Welcoming Speech by Mr. Pierre Beck
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Ladies and Gentlemen,

It is a pleasure for me to welcome you in the premises of the Central Bank of Luxembourg at the occasion of the 9th European SSM Round Table, and to share with you some thoughts and experiences about today´s topic "Progress in SSM Regulation". Five years ago, the EU has adopted the SSM Regulation , which established [1] the Single Supervisory Mechanism (SSM) and in November 2014, the SSM became operational.

Anniversaries are good opportunities to put things in perspective and evaluate what has been achieved. Let me first set the scene, looking back at the past developments, which defined the legislative and institutional framework of the Single Supervisory Mechanism (SSM).
The SSM was the first step towards the establishment of a Banking Union, a project decided in 2012, as a response to the global financial crisis.
The bailing out of banks heavily affected the public finances of the Member States and they became even unsustainable in some instances. This triggered a negative feedback loop between bank debt and sovereign debt and the financial crisis thus turned into a sovereign debt crisis, which peaked between 2010 and 2012. Two aspects drew particular attention: the crisis put the spotlight on financial institutions that were *too big to fail* and highlighted the need to strengthen supervision of large and complex financial institutions. At the same time, the concept of systemic risk re-emerged.
In October 2008, the European Commission mandated a High Level group, chaired by Mr Jacques de Larosière, to make proposals to strengthen European supervisory arrangements covering all financial sectors, with the objective to establish a more efficient, integrated and sustainable European System of Supervision. The de Larosière report provided [2] a blueprint to

review the entire framework.

A revised supervisory framework

As a result, in 2010, the European System of Financial Supervision (ESFS) was introduced. It comprises the following institutions:

- the European Systemic Risk Board, the ESRB;
- three (3) European Supervisory Authorities (ESAs)[3] in charge of the oversight of micro-prudential risks, namely
  - the European Banking Authority (EBA),
  - the European Securities and Markets Authority (ESMA) and
  - the European Insurance and Occupational Pensions Authority (EIOPA),

All of these are supposed to cooperate closely with national authorities.

The mission of the ESRB is to ensure the macro-prudential supervision of the financial system in the Union. Given the leading role of central banks in this field, the President of the ECB has the chair. Following a recommendation of the ESRB in 2011, each member state had to put in place a national macro-prudential authority[4].

In Luxembourg, the “Comité de risque systémique” / `(*Systemic Risk Committee)*[5] was created in 2015[6] to be the national authority entrusted with the conduct of macro-prudential policy. The Committee is chaired by the Minister of Finance. It comprises representatives of the Central Bank and of the relevant supervisory authorities, i.e. the CSSF and the CAA and the Central Bank also provides the Secretariat. It’s mission is to coordinate the operation of macroprudential policy at national level and European level.

As regards the micro-prudential supervision of the banks, the Banking Union ensures that EU banks are stronger and better supervised. It comprises 3 pillars , the SSM as the first pillar, the Single Resolution Board (SRB) and the Single Resolution Fund as a second pillar, with the Bank Recovery and Resolution Directive (BRRD) harmonising the national frameworks.

Finally, the third (3rd) pillar consisting of the deposit guarantee schemes (DGS) was also improved and further harmonised at

