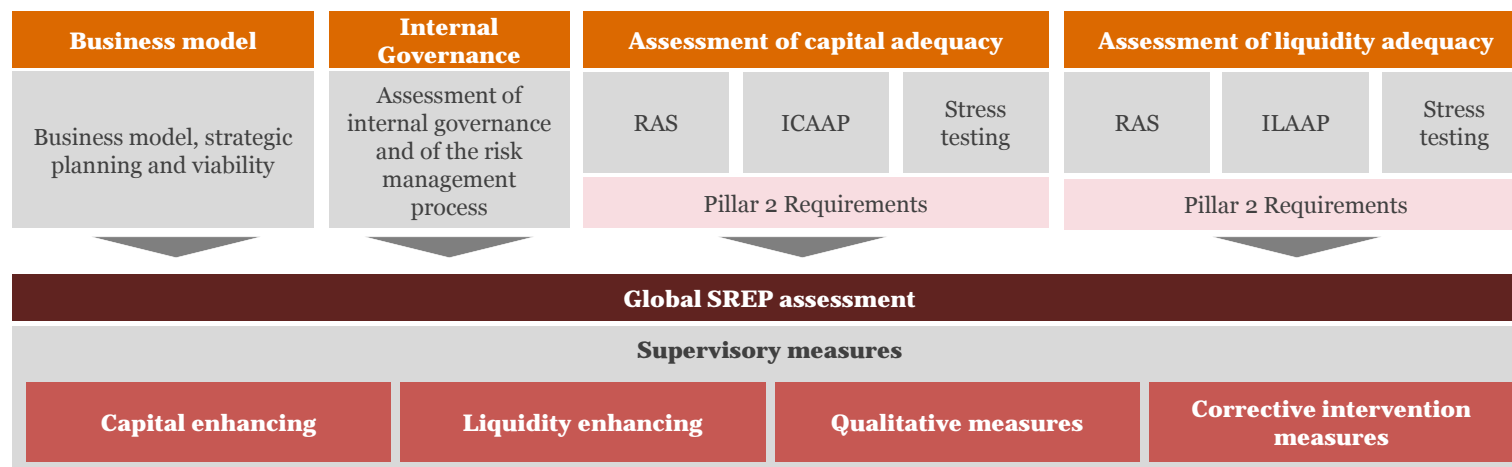
Status	Threats	Opportunities
 <p>Working with the SSM Collaboration with the JSTs</p>	<ul style="list-style-type: none"> • Misunderstandings arising from language difficulties 	<ul style="list-style-type: none"> • Continued professional cooperation between the banks and JSTs
 <p>Working with the SSM SSM's information requests</p>	<ul style="list-style-type: none"> • Lack of harmonised requirements, leading to double efforts from banks • Data and information requests too onerous for less significant institutions 	<ul style="list-style-type: none"> • Harmonise information and reporting requirements across supervisory bodies • Standardise data requests to avoid banks needing to rework data collections
 <p>Working with the SSM Transparency in SSM decisions</p>	<ul style="list-style-type: none"> • Significant delays in the SSM's decision making process • ECB Supervisory Board overloaded, leading to inefficiencies 	<ul style="list-style-type: none"> • Individual decisions for banks are clear and understandable • Transparency on how long SSM decisions will take to be processed
 <p>Working with the SSM Relationship SSM - NCA</p>	<ul style="list-style-type: none"> • Lack of harmonised information and data requests from different supervisory bodies 	<ul style="list-style-type: none"> • Improved cooperation between SSM and NCA teams

The experience so far

2

2. The experience so far

2015 Supervisory Review and Evaluation Process (SREP)



General findings

- Banking business models are under significant pressure (low interest rates, profitability, competitive pressure)
- Medium-term financial planning is not always consistent with capital planning processes
- Stress testing results are not sufficiently taken into account in assessing a bank's risk bearing capacity
- Insufficient consideration of risk appetite and risk culture
- Emphasis on the importance of liquidity ratios

