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Adapting SSM supervision to the diversity of banking business models

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In the wake of the collapse of some local US banks, the debate on the risks inherent in their business strategies has heated up. Aggressive growth with strong ties to the technology industry, concentration in large deposits, and investment of ample excess liquidity in long-term bonds in times of low interest rates were the basic features of such strategies. This confirms that a clear business model, coupled with robust governance, is key to ensuring the viability of firms.

In the Single Supervisory Mechanism (SSM) banking landscape, with over 2,200 consolidated credit institutions, more than 10 different business models are used for peer comparison based on banks': (i) main source of income; (ii) customer and funding base; and (iii) size and geographical focus. These embody quite different competitive banking strategies, taking in everything from custodian banks to diversified lenders, consumer credit lenders to development lenders and G-SIBs to small market lenders, to name but a few contrasting examples. Each bank business model is typically associated with certain common vulnerabilities and is affected in different ways by market threats.

At the SSM we have to deal with this considerable diversity of banking models in the context of a common European banking regulation that seeks to preserve a level playing field. Under the coordination of the European Banking Authority (EBA), the Single Rulebook comprises a set of harmonised prudential rules, which all banks in the European Union must respect so as to ensure a resilient, transparent and efficient European banking sector. However, the characteristics of individual banks, especially the specific features of their different business models, need to be factored in when enforcing these common rules. Banking supervision can play an important role in this respect, with supervisory activities tailored to specific groups of banks.

The supervisory risk management framework at the SSM is made up of four sequential phases:

1. Identifying and monitoring of risks to the SSM banking sector
2. Formulation of strategic priorities
3. Operationalisation of strategy
4. Monitoring priorities and supervisory activities

In the first two phases we generally adopt a universal approach for the entire set of banks, paying limited attention to business model-related aspects. It is at the operationalisation stage where banking business models come into play, with detailed action plans for particular banks or clusters. This typically results in the design of thematic reviews or horizontal analyses for off-site activities and the planning of OSI campaigns for on-site supervision and the selection of participating banks. Business models are among the elements considered when assembling these samples. Finally, the SREP benchmarking exercises include a peer comparison within each business model group.

Taking into consideration all the available tools, the SSM could take a further step forward in the continuous improvement of its banking supervisory practices if needed. The risk and vulnerabilities assessment could be tailored to the specific business models from the very beginning, while also allowing for more targeted strategic priorities as a prior step to defining the detailed action plans. This would help to better focus the supervisory efforts on the risks that are relevant for each institution.

A supervisory risk management framework more centred around banking business models offers certain clear benefits for SSM banking supervision, given that it would:

- Contribute to a more focused process, by contemplating from the outset the risks associated with the specific vulnerabilities of the different banking models, allowing potential common problems for groups of banks with similar attributes to be identified.
- Help to better estimate the impact of events affecting some specific activities according to business models, facilitating proportionality and a more risk-based approach to supervision, by further tailoring the intensity and focus of supervisory activities to banks' characteristics.
- Enhance the level playing field treatment of SSM banks, by better accounting for their similarities and differences and facilitating peer comparison throughout the entire supervisory process.

Recent events have shown the importance of proper risk management, backed by the appropriate analysis and supervision of business models.
Here at the SSM, we must analyze the tools required to fine-tune the methodology and the supervisory and risk tolerance framework in order to better adapt them to the different business models. This process calls for seamless implementation, taking cautious steps so as not to overcomplicate matters and always considering the expert judgment that the Joint Supervisory Teams bring to risk-based supervision.