

The SSM: legal hurdles in practice and the 2015 Annual Report

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The ECB published its 2015 Annual Report on the Single Supervisory Mechanism in March 2016. In this article we will compare the ECB's observations with the actual banking supervisory practice. Impressive steps have been taken, but supervision in the Banking Union is still far from perfect.

1. Introduction

On 23 March 2016 the European Central Bank (hereafter: the ECB) published its Single Supervisory Mechanism (hereafter: SSM) annual report over 2015 (hereafter: the Annual Report),² its first annual report covering a full calendar year. Having started on 4 November 2013, and having commenced its supervisory tasks one year later, the SSM has become the world's largest supervisory banking authority. This in less than two years – a historic and major accomplishment.

In this article we shall describe the most relevant observations from the Annual Report.³ We will do so by highlighting those observations per topic. At the same time, per topic, we will address various practical aspects for Dutch banks that we have seen in the market. What challenges do banks encounter in their supervision by the ECB and the Dutch Central Bank (De Nederlandsche Bank, hereafter: DNB)?⁴ To what extent does the ECB acknowledge those issues in its Annual Report?

2. The SSM – a high-level overview

2.1. General

For a full understanding of this article, it is necessary to be familiar with the most important parameters of the SSM. For ease of reading, we shall touch on those briefly below.^{5,6}

As from 4 November 2014, the ECB is the prudential supervisory body of all banks with a seat within the euro currency area. The ECB conducts direct prudential supervision with regard to 'significant' Dutch banks. With regard to the other – 'less significant' – Dutch banks, DNB is the direct prudential supervisory body, although the ECB will indirectly be of great influence.

The legal framework of the SSM is primarily laid down in the SSM Regulation and the Framework Regulation.⁷ With regard to its tasks, the ECB is authorised to adopt further regulations, guidelines, recommendations and decisions. These will then also become part of the Single Rulebook.⁸ In addition to the SSM Regulation and the Framework Regulation, the ECB has drawn up an internal 'Su-

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2. See: www.bankingsupervision.europa.eu.

3. We are writing this article in English. The SSM does not stop in the Netherlands. As we will set out below, with a view to efficiency and true harmonisation, we consider it important that the regulatory world speaks the same language, both literally and figuratively. This is also in line with actual SSM practice, as all significant banks have been asked to communicate with the ECB in English. According to the Annual Report (pp. 11 and 12), not all banks have agreed to receive formal ECB decisions in English: 34 out of 123 banking groups use a different EU language.

4. For this article we have received input and insight from various representatives of relevant banks.

5. In this article, we shall not discuss other elements of the EU Banking Union, such as the new Single Resolution Board or the envisaged European Deposit Guarantee Scheme.

6. See for instance: Danny Busch and Guido Ferrarini, *European Banking Union*, Oxford University Press 2015, Chapters 4 and 5 and B. Bierman and mr. L.J. Silverentand, 'De juridische en praktische gevolgen van het SSM: van het Frederiksplein naar de Kaiserstrasse', *FR* 2014, nr. 11. A user-friendly overview of the main supervisory processes, procedures and methodologies can be found in the 'Guide to banking supervision', published by the ECB on 29 September 2014. See: www.bankingsupervision.europa.eu.

7. Regulation (EU) nr. 1024/2013 and Regulation (EU) nr. 468/2014 (ECB/2014/17), respectively.

8. The Single Rulebook refers to the directly applicable harmonised material rules in the EU Banking Union (such as the prudential requirements of the Capital Requirements Regulation).

pervisory Manual' which functions as the basis for the supervisory work within the SSM.⁹

2.2. Significant banks

The supervision by the ECB takes place directly on 'significant institutions'. The ECB conducts indirect supervision on 'less significant institutions'.¹⁰ Significance is determined at group level.

If a bank established in a participating Member State (or its financial holding) is being consolidated at the highest level within the consolidation group satisfies one of the relevant significance criteria, it qualifies as 'significant'.¹¹ As an example, if the total value a banking group's assets is more than EUR 30 billion, such group qualifies as significant.

The ECB keeps a list of significant and less significant institutions and groups. According to the Annual Report, as per the end of 2015, 129 bank groups have been designated significant.¹² Those groups consisted of a total of around 1,117 supervised solo entities. At that moment, those banks represented almost 82% of the total banking assets in the Eurozone.¹³

For the Netherlands, on the basis of the abovementioned criteria, currently the following groups are considered significant: (i) ABN AMRO Group N.V., (ii) ING Groep N.V., (iii) Coöperatieve Rabobank U.A., (iv) SNS Holding B.V., (v) N.V. Bank Nederlandse Gemeenten N.V., (vi) Nederlandse Waterschapsbank N.V. and (vii) RFS Holdings B.V. All the banking subsidiaries in the same group established in a participating Member State are also considered a significant entity.¹⁴ They thus fall not only under consolidated basis but also under solo basis under direct supervision of the ECB.

2.3. Competent supervisory bodies

The ECB is the direct prudential supervisory body with regard to significant banks, in respect of the tasks and powers explicitly assigned to it. The day-to-day supervision on significant banks is largely assigned to the so-called *Joint Supervisory Teams* (hereafter: JSTs), who are under the management of the ECB, but in which employees of the National Competent Authority (hereafter: NCA), DNB for the Netherlands, will also participate. The NCA also often functions as a *single point of entry* for certain applications (with regard, for example, to licences and declarations of no objections) or reports.

The less significant banks fall under indirect supervision of the ECB. The ongoing supervision, with a number of exceptions, will still be conducted by the

relevant NCA. The ECB conducts overall oversight hereon. The ECB can nonetheless at all times decide to conduct direct supervision on certain less significant banks as well, such in order to safeguard the consistent application of high supervisory norms.