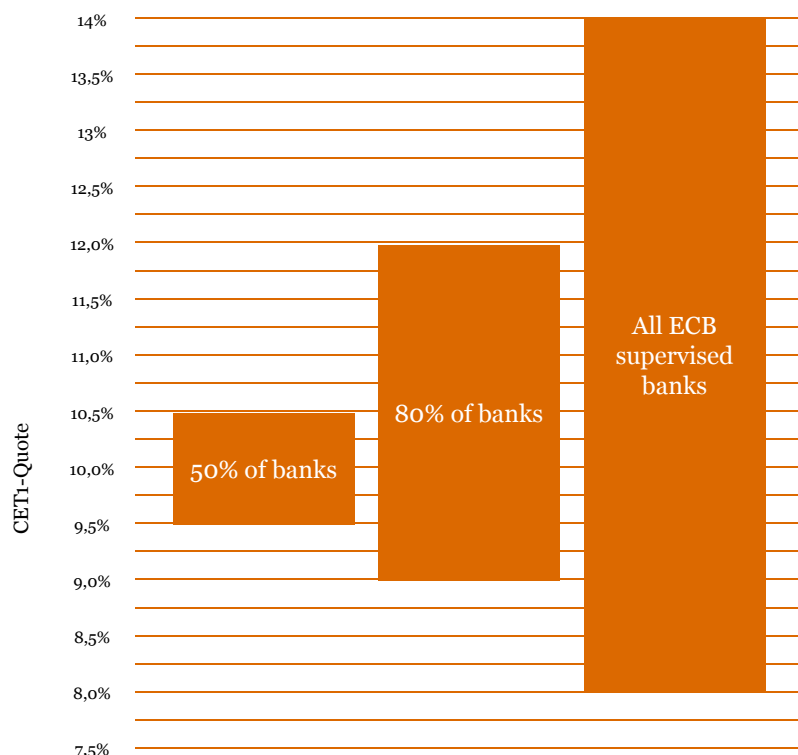
ICAAP findings

- Insufficient consideration of interest rate risk in the banking book
- Insufficient consideration of concentration risks
- The need to take into account business model risk
- Adequacy of the confidence level used in pillar II capital modelling
- Emphasis on the importance of the liquidation approach to calculate risk factors

2. The experience so far

2015 SREP – Capital outcomes

Preliminary 2015 SREP capital ratios*



* incl. Capital conservation buffer

- Average capital requirements across SSM banks have risen compared to 2014 up to 10.1% CET 1, **within a range of 8-14%** (Sabine Lautenschläger, 17.11.2015)
- Buffers **include capital conservation buffer**, but not the countercyclical, systemic risk and systemically important bank buffers
- Oral information about classification of banks (1 to 4)

ECB's priorities for 2016

3

3. ECB's priorities for 2016

ECB's areas of focus for 2016 and beyond

Business model analysis / review	EBA EU-wide stress test	ILAAP	IFRS 9 / accounting issues
IT resilience and cyber security	Targeted Review of Internal Models (TRIM)	Non performing loans	Less significant institutions
ICAAP and internal stress testing	Asset quality reviews	BCBS 239	Data quality & Reporting
Conduct and operational risk	AnaCredit	National discretions and options	Internal governance and risk appetite

3. ECB's areas of focus for 2016 and beyond

Business model analysis / review

Background

- Comprehensive Assessment addressed issues of bank solvability in the Eurozone, **the issue of the viability of European banks** remains
- ECB business model analysis focussed on the following:
 - Viability and sustainability
 - Profitability drivers and ability to generate acceptable returns over a forward-looking period
 - Extent of interest rate risk inherent in the business model

The experience so far

Analysis being completed by the ECB through two means:

1. SREP

Collection and analysis of data related to forecast profitability

2. Specific on-site missions

Very granular analysis of the banks' historical performance and forward looking strategic and business plan, with data requests including:

Margin contributions / profitability calculations at the lowest level of detail

5-year historic profitability, split into ECB defined segments

Overview of profitability by product and by customer

5-year historic cost of funding broken down by funding sources

5-year historic new business analysis, including planned vs realised results, broken down by new business from existing vs new customers

