ECB-SSM sets 2018 supervisory fees

May 2018

What is the impact for existing and new firms?

Quick Take

Supervisory fees at the ECB-SSM continue to rise for those that are directly as well as indirectly supervised by the ECB. With overall fee levels, including those of other supervisors likely to continue to rise, there are perhaps compelling arguments for existing firms in the Banking Union or those looking to establish themselves to invest in revising policies and procedures to reduce their perceive risk levels and other factors that define the level of fees.

What is the impact for existing and new firms?

Every 30 April, the European Central Bank (**ECB**), acting in its role in the Single Supervisory Mechanism (**SSM**), publishes details of its annual supervisory fees for its prudential supervision in the Eurozone and its Banking Union. Coming in at €474.8 million, these fees will be collected from Banking Union Supervised Institutions (**BUSIs**) when they receive their individual fee notices in October with payment due in November 2018.

These ECB-SSM fees are in addition to the range of supervisory fees that BUSIs may have to pay to other national authorities in the Banking Union, the EU and elsewhere. The fact that the total cost of SSM supervision is now estimated at running to more than €.5 billion as the SSM heads towards its fifth birthday raises a number of questions as the SSM ceases to be a nascent institution. Even if that figure will be met by the fees collected from BUSIs in October plus a surplus of €27.7 million, carried over from 2017,[1] a number of existing BUSIs and those firms looking to establish themselves in the Banking Union as a result of BREXIT or otherwise, may want to assess whether there are any steps they can take to reduce the factors that contribute to the level of SSM fees for each individual BUSI. This Client Alert highlights some of these considerations.

Why so high?

The 30 April Press Release[2] accompanying ECB Decision (EU) 2018/667[3] sets out what makes up the 2018 estimated annual costs of supervision and the reasons for the increase in fees. Whilst some of these factors have previously been communicated by the ECB-SSM, i.e., the impact of BREXIT, the costs of stress tests and the continued multi-annual targeted review of internal models (TRIM), other reasons for the nearly 12 percent increase in fees to be collected in 2018 when compared to 2017 are less clear.

Another area that will remain on the horizon and thus be funded by fees is the SSM's ongoing work to have BUSIs tackle non-performing loans and exposures (NPLs) in terms of policies and processes and also to cure deficiencies in internal set-up to steer profitability and business viability overall. The ECB's 2018 supervisory priorities, as supplemented by policy announcements in its 2017 Annual Report on Supervisory Activities, all point to this being a key area of scrutiny in thematic reviews or on-site inspections. It is also an area that will remain part of the supervisory dialogue with firms, including where

---

[1] Due to costs of supervision during the 2017 supervisory cycle being six percent less than estimated.

[2] https://www.bankingsupervision.europa.eu/press/pr/date/2018/html/ssm.pr180430.en.html

[3] http://www.ecb.europa.eu/ecb/legal/pdf/en_ecb_2018_12_f_sign.pdf

that dialogue is also changing due to the SSM-style of the EU standardized Supervisory Review and Evaluation Process (SREP) being rolled out to all BUSIs.

Moreover, while on-site inspections rules have been improved, including by the issuance of a new supervisory "guide"/rulebook, the main SSM cost factor in the 2018 fees remains "salaries and benefits" followed by "other operating expenditure." These cost items appear to be separate to any fees paid to third-party service providers that are tasked to assist with ECB-led on-site inspections or other engagement.

Since the SSM's inception, the amount of what it is tasked to do has expanded. So too has its budget, which has grown by a remarkable 46 percent from €326 million during 2014/2015 and its inaugural supervisory cycle. A lot of this is due to tasks related to direct supervision of BUSIs but also "horizontal tasks" such as the Secretariat to the Supervisory Board, macroprudential tasks, statistical services and dedicated legal services. Various external audit reviews, notably the 2016 Review of the SSM by the European Court of Auditors[4] noted room for improvement and this is slowly being implemented to make supervision "smarter." Whilst movement in that direction is tangible, it remains to be seen whether "smarter" supervision will translate into more a valued and cost efficient supervisory engagement experience for large but also smaller BUSIs or those with higher degrees of risk.

Firms' fee levels and their factors

Proportionality is a key tenet of the SSM. This also applies in terms of setting supervisory fees. About 90 percent of the fees or €428.5 million will be paid by those 118 BUSIs that are designated as "significant credit institutions" and thus directly supervised by the ECB within the SSM. The remaining 10 percent or €46.3 million will be paid by those much wider range of BUSIs (approximately 5,500 legal entities) that are designated by the ECB as "less significant institutions" and subject to indirect ECB but direct national level SSM supervision. It should be noted that the ECB-SSM have already indicated[5] that less significant institutions during 2018 will have to pay €2.3 million in addition to the 2018 fees as they were undercharged during 2017.