In the Netherlands, the AFM remains responsible for the conduct of business supervision of all banks. DNB in its turn, still conducts supervision on all Dutch banks with regard to tasks and powers which are not assigned to the ECB. DNB remains the supervisor on certain integrity aspects (such as sanctions or the prevention of money laundering and the financing of terrorism) for all Dutch banks. The same applies to topics such as payment services and the European Market Infrastructure Regulation.¹⁵

2.4. Tasks and powers of the ECB

The supervisory tasks and powers which have been specifically assigned to the ECB on the basis of Article 4(1) of the SSM Regulation relate to the supervision of the compliance with the regulatory framework for banks set out in the EU Capital Requirements Directive (hereafter: CRD IV) and the Capital Requirements Regulation (hereafter: CRR).¹⁶ To the extent relevant for this article, those tasks include:

- i. the granting and revoking of bank licences;
- ii. the granting of a declaration of no objection (hereafter: dno) for the acquisition or disposing of qualified participations in a bank;
- iii. the supervision of compliance with (CRR) rules with regard to capital requirements;
- iv. the supervision of (CRD IV) rules with regard to sound and controlled business practices, such as the fit and proper tests of persons responsible for the management, risk management processes, internal control mechanisms remuneration policy and effective internal capital adequacy assessment procedures (the ICAAP); and
- v. the conducting of supervisory review and evaluation processes (hereafter: SREP), including regular stress tests.

The two tasks first mentioned, the granting and revoking of bank licences and the granting of a dno, are assigned to the ECB with regard to all banks; thus also with regard to less significant banks.¹⁷

When supervising significant institutions, the ECB has the power to take measures if the bank does not comply, or will likely not comply, with the relevant prudential legislation and regulations.¹⁸ In such circumstance, the ECB has a number of specific far-reaching powers.

9. This Supervisory Manual is not public (see further below on this).

10. For the sake of clarity, hereinafter we will use the terms 'significant bank' and 'less significant bank'.

11. See Article 6(4) SSM Regulation.

12. Annual Report, p. 48.

13. Annual Report, p. 49.

14. Article 40 Framework Regulation.

15. Regulation (EU) nr. 648/2012.

16. Directive 2013/36/EU and Regulation (EU) nr. 575/2013, respectively.

17. Articles 14 and 15 SSM Regulation.

18. Article 16 SSM Regulation.

2.5. Applicable law

When it comes to the SSM, the ECB has to take into account all the applicable Union law (i.e. the Single Rulebook).¹⁹ This means the ECB applies all Regulations and further European legislation, consider in addition to the CRR also Implementing Technical Standards and Regulatory Technical Standards of the EC and Guidelines of the European Banking Authority (hereafter: EBA).

When it concerns directives, however, the ECB is required to apply the national legislation into which the directives have been transposed. Also where it concerns a Member State option in a Regulation, the ECB applies the national legislation in that framework. In those cases, the ECB thus applies the rules pursuant to or by virtue of the Act on Financial Supervision (*Wet op het financieel toezicht*, hereafter: Wft).

3. The Annual Report in practice

The Annual Report covers many aspects of the SSM. We have selected the topics which – in our view – are the most relevant and which result in practical obstacles for Dutch banks, both significant and less significant. The topics we will discuss below are:

1. Harmonisation;
2. Common supervisory methodology;
3. Reporting obligations;
4. Less significant institutions;
5. Proportionality;
6. Ongoing supervisory procedures;
7. Enforcement;
8. Administrative law protection; and
9. Supervisory priorities 2016.

3.1. Harmonisation Single Rulebook

The ECB has time and time again stressed that one of its main goals is to realise a fully harmonised set of regulatory banking rules (under the Single Rulebook) that is applicable to all banks in the SSM, regardless of their significance or location. The underlying rationale is that only full harmonisation results in a level playing field and unbiased supervision. The Annual Report states, rather strongly:

*'[A] fragmented regulatory framework is at odds with the overarching objectives of the banking union. At the same time, dealing with a wide array of different national legislations is far from ideal for the single European supervisor.'*²⁰

*'[T]he regulatory playing field in Europe is not as level as it should be.'*²¹

In addition to a harmonised set of material rules and requirements, the ECB also strives for a harmonised supervisory methodology applicable to the ECB and all NCAs. We will discuss this in greater detail in paragraph 3.2 below.

As to the banking rules, the ECB sees issues in respect of (i) different national interpretations and implementations of CRD IV / CRR rules, and (ii) in various options and national discretions allowed for by the CRD IV / CRR framework.

3.1.1. Different national implementation and interpretations

In the Annual Report, the ECB shows it is a strong opponent of national interpretations or gold-plating of banking rules. It states:

*'[T]he regulatory framework remains fragmented to a certain degree. With regard to CRD IV, for example, Member States have interpreted several provisions differently. National legislation varies from strict word-for-word transpositions of European legislation to national gold-plating. And in some countries national legislators are increasing fragmentation even further by converting non-binding supervisory practices into binding legal acts.'*²²

The ECB acknowledges that the lack of harmonisation leads to practical obstacles. Since the ECB has to apply the national rule implementing a relevant CRD IV provision, the ECB has encountered material competency issues. It is also confronted with a lack within its organisation of expertise on the local regulatory frameworks:

*'This [the lack of harmonisation, BBAD] poses another operational challenge for decision-making, since expertise on each of the 19 different national legislative frameworks is necessary also at the central level. And the regulatory framework is still being fragmented even further (...). In addition, national transpositions of CRD IV and national regulatory requirements that go beyond the European norms have, in specific cases, led to a debate about the ECB's exact supervisory powers. In a number of cases, this has led the ECB to exercise supervision through instructions to national competent authorities (NCAs).'*²³

The Administrative Board of Review (hereafter: ABR) also shares this concern in the Annual Report.

'In dealing with these topics, the Administrative Board has observed a lack of harmonisation in the implementation of European law at

19. See Article 4(3) SSM Regulation.

20. Annual Report, p. 5.

21. Annual Report, p. 67.

22. Annual Report, p. 5.

23. Annual Report, p. 12.

national level in areas such as bank consolidation or fit and proper requirements. In examining the requests for review, the Board noted that, in allowing a broad range of interpretation among the credit institutions, these differences make it challenging to review ECB decisions in a consistent manner.²⁴

The Dutch legislator (the Dutch parliament and the Ministry of Finance) and DNB are gold plating champions. For instance the 20% bonus cap, the bankers oath, the Dutch suitability requirements for board members and DNB's policy requirement that 50% of bank's supervisory board is formally independent. These rules create a serious lack of a level playing field for Dutch banks vis-à-vis their EU peers. It also makes proper supervision by the ECB, and proper review thereof by the ABR, very difficult.