Full customer lists

Business suggested by supervisory and management board members

Overview of business and distribution channels

3. ECB's areas of focus for 2016 and beyond

EBA EU-wide stress test – key changes from 2014 exercise

	Stress test 2014	Stress test 2016	Effort	Impact
Hurdle rates	<ul style="list-style-type: none"> • Pass / fail approach • Hurdle in baseline scenario: 8% • Hurdle in adverse scenario: 5,5% 	<ul style="list-style-type: none"> ▪ No hurdle rates ▪ Results to be used in deriving pillar capital requirements through SREP 	→	-
Static balance sheet	<ul style="list-style-type: none"> • Static balance sheet as at 31.12.2013 • Recognition of official restructuring plans 	<ul style="list-style-type: none"> ▪ Static balance sheet as at 31.12.2015 ▪ No recognition of official restructuring plans 	→	↗
Documentation	<ul style="list-style-type: none"> • Documentation requested 	<ul style="list-style-type: none"> ▪ Increased focus ▪ Increased demands for documentation 	↗	-
Interplay with AQR	<ul style="list-style-type: none"> • Concurrent implementation of AQR and stress test • Results joined up 	<ul style="list-style-type: none"> ▪ No separate full-scale AQR 	↘	-
Conduct Risk	<ul style="list-style-type: none"> • To be considered within operational risk 	<ul style="list-style-type: none"> ▪ Distinction made between OpRisk and Conduct Risk ▪ Complex stress testing methodology for conduct risk to be applied 	↗	↗

3. ECB's areas of focus for 2016 and beyond

ILAAP – key aspects

Background and objectives

- All significant banks to produce an ILAAP from 2016
- ILAAP and data collected through the Short Term Exercise used to calibrate SREP requirements on liquid asset buffer
- Three main objectives:
 1. Board awareness of liquidity management framework and adequacy of liquidity resources
 2. Liquidity resources adequacy assessment under business as usual and stress
 3. Documentation of the overall liquidity framework (identification, management, measurement, mitigation and reporting)

ILAAP requirements (as defined in EBA guidance Dec 2015)

Overview of ILAAP process

- How liquidity risk is identified, measured, monitored, planned and mitigated
- Proportionate to the size and complexity of the entity and its business model
- Supported by documentation and records in relation to the various components of the framework
- Integrated with the risk appetite framework and linked to business strategy, risk strategy and ICAAP

ILAAP main components

- Measurement and management of liquidity risk, liquidity buffers and counterbalancing capacity
- Presentation of funding plans with quantitative past and forward looking information
- Integration of liquidity transfer pricing into the measurement of profitability of new asset and liabilities
- Intraday liquidity risk management including a quantitative overview past year of intraday liquidity risk

ILAAP governance

- Organizational structure and internal control
- Scope of ILAAP and interaction with the credit institution's decision making
- Evidence of use tests of ILAAP as the support of existence of internal validation
- Management approval for ILAAP

Liquidity stress testing

- Description of the scenarios
- Information on methodology and parameters
- Scenario results
- Analysis of the relevance of the outcomes on internal limits, risk appetite, buffers and feasibility of funding plans

3. ECB's areas of focus for 2016 and beyond

IFRS 9 – EBA questionnaire

Background

The EBA has launched an impact assessment of IFRS 9 covering approximately 50 institutions, weighted towards larger banks
The aim of the exercise is threefold:

1. Help the EBA understand the impact of IFRS 9 on regulatory capital
2. Assess the interaction between IFRS 9 and other prudential requirements
3. Assess the way institutions are preparing for the application of IFRS 9

Questionnaire content

1. Qualitative – how are banks preparing? Governance (board involvement), judgmental aspects, lending practices, impact expected by institutions, implementation stage
2. Quantitative - by big themes: impairment, etc. Impact on CET1, total impact to see impact on reg cap (provisions, etc)

Timing

Questionnaire requested for end of April. Analysis should be ready for Q3. Not sure if report will be published, depending on data quality. The EBA will probably do another one next year as this year, data was requested best effort basis.