the EU level. Needless to mention the necessity to finalise the Banking Union by establishing the European deposit insurance scheme (EDIS), which, at this juncture, remains a legislative proposal.
At national level, the BCL participates in the national resolution authority, the Conseil de Résolution, (in short "Coderes"), the second pillar, and in the *Conseil de protection des déposants et des investisseurs*, the CPDI, the third pillar.
After having set the scene, let me now turn to the achievements and challenges of the SSM Regulation, with my assessment being also based on practical experience and insights derived from our role as Central Bank of Luxembourg in the functioning of the Single Supervisory Mechanism.
Regarding the SSM, since its inception, the BCL is playing an **active role** in assisting the European Central Bank (ECB) to carry out its tasks of single supervisor together with national competent authorities and central banks.Despite the fact that there is a separate competent authority in Luxembourg, the BCL is represented at the Supervisory Board and as a member of the Governing Council, the Governor participates in the ultimate decisions pertaining to SSM-related matters. Indeed as, by law, the BCL is in charge of the supervision of liquidity, the experts from the BCL participate in various committees, SSM networks, working groups and task forces and they are also participating in the Joint Supervisory Teams (JSTs), which are in charge of the supervision of individual significant institutions at ECB level. This institutional setup ensures that the BCL closely cooperates in this multidimensional framework with other institutions including the national competent authority.
In October 2017, the European Commission published a report on the review of the SSM regulation. Overall, the Commission concluded that the establishment of the Single Supervisory Mechanism, and I quote: *"has been successfully established, functions well and proves its effectiveness"*. Moreover, *"the application of the SSM Regulation appears to work well in practice"* and the *"SSM represents a solid reliable element of the Banking Union that could prove its full potential in the context of a completed Banking Union"*.
Indeed, in day-to-day supervision we benefit today from a harmonised methodology – the SSM SREP Methodology

(Supervisory Review and Evaluation Process) – for all significant institutions under the direct supervision of the ECB. For the less significant institutions (LSIs), a common SREP methodology has been developed in line with the principle of proportionality.

Supervisory priorities for 2019

The ECB Banking Supervision also benefits, especially in the context of cross-border banks, from the definition of yearly **supervisory priorities** that are communicated in a transparent manner to the supervised banks.
The supervisory priorities build on an assessment of the key challenges facing supervised banks in the current economic, regulatory and supervisory environment. As such, the supervisory priorities are an essential tool for coordinating supervisory actions across banks in a harmonised, proportionate and effective manner.
The SSM Supervisory Priorities for 2019 were communicated[7] last month with the following three high-level priority areas:

- Credit risk;
- Risk management; and
- Activities comprising multiple risk dimensions, such as the Brexit preparations or Trading risk and asset valuations.

As you know, for *credit risk*, the stock of Non-Performing Loans (NPLs) remains an area of concern, despite the progress that has been achieved. ECB Banking Supervision will engage with affected institutions to define bank-specific supervisory expectations. In addition, it will assess the quality of banks' underwriting criteria with a focus on new lending which may result in bank-specific actions.
For the supervisory priority, *risk management,* the focus will remain on the Targeted Review of Internal Models (TRIM), which will continue in 2019.
Furthermore, the ECB Banking Supervision will review the quality of institutions' Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assesssment Process (ILAAP) as a fundamental part of the SREP. From experience, we know that adequate levels of capital and liquidity capturing banks' risks in a forward-looking

manner are essential for the resilience of individual banks. Here, let me draw your attention to the ECB guides on ICAAP/ ILAAP that were released beginning of November this year and which will be applied by the ECB Banking Supervision as from 2019 onwards. The ECB aims at incentivising banks to improve their ICAAPs and ILAAPs and will therefore intensify its supervisory assessments and will further increase the role the ICAAP and ILAAP play in the yearly “Supervisory Review and Evaluation Process”

New technologies, Fintechs

For the supervisory priorities in 2019, an additional special focus will be put on the area of new technologies: IT, cloud computing, big data and cyber security. These areas will be further scrutinized with a number of on-site inspections.
I take the opportunity to recall that the ECB published a guide to assess licence applications for Fintechs in March 2018. In general, when it comes to technological innovation, the ECB Banking Supervision applies the principle of “same business, same risk, same rules” and, as such, supervisory approaches are supposed to be technology-neutral[8].

Liquidity stress test
Furthermore, on the supervisory priority for risk management, I would like to mention that a Liquidity Stress Test will be performed for Significant Institutions, The results of these tests will inform the following SREP assessments.
For this Liquidity Stress Test, the ECB will leverage on the new “Additional Monitoring Metrics for Liquidity Reporting”[9], which were introduced on the 1 March 2018. With the first reporting, the ECB experienced data quality issues for Significant and Less Significant Institutions [10]. I would therefore encourage the reporting institutions to ensure a high data quality in the figures they report to allow for meaningful results.