The ECB explicitly requests legislators and regulators to take into account the SSM and the requisite harmonisation, when creating regulatory laws. We sincerely hope that the Dutch legislator and DNB take this request to heart.

'Many of the variations in national legislation can no longer be justified. Article 1 of the SSM Regulation requires the ECB to carry out prudential supervision 'with full regard and duty of care for the unity and integrity of the internal market'. The Article also refers to the 'equal treatment of credit institutions with a view to preventing regulatory arbitrage'. A fragmented regulatory framework makes it difficult for the ECB to meet these requirements.'

'And new differences are still being created. Some national legislators are converting non-binding supervisory practices into binding legal acts, thereby making it harder for the ECB to harmonise these practices. (...)'

'National banking legislation adopted after the establishment of the SSM should adequately consider the ECB's new responsibilities, with a view to facilitating the harmonisation of supervisory practices in the banking union.'²⁵

We note that a lack of harmonisation exists not only for the implementation of requirements, but also in respect of the backbone of banking regulation: the definitions. For instance, all Member States have their own (historical) interpretation of the definition of 'credit institution'. What is a bank? Since the entry into force of the CRR the definition of credit institution has been included in a directly applicable regulation. But the meaning of elements in that definition, such as 'public' and 'deposits and other repayable funds', has not yet been harmon-

ised and crystallised at an EU level. The Dutch legislator has indicated that as long as there is no EU level meaning of such elements, the former Dutch interpretations should be used.²⁶ In an opinion of 27 November 2014 on the perimeter of credit institutions the EBA indicated that there are too many different approaches across EU Member States on the interpretation of the definition of 'credit institution' in the CRR.²⁷ The EBA calls for one clear interpretation.

It is not clear, however, if and when that EU interpretation will be available. In order to remove uncertainties, we would welcome clear EU guidance in this respect. It is important, given the substantial practical impact of changing such interpretations, that any guidance allows for a sufficient phase-in or grandfathering period for those entities which suddenly qualify, or no longer qualify, as a bank.

On EU harmonisation, we note that the competent Dutch administrative court of appeals, the Trade and Industry Appeals Tribunal (*College van Beroep voor het bedrijfsleven*, hereafter: CBB) recently issued an interesting decision. The CBB had to decide on the definition of 'credit institution' for events occurring before the definition was included in the CRR, but was included in the Recast Banking Directive (as implemented in the Wft).²⁸ The appealing party referred to the difference in interpretation of that definition in other EU member states and claimed that the CBB should take that into account. Otherwise this would result in a lack of level playing field in the EU. The CBB considered that, given that the examples related to entities in another EU member state, there had not been a violation of the principle of equality.²⁹

'The fact that the definition of bank is based on EU legislation, does not make this differently. This involves the application of rules in concrete cases by other supervisory authorities in other member states. In accordance with standing case law of the CBB, for example the decision of 8 March 2006 (ECLI:NL:CBB:2006:AV5872), the fact that member states differently apply the implementation of EU legislation (...) does not mean that an administrative body violates the principle that equal cases must be treated equally, if this body applies EU legislation correctly.'

24. Annual Report p. 15.

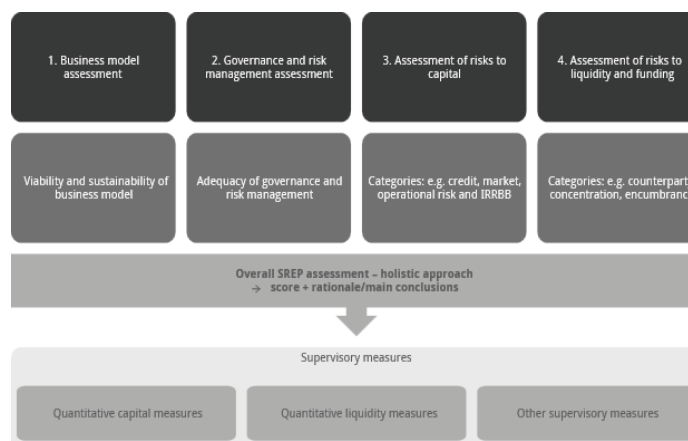
25. Annual Report, p. 67.

26. *Kamerstukken II 2013/14*, 33 849, nr. 3, p. 31. This means for instance that in the Netherlands 'public' is currently interpreted as 'to others than professional market parties, outside a restricted circle'.

27. The Opinion was based on a report in which the EBA summarizes the findings of a comprehensive study, which focuses on the interpretation of the term 'credit institution' and the prudential treatment of those entities established in the EU which carry on credit intermediation but are not 'credit institutions'.

28. Directive 2006/48/EC.

29. See Consideration 7.1.



Source: Annual Report, p. 31.

In our view, under the current SSM framework this consideration could not be upheld in respect of definitions or requirements from a directly applicable Single Rulebook. In order to achieve the ECB's goal of full harmonisation within the SSM, the competent Dutch courts should also take into account the interpretations and decisions by other competent authorities within the SSM.

3.1.2. Options and national discretions

In more concrete terms, on the road towards harmonisation, the ECB (together with the EBA) have decided to harmonise the various options and national discretions (hereafter: ONDs) in CRD IV and CRR (and further Delegated Regulations).³⁰ When drafting the CRD IV and the CRR in 2012 and 2013, the EU legislator left some flexibility to Member States (and their supervisory authorities) in the form of ONDs on whether or how to apply certain provisions. The intention hereof was to accommodate different national specifics and approaches. Note that at that time, the establishment of the banking union or the SSM was not yet conceivable. Currently 167 ONDs have been identified, of which 122 had been directed to the national supervisory authorities. ECB aims to harmonize those technical ONDs.

*'Many of [the ONDS, BBAD] (...) are the mere reflection of unquestioned traditions, pure national interest and regulatory capture. They have material effects on the level of prudence of the framework and on the comparability of capital ratios. They also add an additional layer of complexity as well as a source of regulatory arbitrage.'*³¹

The ONDs were divided between a Regulation and a Guide according to their modality of application (i.e. general or on a case-by-case basis).³² The regulation will become applicable on 1 October 2016.