ECB / SSM involvement

The ECB is very interested to see the results of the analysis, as there is a view that IFRS 9 could have a significant impact on banks' regulatory capital

ECB may also add some banks into the scope of the questionnaire

3. ECB's areas of focus for 2016 and beyond

IT resilience and cyber security

IT resilience and cyber security remain a major concern for the ECB in 2016

Through 2015, the ECB required supervised banks to complete a questionnaire, assessing how banks protect themselves from cyber fraud

The basis of the questionnaire was the Cybersecurity Framework of the National Institute of Standards and Technology (NIST), as non-regulatory agency of the US Government

The submissions are currently being processed and results are expected to be published in 2016

The ECB remains concerned about the risks faced by banks in relation to cybercrime, rating it as one of their key risks for 2016

Supervisory concerns about risks of cybercrime are still growing

The supervisor will continue to assess the risk of IT and cybercrime through the **individual review** of banks' cyber risk profile and mitigation capabilities and through **cross-sectional review** and benchmarking

3. ECB's areas of focus for 2016 and beyond

Targeted Review of Internal Models (TRIM)

Objectives

- **Restore credibility, adequacy and appropriateness** of approved Pillar 1 internal models
- **Ensure compliance** with regulatory requirements and **harmonise** supervisory practices
- **Integrate international regulatory developments** (EBA/ BCBS) to accommodate upcoming changes
- **Take a targeted approach** to specific topics and models based on material issues requiring harmonisation
- **Integrate TRIM-related activities** in regular model validation (infrastructure, tools, processes & methodologies)

Scope & timelines

- Focus on **credit, market and counterparty credit risk models**
- **2016**: emphasis on **methodological harmonisation**, model **governance framework review** (including model validation policy, model use and data quality processes) and **model map & prioritisation** (including **benchmarking**)
- **2017/8**: **IT and data quality** review; model-specific **on-site reviews**



2016

- Answers to **data requests**
- Preparation of **supervisory visits**
- Anticipation of **model approval requests** for 2017
- Well-defined **internal organisation and resource availability**

2017 / 2018

- On-site **IT data quality review** on approved models
- Large number of supervisory **on-site investigations** over 2017 and 2018 (targeted model specific reviews)
- Appropriate resources to deal with **on-site teams**
- **Logistics** for the on-site teams