The annual supervisory fee for each BUSI is set in a detailed Decision[6] with standard templates to capture BUSIs' risk profiles and to determine the relevant fee factors. The annual fee level consists of a minimum fee component and a variable fee component. The variable fee component takes into account the BUSI's importance measured via its total assets and the bank's risk profile measured via "Total Risk Exposure", a number drawn from a BUSI's data submitted as part of the Common Reporting Framework (COREP) process. Therefore, riskier entities pay a higher variable fee component. Groups of banking entities nominate a single-fee paying bank that acts as a "fee debtor" on behalf of the whole group i.e. subsidiaries but also branches. A fee debtor is not only tasked with paying the fees but also with using the relevant templates in providing information to determine the fee factors for entities within and also outside of the Banking Union. In certain instances, it may be more advantageous to pay fees using a fee debtor entity in specific Eurozone jurisdictions.

Whilst there is no current empirical study that assesses the relationship between the setting of ECB-SSM supervisory fee levels and the strength of its compliance, governance, risk and other control functions, as with other regulatory approaches, it is safe to assume that those BUSIs that are perceived to embed a culture of compliance on an enterprise-wide business, with a strong involvement of control functions, tend to be perceived by supervisors as being less risky. This is especially the case as the supervisor, even when faced with a heterogeneous set of firms and where small does not mean low risk, is required to take a holistic assessment of the risk situation at a firm in setting its risk. This setting of risk translates into the setting of applicable fee levels, even if using a proportionate risk based approach. Moreover, with BREXIT having reopened the debate amongst firms on both sides of the Channel and the Irish Sea as to where and whether to set up subsidiaries and branches, fee planning for the 2018 supervisory cycle and beyond will also need to pay closer attention to say how assets of a branch factor in the "Total Assets" category that makes up the minimum fee component or how the "Total Risk Exposure" could be reduced.

Outlook

Despite a number of calls from market commentators during the set-up of the SSM and subsequent fee decisions that have followed, the ECB-SSM has not fully committed itself to setting a clear long-term budgetary plan for supervision on a multi-annual framework. This is the case even where systemic supervisory issues, such as TRIM, cause for on-going costs. The pending amendments to the core prudential supervisory legislation in CRR/CRD IV, which the ECB-SSM have itself further streamlined within the Banking Union and BUSIs,

4 See: https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=39744

5 See: https://www.bankingsupervision.europa.eu/organisation/fees/total/html/index.en.html

6 See: https://www.bankingsupervision.europa.eu/ecb/legal/pdf/oj_jol_2015_084_r_0008_en_txt.pdf

entail further costs. Add to that the fact that supervisory resources are at present still lacking in certain areas or still building a common supervisory culture. All of that is happening against a backdrop where both the central banking and SSM side of the ECB are under pressure to be more cost-efficient.

With that in mind, there are a number of areas under supervisory scrutiny where BUSIs have an ability to set themselves apart from their peers in terms of governance, risk, compliance and other control functions leading on setting and taking ownership of what the SSM would like to see in terms of an appropriate "risk culture." Part of that is down to ensuring specific policies and procedures, especially those that are required or expected by the ECB-SSM, are best in class. The other part of that is consistency across functions but also physical locations. There is a greater supervisory expectation that BUSI's relevant staff are generally expected to demonstrate a depth of understanding of material rules and principles as they apply to the relevant firm as opposed to just their business line or physical location.

As a result, the cost/benefit analysis of retaining specialist advisers to undertake specific or firm wide reviews and document relevant enhanced standards may be an initial investment, but with the rate of growth in SSM's fees and the path on supervisory policy pointing to more rather than less, existing BUSIs and those wishing to establish themselves in the Banking Union may want to consider the payoff to reducing on-going fee driven burdens.

If you need assistance on how to optimize your business' SSM fee level exposure, or if you would like to receive more analysis from our wider Eurozone Group in relation to the topics discussed above, including what other SSM rules might mean for specific market participant types within or looking to enter the EU and/or the Eurozone, then please do get in touch with any of our Eurozone Hub key contacts below.

Your Eurozone Hub Contacts:

Michael Huertas
Partner
Frankfurt
D +49 69 45 00 12 330
michael.huertas@dentons.com

Dr. Markus Schrader
Counsel
Frankfurt
D +49 69 45 00 12 362
markus.schrader@dentons.com

Dr. Katja Michel
Senior Associate
Frankfurt
D +49 69 45 00 12 272
katja.michel@dentons.com

Brand-9101-Briefing note-supervisory fees-05 – 15/05/2018