30. Annual Report, p. 62-66.

31. Annual Report, p. 4 and 5.

32. Regulation (EU) 2016/445 of the ECB of 14 March 2016

To date, ONDs directed at the national Member States have been left untouched. Unfortunately this also applies to one of the most material impediments to the level playing field in practice; the possibility to have a lower bonus cap than 100/200%, resulting in the Dutch 20% cap. However, in its Annual Report, the ECB leaves room for hope:

*'Finally, a future line of work, to be pursued with the cooperation of the European Commission and the relevant national authorities, relates to the ONDs that have been exercised through national legislation, which remain a relevant source of asymmetry in supervisory treatment across the euro area.'*³³

3.2. Common supervisory methodology

The impact of regulatory supervision is not in the rules, but in the enforcement thereof by the competent supervisory authority. Supervisory practices and methodologies therefore, in practice, are equally as important as the relevant regulatory framework. As a result, it makes complete sense that the ECB also strives for one harmonised methodology across the SSM.

To this end all significant banks were for the first time subjected to a common annual supervisory review and evaluation process (hereafter: SREP) in 2015. The SREP is the annual assessment by the supervisory authority of each bank's compliance with the banking regulations (CRD IV and CRR). The JSTs applied the same methodology for all banks. The ECB published an SSM SREP Methodology Booklet on 19 February 2016.³⁴ Schematically, the SSM SREP methodology is as follows (see figure at the top of this page):³⁵

on the exercise of options and discretions available in Union law and the 'ECB Guide on options and discretions available in Union law' of March 2016.

33. Annual Report, p. 67.

34. https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm_srep_methodology_booklet.en.pdf

35. Annual Report, p. 31.

Based on the SREP, the ECB takes a SREP-decision for each bank in which it can set measures that it deems necessary given that bank's position.³⁶ This contains, for instance, the increase of regulatory capital (also called the 'Pillar 2' capital requirements).

In practice, we see that DNB uses its SREP and Pillar 2 powers to achieve the results it desires, whereby it works almost completely on a discretionary basis. In favour of the foreseeability of regulatory supervision and the level playing field among banks, we welcome a common SREP methodology. As we will discuss in paragraph 3.4 below, it is also important that such a common methodology fully and exclusively also applies to DNB's supervision of less significant banks.

As part of the common methodology, the ECB (and the NCA's) shall often and structurally apply on-site supervision.³⁷ The supervisory authority can be at the premises of the bank on a day-to-day basis. These on-site inspections can be on a case-by-case basis or be a part of a thematic assessment. The ECB has a specific Centralised On-Site Inspection Division, and creates common rules for on-site practices. It is important that DNB's on-site teams also apply those common practices.

Finally, with regard to the harmonised supervisory methodology, we would like to again mention the Supervisory Manual. This manual is described in the Annual Report as follows:

*'detailing the general principles, processes and procedures as well as the methodology for the supervision of significant and less significant institutions, taking into account the principles for the functioning of the SSM. It describes the procedures for cooperation within the SSM and with authorities outside the SSM. The Supervisory Manual is an internal SSM staff document (...).'*³⁸

Also see the Annual Report 2014:

'The Manual covers, among other topics, the methodology for the Supervisory Review and Evaluation Process (SREP), off-site and on-site reviews, risk assessments and model validations.

*The Manual was developed on the basis of the best supervisory practices of participating Member States. It needs to be implemented in all participating Member States to foster the necessary convergence of supervisory practices.'*³⁹

36. See Article 16(1)(c) SSM Regulation.

37. Annual Report, p. 35 and 36.

38. Annual Report, p. 77.

39. Annual Report 2014, p. 34.

The ECB even writes that the Supervisory Manual is 'pivotal to ensuring that the same supervisory standards are applied across the banking union'.⁴⁰

The fact that the Supervisory Manual is an internal staff document, means that the content thereof is not public and unknown to banks. It can be frustrating to supervised banks when members of the JST, in the framework of the fulfilment of their tasks, refer to the Supervisory Manual. This is a regular occurrence in practice. In the event and insofar as further details are provided in the Supervisory Manual on the relevant regulations, the confidentiality, furthermore, may be in conflict with the principles of legal certainty and equality of arms.

We understand that the Supervisory Manual is a living document and that the ECB would like to have the discretion to update the document at any time to reflect new market developments and supervisory practices. However, for reasons of transparency, the ECB should decide to publish the content of the Supervisory Manual on its website.

3.3. Reporting and data quality

The ECB is highly data-driven. As a result, the ECB aims for a harmonised data reporting framework with common reporting formats.⁴¹ In practice, we have noted that the ECB has a focus on data that is unprecedented in the Netherlands. This varies from the desire for a real-time insight into the bank's balance sheet, to requesting highly granular information on specific individual loans. We have various concerns in this connection.

Our first concern is the costs for banks related to implementing the new detailed formats. In the Annual Report, the ECB acknowledges proportionality for different types of reporting banks (significant or less significant and total assets). However, the ECB does not seem to acknowledge proportionality in respect of risk exposure for – for instance – loans on which a bank must report.⁴² The ECB aims to strike a balance between the availability of complete, consistent and regular reporting and the avoidance of an undue reporting burden.⁴³ However, the reasons why the requested information is reasonably relevant to the supervisory duties of the ECB are not always clear. This is important as, we understand from practice, the operational/IT costs for banks for changing data or reporting formats are very high.⁴⁴ This is also the case for the costs

40. Annual Report 2014, p. 34.

41. Annual Report, p. 19-20.

42. An important point for attention will be the introduction of credit data-analysis system AnaCredit (analytical credit datasets). On the basis thereof banks will have to furnish an enormous quantity of detailed information regarding individual credit facilities on a monthly basis. According to the current proposal this encompasses approximately 100 data fields per credit facility. It is expected that the gathering of data will start in 2018.

43. Annual Report, p. 19.

44. Also, in respect of timing the ECB does not seem to

of obtaining information from within the organisation, in order to comply with a one off information request.