3. ECB's areas of focus for 2016 and beyond

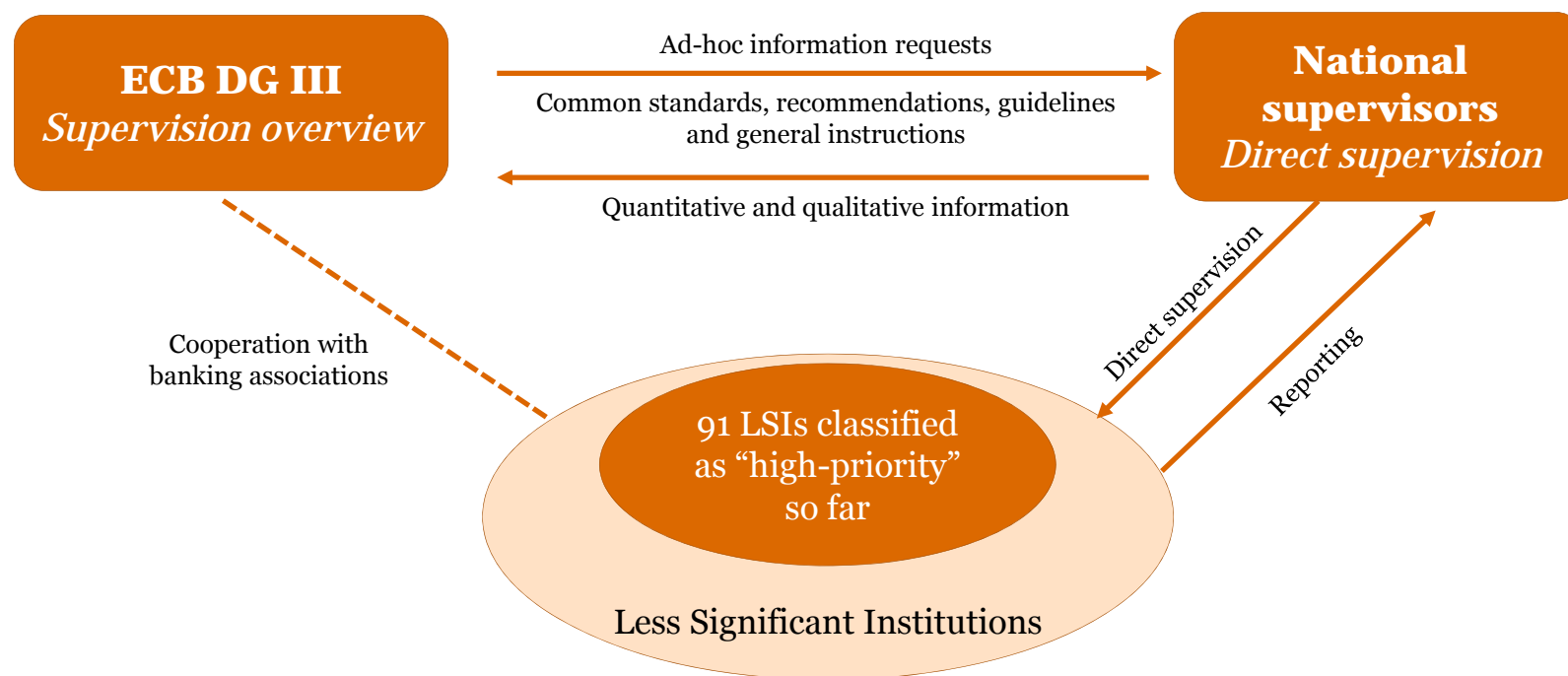
Non-performing loans	Less significant institutions	ICAAP & Internal stress testing	Asset quality reviews	BCBS 239
<ul style="list-style-type: none"> Taskforce formed led by the former head of banking supervision in Ireland Focus will be on countries and individual banks where NPL ratios are deemed too high 	<ul style="list-style-type: none"> Guidelines to be published on supervision of less significant institutions List of 91 "high priority" less significant institutions to be released (so far) SREP process for LSIs to be similar to the current significant institution process 	<ul style="list-style-type: none"> For banks not included in the EBA exercise, ECB will conduct its own stress test consistent with the EBA methodology To be used to assess Pillar 2 capital through the 2016 SREP Focus also on preparedness for gone-concern scenarios (MREL / TLAC) 	<ul style="list-style-type: none"> Process already under way to conduct AQRs on all new significant banks AQRs also to be conducted on specific portfolios (e.g. shipping) and less significant institutions on a case by case basis 	<ul style="list-style-type: none"> Increased importance of risk data aggregation and risk reporting (e.g. AQR, EBA stress testing, regulatory data requests) ECB expects banks to improve their risk data aggregation capabilities

3. ECB's areas of focus for 2016 and beyond

Data quality and reporting	Conduct and operational risk	AnaCredit	National discretions and options	Internal governance and risk appetite
<ul style="list-style-type: none"> Continued requests for ever more granular data in the context of stress testing, on-site missions, AnaCredit etc. Poor data quality and processes could lead to capital buffers 	<ul style="list-style-type: none"> Reviews to be done mainly through the SREP process Focus will be on risk culture and the effectiveness of the supervisory board 	<ul style="list-style-type: none"> AnaCredit requirements to be finalised through 2016 	<ul style="list-style-type: none"> Consultation launched in November on harmonising the exercise of options and discretions in union law To be finalised and implemented in the first half of 2016 	<ul style="list-style-type: none"> Underlying sentiment that governance within certain banks is insufficient, e.g. <ul style="list-style-type: none"> – Quality of the Board – Independence from management – Use of risk appetite in decision making

