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Let us, big and small, all hail the SSM!

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The two acronyms that will undoubtedly top the list of oft-used expressions by European bankers in 2014 are AQR and SSM. With the AQR behind us, most of the banking world is now fully cognisant of the process. The AQR and join-up into the stress testing exercise is something that Malta's three significant banks have painfully gone through over the larger part of 2014. Our attention therefore now turns to the Single Supervisory Mechanism or SSM.

The SSM framework lays the foundation for the transfer of supervisory authority of the national supervisory authorities or NCAs like the MFSA to the ECB for some banks, based on the classification of institutions into "significant" or "less significant". Significant banks, which account for approximately 85% of the assets of the euro area banking sector, will be directly supervised by the ECB – primarily driven through specific taskforces, which are referred to as the Joint Supervisory Teams (JSTs), and which are made up of staff from both the ECB and the local regulator. It is widely acknowledged that the responsibility in the oversight of "significant" institutions will almost exclusively be at the ECB level, with local regulators having more of a supportive function – albeit we still have to see how this will work in practice.

On the other hand the NCAs will have responsibility for direct supervision of the approximately 3,400 "less significant" institutions, with ECB monitoring such supervision, thereby guaranteeing a harmonised approach and consistency of quality. Less significant should not be construed as meaning lower risk or, less important. In fact, very often smaller institutions may carry more risk insofar as systems, controls and governance. However the impact of that risk crystallising is not considered to be as significant on the EU wide financial landscape.

Pertinent to point out however that, all banks will be supervised according to the same supervisory manual, with the ECB retaining the right to assume direct supervision of any credit institution so as to ensure certain levels of supervisory standards. Most of the less significant banks are not understanding the implication of this. Many strongly believed that since they have been spared the AQR process, therefore change will not be heading their way. In reality they too will not be spared and it is safe to say that the ECB's supervisory powers, in principle, will extend to all credit institutions.

While it will be challenging for the ECB to monitor "less significant" banks effectively, comprehensive reporting will play an integral part in ensuring that the ECB is on top of things. NCAs now have the obligation to submit regular reports to the ECB, in particular, but not limited to providing data on performance of banks, information on high earners, issues on money laundering etc. In addition to this, there will also be a possible increase in ad-hoc requests from the ECB directly to the banks, including on-site inspections which may be on the increase. Banks big and small should therefore brace themselves for a significant increase in the volume of data required to complete assessments, the use of key risk indicators, and the level of prescription within the assessment themselves (e.g. use of questionnaires in each of the risk categories). In general requests for data will increase and therefore banks must continue to develop their data warehousing and analytics capabilities.

In addition to NCAs sending annual reports to the ECB in a specified format, NCAs will also have the obligation to report immediately to the ECB on the deterioration of the financial situation of an institution. To cater for ongoing monitoring of banks, the SSM has developed a common methodology

known as the Supervisory Review and Evaluation Process (SREP), which manages the on-going assessment of credit institutions' risks, their governance arrangements and their capital and liquidity situation. The idea is to apply SREP proportionately to both significant and less significant institutions to monitor that the highest and most consistent supervisory standards are upheld.

It is expected that there will be at least three new additions to the list of Maltese credit institutions by the end of 2014. But the impact of the ECB on the granting of new banking licences is currently a question mark for potential investors. It is known that under the SSM, the ECB jointly with the NCA has the power to grant and withdraw the authorisation of any credit institution in the euro area. Authorisations of fresh licenses will be managed through a set of procedures, known as, the "common procedures" which outlines the process that the NCA must follow to inform the ECB of a new banking application. Briefly, the NCA has 15 working days to advise the ECB of the fresh banking licence, and assuming that all required information has been submitted, such applications will then be subject to a simultaneous assessment by the receiving NCA, the ECB and potentially any other NCAs concerned, to ensure that all parties are au courant of the proposed business model of the new bank and its viability. The final decision on approval or rejection rests with the ECB.

As of the 4th of November 2014, the SSM has become a reality. However, as with anything new, there remains a substantial amount of detail still to emerge. A critical factor surrounds the existent relationships and how these will change. Most Maltese banks and industry stakeholders have traditionally put a lot of store by supervisory relationships, but the truth is that the domestic nature of banking supervision has, as of this year, been relegated to the history books. The role and responsibility of the Banking Supervision Unit at the MFSA will need to morph in response to the new supervisory techniques and expectations.

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