The same goes for our second concern, which sees to the legal basis of the various information and data requests. The ECB has adopted the ECB Regulation on reporting of supervisory financial information.⁴⁵ The regulation aims to close some of the data gaps in supervisory reporting.⁴⁶ The ECB, however, also collects reporting and 'statistical information' on the basis of other regulations, which data may also be used for supervisory and risk analysis purposes and for decision-making.⁴⁷ The mutual connection and the order of precedence between the relevant ECB regulations and ECB decisions is not easy to understand. The situation becomes even more complex when both the NCA (DNB) and the ECB request similar information in apart from each other. It would benefit the transparency if the patchwork of different rules on the powers to request information were further streamlined and harmonised. The ECB should also clearly inform the relevant bank of the specific legal grounds for each of these information requests.

Our third concern is the possible conflict between reporting personal customer details to the ECB and applicable privacy laws. The ECB has issued Guidelines concerning the extension of common rules and minimum standards to protect the confidentiality of the statistical information collected for its supervisory tasks.⁴⁸ The Guidelines list the protective measures that the ECB will take in order to protect confidential statistical information. These measures aim to prevent unauthorised access to confidential statistical information and for instance limit staff's access to physical areas. But those guidelines do not restrict collecting data in itself and do not provide for specific measures to protect the privacy of individuals. The policy on the protection of individuals with regard to the processing of their personal data by the ECB is based on the Data Protection Regulation⁴⁹, which applies to all EU institutions. The ECB is required to process personal data in accordance with this regulation. Within the ECB, the Data Protection Officer aims to ensure that the provisions of that regulation are applied. These safeguards do not change the fact that de ECB, being provided with data from approximately 4,600 significant and less significant banks relating to a very large number of clients, has access to an enormous amount of personal data. The Supervisory Statistics Division collects and recon-

ciles more than 24,000 data reports per quarter.⁵⁰ This data is stored within the Supervisory Banking data system (SUBA). In our view, banks should be given the opportunity to provide the requested data to the ECB on an anonymous basis, with personal data removed.

3.4. Less Significant Institutions

The SSM is also highly relevant for less significant banks.

As stated above, the ECB applies direct supervision on the significant banks, and only an indirect oversight of supervision on less significant banks. In the Netherlands, DNB remains the day-to-day supervisor for all less significant banks.

However, the ECB takes its oversight role on less significant bank very seriously. The Annual Report explains in detail the ECB's overview of supervision on less significant banks.⁵¹ In its overview of the NCAs, the ECB notes there are significant variations 'in areas such as:

- *the staff resources per supervised LSI [less significant bank; BBAD];*
- *the number of supervisory decisions related to LSIs taken by NCAs (indicating differences between NCAs decision-making approaches);*
- *the average durations of on-site inspections at LSIs;*
- *the frequency and type of regular interaction with LSIs;*
- *different risk assessment methodologies (e.g. in terms of frequency, scoring scale or aggregation methodology).*

Some of these variances relate to temporary factors, to differences in terminology or to the different nature of the LSI sectors across the SSM, while others reveal more fundamental differences in the conduct of supervision at the start of the SSM.⁵²

As a result, in 2016, the ECB will work with the NCAs towards harmonisation. Further convergence has been highlighted, for example, in developing the common risk assessment system, a common SREP, and preparing joint supervisory standards on topics such as on-site inspections. There will also be a compendium of joint supervisory standards and legal instruments providing consistency in the main areas of NCAs' supervision of less significant banks. The ECB also actively assesses certain high-priority less significant banks. The NCA's provide the ECB *ex ante* notifications on material supervisory procedures and on draft decisions relating to high-priority less significant banks on various supervisory issues (a total of 54 in 2015). The ECB also participates in the assessment of common procedures related to the less significant banks (such as granting/with-

take into account that the moment to change IT based formats within a bank depends on its IT 'change calendar'.

45. ECB/2015/13.

46. Annual Report, p. 20.

47. For an overview of these other regulations, we refer to considerations 1 to 3 of the Regulation ECB/2015/13.

48. Guideline (EU) 2016/256.

49. Regulation (EC) No 45/2001.

50. https://www.bankingsupervision.europa.eu/about/ssmexplained/html/supervisory_statistics.en.html.

51. Annual Report, p. 41-45.

52. Annual Report, p. 44-45.

drawal of authorisations and qualifying holdings assessments).

The ECB provides support and input to the NCAs for conducting the direct supervision of less significant banks. The ECB also has specialised country desks. This is intended to further nurture harmonisation of the NCAs' supervisory assessment methodologies.

In practice, we see a schism between the significant banks and non-significant banks as DNB's supervision is not entirely aligned with the ECB's supervision. An example of this relates to the SREP assessments by DNB and the ECB. In practice, DNB aims to impose certain requirements on all Dutch less significant banks, as a Pillar 2 requirement. Those same requirements are not equally imposed by the ECB on all significant banks.

We trust that DNB will truly adhere to the harmonised rules and methodologies, in respect of less significant banks. Also, it should not add its own policies, rules and methodologies. Otherwise, the SSM will consist of two supervisory frameworks which results in an inherent lack of a level playing field between significant and less significant banks, and between less significant institutions in different Member States.

We note that reports of breaches of relevant EU law by the NCA's in its supervision of a less significant bank, can be provided to the Enforcement and Sanctions Division of the ECB (also see below in paragraph 3.7).⁵³ In our view, this means a less significant bank might request the ECB to start an investigation if it considers that the NCA has breached harmonised rules from the Single Rulebook, for instance with regard to capital requirements as contained in a SREP decision.⁵⁴

3.5. Proportionality

Both under Dutch administrative law as well as under EU supervisory powers, the importance of proportionality in the context of the exercise by the ECB cannot be understated.⁵⁵ The EU proportionality principle applies to all institutions of the EU and provides – in short – that the content and form of an action by EU institutions shall not exceed what is necessary to achieve the objectives of the Treaty on the European Union. Under the principle of proportionality any proposed measure must be appropriate and necessary to achieve the objectives pursued, and must genuinely meet the concern in a consistent and systematic manner.⁵⁶ The measure

must be the least restrictive means available to secure those objectives and must not create disadvantages that outweigh the benefits.⁵⁷ The greater or more onerous the restriction, the more compelling the justification or objective pursued.⁵⁸