Improvements needed
I take the opportunity of having your attention to recall that, despite all the progress made, a lot remains to be done in the legislative area in order to improve and finalise the legal

framework of the Banking Union. Fragmentation needs to be further reduced, the Capital Market Union plan has to be implemented, and regulatory loopholes have to be closed. This year[11], the IMF made, after its first Financial Stability Assessment Programme (FSAP) on the euro area, a certain number of recommendations, **which for most of them are fully supported by the Governing Council of the ECB. Some of these recommendations will** require legislative changes in Union law.

Investment firms' oversight

One of the loopholes relates to the *supervision of (large) investment firms, which* is outside the responsibility of the ECB, who is, as we know, only in charge of the supervision of significant credit institutions. The IMF recommends putting large investment firms (so-called "class 1" investment firms) under the prudential oversight of the ECB. This recommendation has been endorsed by the European Commission, who took it up in its proposal in order to establish a more effective prudential supervisory framework for investment firms. This proposal is currently under legislative review.

Third country branches

Another topic highlighted by the IMF is the *supervision of third country branches,* which again are outside the responsibility of the ECB. The IMF recommends that the ECB takes over the authorisation and the supervision of large third country branches. This recommendation as well is actively supported by the ECB, including a further harmonisation of the third country regime.

Moreover, the IMF advises to put **third country branches** under the supervision of the SSM and to require the establishment of an **intermediate EU parent undertakings** (IPUs) for institutions that are part of [12] the same third country group.

These proposals will be of particular relevance in the context of Brexit.

Anti-money laundering (AML)

Another topic is Anti-money laundering (AML) and Counterfinancing

of terrorism (CFT), which are also outside the scope
of the SSM Regulation, these tasks remaining at national level.
However, anti-money laundering issues are relevant for SSM prudential supervisory decisions in several areas, such as:
- the process of granting authorisations to credit institutions,
- the acquisition of qualifying holdings in supervised entities,
- the fit and proper assessments of existing or prospective managers of supervised entities,
- the day-to-day supervision in the context of the SREP, and
- the sensitive topic of withdrawal of licenses.

When it comes to qualifying holding procedures, anti-money laundering risk should, according to the CRD[13], be included in the supervisory assessment. This procedure is a so-called "common procedure" under the competence of the ECB, because it covers both significant and less significant institutions. Here as well as for the withdrawal of licence, another "common procedure", the ECB needs to rely fully on the work performed by the competent authority for anti-money laundering at the national level for both the significant and the less significant banks.
More generally, we observe that anti-money laundering requirements are set via Directives, which require an implementation at national level. [The last one, the 5th AML Directive should be transposed into national [14] legislation by January 2020][15]. The latest proposal of the Commission to give a leading and coordinating role to EBA for anti-money laundering tasks will however take the form of a regulation[16]. From an SSM point of view, European regulations are indeed, because of the consistency of their applications, preferable to directives.

Options and discretions
Another area for improvement and legislative changes is the field of national options and discretions. The ECB already identified and, to the extent possible, streamlined those options and discretions that are available to the supervisor during an extensive analysis.

As an outcome to this work, after a public consultation, the ECB issued a regulation in relation to significant [17] institutions, as well as a guideline[18] and recommendations[19] to national competent authorities in 2017 in relation to less significant institutions. Nonetheless, the high number of these options and discretions create an uneven level playing field and add a layer of regulatory complexity. They increase compliance costs and leave room for regulatory arbitrage. The future review of the CRR and CRD package should therefore also aim at reducing the number of options and discretions.

Fit and proper

To illustrate why directly applicable regulations are preferable to directives, I can also take the example of the "fit and proper"assessment of managers. The IMF recommends in its FSAP report on the euro area further harmonising the **fit and proper** framework. Basic rules on fit and proper are provided in the CRD IV, but national transpositions are not fully harmonised. Moreover, the ECB is supposed to apply national legislation transposing Union law[20]. For instance, the Directive covers the fit and proper standards in substance, without, providing any details on the different criteria, and it remains silent on the type of supervisory procedure to be followed. Without going further into detail, there are other areas, which would benefit from additional legislative work, such as insolvency laws, which proved to be crucial in a resolution scenario.