3. ECB's areas of focus for 2016 and beyond

Approach to supervision of LSIs - overview



Tiered approach

- Supervision to be in accordance with the principle of proportionality
- Intensity of supervision and information requests are based on the priority level of a bank
- Risk-based and consistent approach

3. ECB's areas of focus for 2016 and beyond

Approach to supervision of LSIs – key focus areas

- 1** Development of common standards e.g. capital planning and business model analysis
- 2** Exchanging information with national supervisory authorities and continuous monitoring of LSIs by means of "country desks"
- 3** Finalizing the procedure for crisis management
- 4** Thematic audits, e.g. of the Institutional Protection Scheme (IPS) and accounting standards
- 5** Development of a risk assessment / SREP methodology for LSIs
- 6** Data and data analysis: collection and reporting of data, assessment of risks and vulnerability, list of less significant institutions

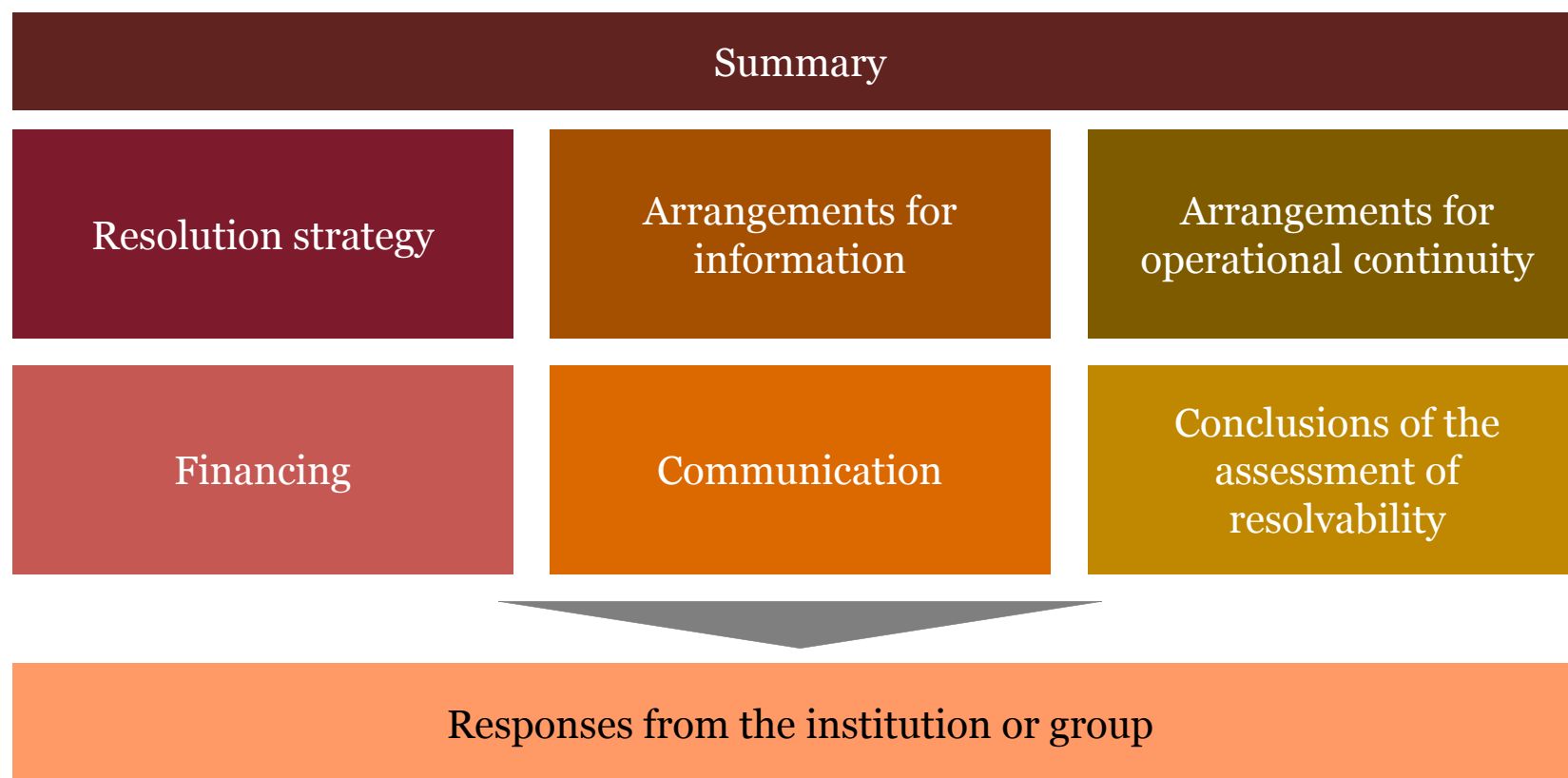
SRM

4

4. SRM

Resolution planning

The EBA specifies the content of resolution plans (submitted to the EC)



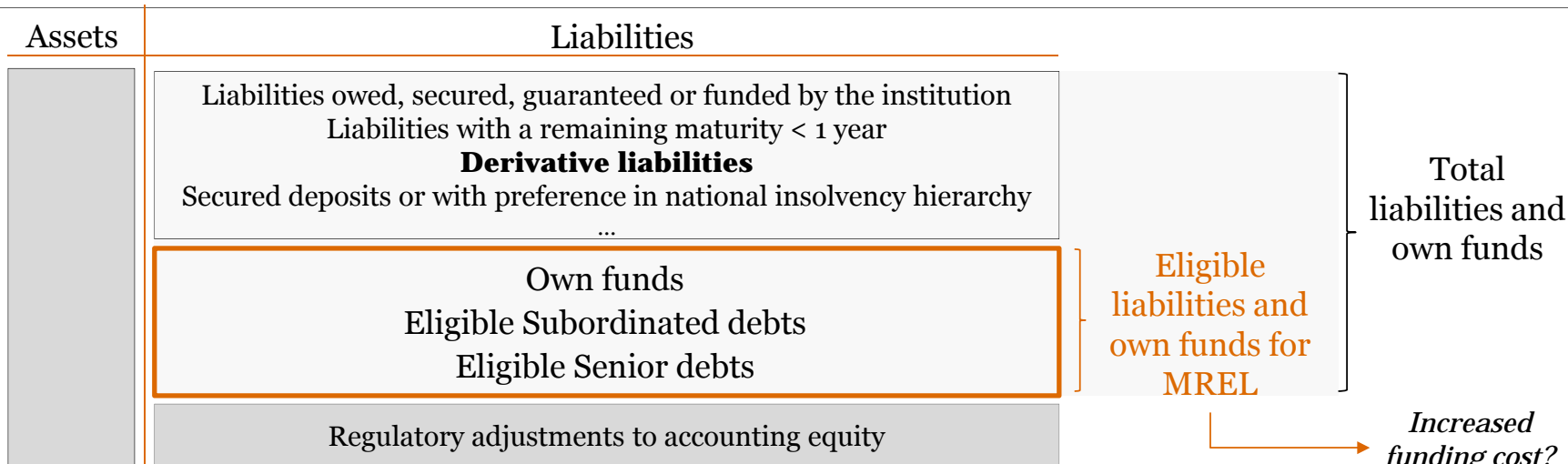
4. SRM

Minimum Requirement for own funds and Eligible Liabilities (MREL)

$$\frac{\text{Eligible liabilities and own funds}}{\text{Total liabilities and own funds}} \geq X\%$$