The importance of the principle of proportionality is acknowledged by the ECB in the Annual Report. In it the ECB writes that it respects the principle of proportionality by distinguishing between different groups of banks, depending on whether they are significant or less significant and taking into account their diversity in terms of size and business models.⁵⁹ The ECB has developed a prioritisation framework, which classifies less significant institutions into low, medium and high priority based on their intrinsic riskiness and their potential impact on the domestic financial system:

*'The classification allows for aligning the level of supervisory oversight and the intensity of supervisory activities accordingly.'*⁶⁰

In a letter dated 2 October 2015 from the chair of the Supervisory Board of the ECB, Danièle Nouy, to the European Parliament following a hearing of the Committee on Economic and Monetary Affairs (ECON), the ECB gives an overview of how the ECB aims to apply the principle of proportionality in the SSM:

'As the use of supervisory tools can be very intrusive, it is crucial that the supervision of credit institutions is consistently guided by the principle of proportionality. For all supervisory measures that the SSM imposes on institutions, including for example Pillar 2 capital requirements, this means that each measure must be (i) necessary to achieve a legitimate aim and (ii) pursued in a suitable and reasonable manner.'

The letter continues:

'(...) applying proportionality means that supervisory practices must be commensurate not only with the systemic importance (which is reflected in the minimum levels of supervisory activities), but also with the individual risk profile of each credit institution under supervision. Accordingly, the intensity of the ECB's supervision varies across credit institutions, with a stronger focus on institutions with a higher risk profile, on the largest and more complex systemic groups and on the more relevant subsidiaries within an SI banking group. This is consistent with the SSM's risk-based and con-

53. Article 23 SSM Regulation.

54. Breaches can be reported via the ECB's website: <https://www.bankingsupervision.europa.eu/banking/breach/form/html/index.en.html>.

55. The principle of proportionality is laid down in Article 5 of the Treaty on European Union. The criteria for applying it are set out in the Protocol (No 2) on the application of the principles of subsidiarity and proportionality annexed to the Treaties.

56. See Case C-186/11, Stanleybet, 2013 and Case C-265/06, Commission v. Portugal, 2008.

57. See Case C-141/07, Commission v. Germany, 2008 and Case C-331/88, Fedesa, 1990.

58. See European Commission, Free Movement of Goods: Guide to the Application of Treaty Provisions Governing the Free Movement of Goods, 2010, at section 6.4.

59. Annual Report, pp. 20 and 43.

60. Annual Report, p. 43.

solidated supervisory approach. In practice, this is reflected, for example, in the different amounts of human resources allocated to the different JSTs.'

The coming years will show the extent to which the ECB is actually able to introduce the principle of proportionality into practice and how the market will perceive this. The number and scope of ECB's data and information requests and the exercise of other supervisory powers, such as on-site inspections, show that this will be a challenge.

3.6. Ongoing common supervisory procedures

As set out above in paragraph 2.1.4, the ECB is responsible for the common supervisory procedures falling within the scope of its tasks for significant banks. For all banks, it is responsible for granting and revoking banking licenses and granting declarations of no objection for qualifying holdings in a bank. In the Annual Report, the ECB describes its activities on these common procedures in great detail.

The ECB has processed a total of approximately 3,400 authorisation procedures.⁶⁴ This included:

- 7 licence applications;
- 61 licence withdrawals;
- 137 acquisitions of qualifying holdings (dno applications);
- 435 passporting procedures; and
- 2,730 fit and proper assessments for management and supervisory boards.

The large number of fit and proper assessments is remarkable. In the Netherlands, the fit and proper tests have been part of a public debate. This is reason for us to focus on these procedures.

The ECB indicates that it has found the large number of fit and proper applications difficult to handle. It confirms our observation from practice that the relevant statutory deadlines have often not been met. Fortunately, instead of aiming for extending the deadlines, the ECB indicates that it will foster better cooperation with the relevant NCAs.⁶²

From a 2015 EBA Report, it appeared that all SSM member states have a different approach and methodology toward fit and proper assessments.⁶³ As a result of this finding, the ECB and the NCA developed harmonised policy stances on this. These policy stances (which to this date have not yet been published) deal with – for instance – the assessment

of a board's collective suitability, the number of directorships, experience and candidate interviews. It should be noted that DNB and the Dutch Ministry of Finance concluded, based on the EBA Report, that its thorough vetting of prospective board member is seen as a best practice.⁶⁴ It is therefore no surprise that the SSM harmonisation effort of the fit and proper methodologies is chaired by a DNB representative.

3.7. Enforcement

When regulatory requirements are breached, the supervisor may impose sanctions.⁶⁵ The Annual Report also discusses enforcement in 2015.⁶⁶ The ECB can for instance impose administrative penalties of up to twice the amount of the profits gained or losses avoided because of breaches where those can be determined, or up to 10% of the total annual turnover in the preceding business year.⁶⁷

The ECB's Enforcement and Sanctions Division investigates alleged breaches by banks of directly applicable EU law, national law transposing EU directives or ECB regulations and decisions. The JST may refer a case to the Enforcement and Sanctions Division for follow-up, based on its own investigation. The Enforcement and Sanctions Division acts independently from the Supervisory Board to ensure the impartiality of the Supervisory Board members when they adopt a sanctioning decision.

In 2015, the ECB initiated one sanctioning proceeding in relation to suspected breaches of directly applicable EU law by a significant supervised entity. In addition, the ECB addressed two requests to NCAs to open sanctioning proceedings within the remit of their national competences. The ECB also initiated one enforcement proceeding regarding a suspected breach of an ECB supervisory decision by a significant supervised entity. It follows from the Annual Report that these suspected violations relate to governance, large exposures, capital requirements, public disclosure and reporting obligations.⁶⁸

Compared to the number of banks which are under supervision of the ECB, it must be concluded that the enforcement activities of the ECB in 2015 were limited. This creates the impression that in 2015, the ECB wished to focus all its attention on assessing the starting picture of all banks which are under supervision. The ECB expects that in the

61. Annual Report, p. 49. For the outcome of these procedures, we refer to the Annual Report.

62. Annual Report, p. 51. This will likely in practice mean that the NCA's will have more responsibilities in respect of procedures for subsidiaries within significant banking groups.

