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The Single Supervisory Mechanism: A Further Step Towards the Banking Union

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From 4 November 2014, the Single Supervisory Mechanism (SSM)[1] will be officially operational and the European Central Bank (ECB) will be in charge of the direct supervision of the most significant banks in the Euro-area (around 130, including 21 in Germany, 10 in France, and 14 in Italy). In the context of the foregoing, the same have been subject to a comprehensive assessment comprising both an asset quality review[2] and a stress test[3].

The ECB will also be responsible for the monitoring of the supervision carried out by national competent authorities on less significant banks (approximately 6,000) in the Euro-area.

The launch of the SSM constitutes a further step towards the integration of the European banking sector and paves the way for the establishment of a banking union among the Euro-area Member States[4].

The Banking Union

The banking union is based upon three foundation stones:

1. a *Single Rulebook*, of European-wide harmonized prudential rules incorporating (a) the so-called "CRD IV package" (*i.e.*, the Capital Requirements Regulation[5] and the Capital Requirements Directive[6]), entered into force on 1 January 2014 for the purpose of implementing the new global standards of the Basel III agreement and setting out, among others, common rules on corporate governance arrangements and remuneration, (b) the comprehensive framework for banking crises management established pursuant to the Bank Recovery and Resolution Directive[7], and (c) the strengthened regime for savings protection schemes in case of bank failures pursuant to the new Directive on Deposit Guarantee Schemes[8]. The EBA is responsible for promoting convergence of supervisory practices and developing the Single Rulebook among EU Member States;

2. the *SSM*; and

3. a *Single Resolution Mechanism* (SRM), establishing, among others, a single resolution fund (fully financed by banks' contributions) to ensure the orderly resolution of failing banks[9].

SSM: What and How?

The key element of the SSM is the granting to the ECB of a prudential supervision role, including the responsibility for:

- directly supervising most significant banks (including all banks having assets of more than €30 billion or representing at least 20% of their home country's GDP);
- monitoring the supervision carried out by national competent authorities on other banks, which will include the power to take over supervisory functions, to ensure consistent application of high supervisory standards;
- granting/revoking authorization to carry out the banking business and assessing the acquisition/disposal of qualifying holdings in credit institutions; and
- ensuring the coherent and consistent application of the Single Rulebook in the Euro-area Member States.

The ECB has been granted extensive supervisory and investigatory powers (including the power to request information, conduct general investigations, and perform on-site inspections) and the power to impose administrative penalties. Among the supervisory powers, it is worth mentioning, *inter alia*, the power to:

- restrict or limit the business, operations or network of institutions or to request the divestment of activities posing excessive risks to the soundness of an institution;
- require institutions to limit variable remuneration as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base;
- require institutions to use net profits to strengthen own funds;
- restrict or prohibit distributions by the institution to shareholders, members or holders of Additional Tier 1 instruments where the prohibition does not constitute an event of default of the institution;
- impose specific liquidity requirements, including restrictions on maturity mismatches between assets and liabilities; and
- remove at any time members from the management body of credit institutions who do not fulfil the requirements set out in European or national legislation.

A Game-changer for the Banking Business

The establishment of the SSM is a regulatory development of unprecedented magnitude and is likely to profoundly change the face of the industry.

Further integration of the sector is to be expected: unified supervision is, in fact, likely to drive banks towards the path of consolidation, in an attempt to optimise internal management of capital and liquidity and reduce compliance costs.

The newly-established regulatory landscape may also prove to be a game-changer for the way banks carry out their operations: purely domestic business paradigms are likely to be gradually replaced by a wider, pan-European, model. Banks will have to adapt to a new, and not purely domestic, legal framework and regulator.

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[1] Council Regulation No. 1024/2013 of 15 October 2013.

[2] The key purpose of which is to enhance the transparency of bank exposures, including the adequacy of asset and collateral valuation.

[3] Aimed at examining the resilience of banks' balance sheets to stress scenarios.

[4] In addition to the Euro area Member States, the SSM will also include the EU Member States outside the Euro-zone that chose to participate in the Single Supervisory Mechanism entering into "close cooperation" with the ECB.

[5] Regulation (EU) No. 575/2013.

[6] Directive 2013/36/EU.

[7] Directive 2014/59/EU.

[8] Directive 2014/49/EU, which amended and recast the Directive 94/19/EC on Deposit Guarantee Schemes.

[9] See the Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014, according to which, the use of the '*Fund shall be contingent upon the entry into force of an agreement [executed on 21 May 2014] among the participating Member States on transferring the funds raised at national level towards the Fund as well as on a progressive merger of the different funds raised at national level to be allocated to national compartments of the Fund*'. The SRM complements the Bank Recovery and Resolution Directive according to which national competent authorities will be vested with the power to intervene and impose measures on financial institutions, including the recourse to the bail-in of shareholders and creditors (*i.e.*, a mechanism of write-down and conversion of bank liabilities, as opposed to a bail-out where a recapitalizations are made through external resources, such as national aid).

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