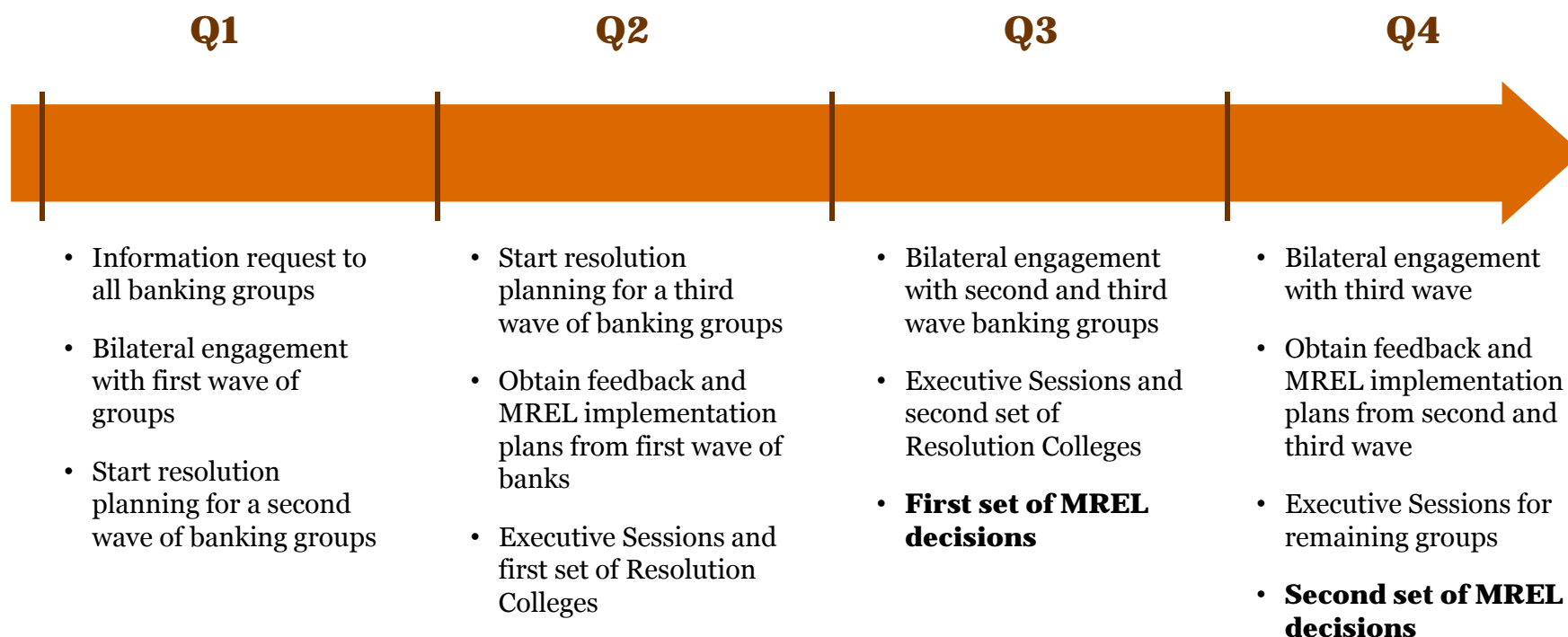
- Based on size, business model, funding profile, risk profile, possible DGS contribution...
- 8% Floor
- Min. Own Funds + Buffer
- Sub-floor for contractual bail-in instruments?

*Case-by-Case
using EBA
criteria*



4. SRM

Timeline for engaging with banks through 2016



4. SRM

Key messages

- 1** The existence of deposit insurance schemes **does not replace the need for MREL**
- 2** SRB to finalise **MREL decisions for the major banking groups within the Banking Union during 2016**
- 3** MREL targets expected to be set **not less than eight percent of total assets** – but on a case-by-case basis possibly above
- 4** **Individual implementation plans to reach the MREL target** to be put in place as soon as possible
- 5** MREL decisions require the **approval of resolution plans by the Executive Session of the SRB** and a **final joint decision** by a **Resolution College**

Thank you.



Burkhard Eckes

Partner, Banking & Capital Markets Leader, Germany
REcCE Banking & Regulatory Leader

direct: +49 30 26 36 2222
burkhard.eckes@de.pwc.com