63. See the EBA Report dated 16 June 2015 on the peer review of the Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2012/06).

64. See a speech by the Dutch Minister of Finance of 24 September 2015: <https://www.rijksoverheid.nl/documenten/toespraken/2015/09/24/toespraak-van-minister-dijsselbloem-bij-de-internationale-conferentie-van-dnb>.

65. See for an overview: R.P.A. Kraaijeveld and G.J.S. ter Kuile, 'Toezichtsbevoegheden en sancties onder het Single Supervisory Mechanism', *TvS&O* 2015, nr. 5/6.

66. Annual Report, p. 52-54.

67. Article 18 SSM Regulation.

68. Annual Report, p. 54.

coming period, it can now focus on enforcement of violations, where appropriate:

*'After the initial stage of the SSM, during which the focus was on gaining knowledge of the prudential situation of the supervised entities, the ECB's policy stance for the next cycle can be expected to lead to an increase in the use of its enforcement and sanctioning powers.'*⁶⁹

After all, the ECB has indicated on various occasions that it will be a tough supervisory authority.⁷⁰

3.8. Administrative law protection

For an overview of administrative law protection under the SSM, we refer to earlier publications in the relevant Dutch legal journals.⁷¹ As far as we are aware, no case law is yet available from the competent Dutch administrative courts and the Court of Justice of the European Union with regard to the exercise of its supervisory powers by the ECB.

It follows from the Annual Report that eight requests for an administrative review were filed with the ABR.⁷² The ABR carries out internal administrative reviews of decisions taken by the ECB in the exercise of its supervisory powers. Any natural person or supervised entity may request a review of an ECB decision which is addressed to them, or which is of direct and individual concern. The ABR may even propose to the Governing Council that it suspends the application of the contested decision for the duration of the review procedure.⁷³ The ABR is composed of five independent members who are not ECB or NCA staff. A request for a review of an ECB decision by the ABR does not affect the right to bring proceedings before the Court of Justice of the EU.

It follows from the Annual Report that the ABR adopted six opinions in 2015: two proposing to maintain the initial ECB decision and four proposing to amend the ECB decision or to improve the reasoning. The other two requests were withdrawn by the applicants.⁷⁴

The ABR dealt with the following main topics in the course of the examination of the decisions under its review:

*'scope of the consolidated supervision (e.g. the powers of the ECB vis-à-vis the holding company as parent of a banking group; the status of joint ventures in banking groups); and corporate governance rules, in particular regarding the separation between supervisory and management functions within the credit institutions.'*⁷⁵

The Annual Report shows that the ABR has taken an active position in order to try to achieve a solution, by mediating between parties:

*'In the two cases where a request for review was withdrawn before the Administrative Board issued an opinion, the Board, including its Secretariat, contributed to the resolution of issues to the satisfaction of both the applicant(s) and the ECB, by playing a mediation role between the ECB and the applicant(s).'*⁷⁶

This mediation role is striking, given that this is not explicitly provided for in the Decision of the ECB concerning the establishment of an ABR and its Operating Rules.⁷⁷

From a procedural point of view, we note that the Annual Report mentions that an oral hearing of the applicant(s) has proven to be an important element of the review process:

*'It gives the applicants, who are often represented by their senior management, the opportunity to be heard by the Administrative Board of Review and the ECB the opportunity to present its views.'*⁷⁸

With regard to the ABR's assessment framework, the Annual Report sets forth:

*'As stated in Article 24.1 and Recital 64 of the SSM Regulation, the scope of the Administrative Board's review should pertain to the procedural and substantive conformity of ECB decisions with the SSM Regulation while respecting the margin of discretion left to the ECB. Where the ECB has exercised this discretion, the Board's review has been limited, in accordance with the case-law of the Court of Justice of the European Union, to establishing whether the contested decision was impaired by a manifest error or misuse of powers and whether or not it clearly exceeded the bounds of the ECB's discretion. The Board has also verified whether the relevant procedural rules were complied with and whether the facts on which the disputed decisions were based were accurately stated.'*⁷⁹

69. Annual Report, p. 54.

70. See for instance Annual Report 2014, p. 5: 'We will be a tough supervisor but, at all times, will strive to be fair and even-handed in our actions'.

71. See for instance S.M.C. Nuijten, 'Rechtsbescherming bij toezicht onder het SSM', *FR* 2014/11 and B.J. Drijber & A. van Toor, Van ESA's, SSM en SRM: rechtsbescherming in een labyrint van Europese regels voor het financiële toezicht, *Ondernemingsrecht* 2015/1.

72. Annual Report, p. 14-15.

73. Article 9 of the Decision of the ECB of 14 April 2014 concerning the establishment of an Administrative Board of Review and its Operating Rules (ECB/2014/16).

74. Annual Report, p. 14.

75. Annual Report, p. 14.

76. Annual Report, p. 14.

77. See footnote 73.

78. Annual Report, p. 14.

79. Annual Report, p. 14.

The above demonstrates that the ABR provides active and pragmatic substance to the tasks it is charged with, while at the same time respecting the margin of discretion left to the ECB. We welcome this. The fact that the ABR consists of members who are not employed by the ECB, means there is an actual effective form of legal protection. True, decisions of the ABR are not binding, but it follows from the Annual Report that the decision of the ABR can in fact influence (further) decision-making within the ECB. This is in contrast to the internal reconsideration in objection by DNB.⁸⁰ This is executed by lawyers in the employment of DNB, assisted by the supervisors who were responsible for the primary decision. We have learned from experience that this setting does not benefit the objectivity of the assessment. There is absolutely no possibility of a mediating role by the handlers of the objection within DNB.

3.9. Supervisory priorities 2016

Having looked at the more general topics of the SSM and its current legal challenges, we consider it important to also briefly describe the ECBs supervisory priorities for 2016. In the Annual Report, the ECB highlights its plans and focal points for the coming year.⁸¹ The ECB indicates that it will use these priorities to coordinate supervisory actions across banks (both significant and less significant) in an appropriately harmonised, proportionate and efficient way.