But this meant to be just some examples of future desirable initiatives. The list of legislative work required for a comprehensive and consistent supervisory framework would be quite extensive and would certainly go beyond the purpose of this speech, so I will stop here.

On a more festive tone, let me remind you - or if you did not know, let me inform you - that Luxembourg also celebrates this year the twentieth (20th) anniversary of its central bank. Hence, organizing this conference in the *Banque centrale du Luxembourg*, gives me the opportunity to celebrate the two anniversaries together and to underline the increasing importance of our institution over the past years.

I have now the pleasure to introduce Dr. Herrmann Reuter, Vice Chairman of the IBF, and Professor Dr. Udo Steffens, Chairman of the Executive Board of “The Frankfurt Institute for Risk Management and Regulation”.

I wish you constructive discussions throughout this conference.

Gentlemen, the floor is yours…

1 Council Regulation (EU) No 1024/2013.

2 Report published on 25 February 2009.

3 The ESFS also includes a Joint Committee composed of the 3 ESAs, in addition to their individual participation.

4 The ESRB recommendation (ESRB/2011/3) was set out on 22 December 2011.

5 The Systemic Risk Committee is composed of (1) the Government, represented by the member responsible for the financial centre; (2) the BCL, represented by its Director General, (3) the Commission de Surveillance du Secteur Financier (CSSF), represented by its Director General and (4) the Commissariat aux Assurances (CAA), represented by its Director.

6 Established by the law of 18 March 2015.

7 On 30 October 2018.

8 Extract from the speech of Ms Nouy at the European Financial Round Table, Frankfurt am Main, 19 October 2016.

9 The EBA Implementing Technical Standards on supervisory reporting were endorsed by the Commission on 9 November 2017 and published in the Official Journal of the European Union on 6 December 2017.

10 The ECB carried out a sensitivity analysis on liquidity in the 2018 LSI Risk Report for which the newly reported maturity ladder data has been used. As of today, 13 November 2018, the Report is not public.

11 The IMF report titled “Euro Area Policies : Financial Sector Assessment Program-Technical Note-Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision” was published on 19 July 2018.

12 The proposal is not controversial at EU level. The Council approved the requirement as proposed by the Commission. The European Parliament holds the view that the proposal should be amended to provide for the possibility to authorise the establishment of a second IPU when the legislation of the third country requires a mandatory separation of activities.

13 Article 23 CRD IV.

14 Key aspects of the 5th AML Directive (June 2018) are for example: (1) an extended scope of the persons subject to the anti-money laundering and counter terrorism financing requirements, in particular to address terrorism financing risks linked to virtual currencies and anonymous prepaid cards; or (2) enhanced customer due diligence measures, in particular in the context of financial transactions involving high-risk third countries.

15 On 8 November 2018, the European Commission published a press release in which it is said that Luxembourg will be referred to the Court of Justice for transposing only part of the 4th AML Directive into their national law.

16 Proposal COM(2018) 646 final as amended on 12 September 2018.

17 Regulation (EU) 2016/445 of the ECB of 14 March 2016 on the exercise of options and discretions available in Union law (ECB/2016/4), OJ L 78, 24.3.2016, p. 60.

18 Guideline (EU) 2017/697 of the ECB of 4 April 2017 on the exercise of options and discretions available in Union law by national competent authorities in relation to less significant institutions (ECB/2017/9), OJ L 101, 13.4.2017, p. 156.

19 Recommendation of the ECB of 4 April 2017 on common specifications for the exercise of some options and discretions available in Union law by national competent authorities in relation to less significant institution (ECB/2017/10), OJ C 120, 13.4.2017, p. 2.

20 The first sub-paragraph of Article 4(3) of the SSM Regulation provides that for the purposes of carrying out its supervisory tasks the ECB will apply all relevant Union law and, where this law is composed of Directives, the national law implementing those Directives.