The priorities are:

(i) Business model and profitability risk

The ECB has started a thematic review on the banks' profitability drivers (both at the institution level and across business models within the institution). An area of supervisory focus for 2016 will be to examine whether profitability is achieved 'through a weakening of credit underwriting standards, greater reliance on short-term funding, or an increase in risk exposures'.⁸² In other words, the ECB will analyse whether banks are increasing profits by taking on riskier business.

(ii) Credit risk

The ECB is concerned about the high level of non-performing loans (NPLs) in some SSM Member States. This is especially the case for a number of 'Mediterranean countries', which have been hit hard by the financial crisis. An ECB task force is reviewing individual institutions with high levels of NPLs, and is to propose follow-up actions. It will

also scrutinize exposure concentrations in areas such as real estate.

(iii) Capital adequacy

Some capital aspects that the ECB will focus on are the quality and consistency of banks' ICAAP (including, for instance, stress tests) and the quality and composition of banks' capital buffers itself. In addition, ECB and the NCAs shall review the banks' preparedness for new regulatory standards such as total loss-absorbing capacity (TLAC)⁸³ and the minimum requirement for own funds and eligible liabilities (MREL).⁸⁴

(iv) Risk governance and data quality

The ECB will assess compliance with the Basel Committee on Banking Supervision's (BCBS) principles for effective risk data aggregation and risk reporting.⁸⁵ There will also be follow-up actions to the 2015 thematic review of risk governance and appetite. Later in 2016, the ECB will publish a report on best practices for risk governance and appetite. Since data quality and security requires a high level of IT infrastructure, the ECB will also focus on IT risks.

(v) Liquidity

The 2015 SREP has shown that many banks do not yet fully have a sound management of liquidity risks. As a result, the ECB is currently further developing the SREP methodology on liquidity risk. In practice, harmonisation across jurisdictions of thematic topics and priorities can sometimes be counter-productive. Even in a single market such as the EU there are still material differences between the various countries and their banks. In the Netherlands the level of NPLs is relatively low. In addition, the Dutch residential mortgage market is historically highly leveraged, but sound. We have seen that supervising Dutch banks without this local expertise, and focusing on a general theme that may not be relevant to Dutch banks, can be costly and inefficient. The same applies to the focus on liquidity risks. Dutch regulatory law already had liquidity requirements in place prior to the EU harmonisation thereof in October 2015. As a result, Dutch banks have relatively good scores on liquidity ratios.

The same applies for a lack at an ECB level of local law expertise. Especially where those laws have not been harmonized at an EU level. For instance, in corporate law related aspects, this can lead to

80. C.A. Doets, 'Boeteoplegging door de AFM en DNB: over redelijkheid en functiescheiding', *TvS&O* 2015, nr. 5/6.

81. See Annual Report, p. 7-9. The ECB had already published the 2016 priorities in January 2016: 'ECB Banking Supervision: SSM priorities 2016', available on www.bankingsupervision.europa.eu.

82. Annual Report, p. 8.

83. This is a capital requirement for Global Systemically Important Banks (in the Netherlands, ING), issued by the Financial Stability Board on 9 November 2015.

84. These requirements shall result in minimum requirements for 'bail-inable' capital instruments under the Banks Recovery and Resolution Directive.

85. See the January 2013 BCBS report 'Principles for effective risk data aggregation and risk reporting'.

difficulties in understanding governance arrangements. Typical Dutch structures such as the two-tier board system or the use of depositary receipts (*certificaten van aandelen*), may require thorough education at ECB level. With a view to this, cooperation between DNB and the ECB, especially on local expertise is crucial. For this to work, the ECB must be open to local law 'peculiarities' which may not always seem the ideal solution for an outsider.

Finally, DNB has also announced its own priorities for 2016.⁸⁶ In the relevant report, DNB indicates that it has coordinated its supervisory themes with the ECB. In our view, it is important that DNB does not add another layer of supervision to the ECB on areas where it does not have competence. DNB has, for instance, included a review on sound remuneration policies in its agenda, whereas – for significant banks – this falls under the ECB's supervision. In addition, DNB remains the integrity supervisor of significant banks (focussing on sanctions and anti-money laundering), whereas the ECB has also made integrity a priority.⁸⁷

4. Conclusion

Institutional relationships do not change overnight. It would be illusory to expect that the genesis of the largest banking supervisory authority would be without hiccups both organizationally and institutionally. At least the Annual Report has been very insightful and transparent. Nevertheless some challenges remain.

We see a few SSM themes over 2015, which will remain relevant for the future:

- Harmonisation: The Annual Report shows ECB's strong aim for true harmonisation within the SSM. We hope that this will help eliminate the tradition of goldplating in the Netherlands. It is good to see that the ECB acknowledges that harmonisation is not only a matter of one set of rules and regulations, but especially of one of methodologies and practices. This should lead to an actual level playing field: both between significant and less significant banks, as well as between banks located in different SSM member states.
- Opaqueness: In some areas the SSM lacks clarity. In practice, members of a JST regularly refer to the internal Supervisory Manual of the ECB, of which the contents remains confidential. The division of responsibilities between the ECB and the NCAs is often not clear, nor are the various roles that the ECB and DNB assume (supervisory authority, statistical authority, integrity supervisor). The same even applies to the question which administrative law protection route to take. We hope that all of this will soon be improved. We see the Annual Report as a good step

in that direction.

- Workload: The SSM has resulted in an even further increase of workload – and costs – for Dutch banks. Examples are the focus on data and reporting, the many information requests, and the common overlap between two supervisory authorities (the ECB and DNB). We hope that the supervisory authorities will realise this and also take into account the costs, effectiveness and feasibility of what they are asking. The proportionality principle should be taken seriously and be applied where reasonable.

We are looking forward to the next SSM annual report, beginning of 2017, to see how these issues will have developed. If the above challenges are sufficiently addressed Dutch banks, both significant and less-significant, might truly benefit from the SSM – maybe even beyond expectation.

86. Outlook on Supervision 2016 (*Toezicht vooruitblik 2016*), see p. 12-14.

87. Annual Report, p. 22-23.