



GERMANY

FINANCIAL SECTOR ASSESSMENT PROGRAM

June 2016

DETAILED ASSESSMENT OF OBSERVANCE ON THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

This Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision on Germany was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on June 2016.

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International Monetary Fund
Washington, D.C.



INTERNATIONAL MONETARY FUND

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DETAILED ASSESSMENT OF OBSERVANCE

June 2016

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

Prepared By
**Monetary and Capital
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) in Germany during February–March 2016 led by Ms. Michaela Erbenova. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

AnzV	Anzeigenverordnung - Verordnung über die Anzeigen und die Vorlage von Unterlagen nach dem Kreditwesengesetz - Regulation Concerning Reports and the Submission of Documentation under the Banking Act
AOC	Auditor Oversight Commission
BaFin	Federal Financial Supervisory Authority
BBk	Deutsche Bundesbank
BRRD	Bank Recovery and Resolution Directive (Directive 2014/59/EU of 15 May 2014)
HGB	Commercial Banking Code
CRO	Chief Risk Officer
CRR	Regulation (EU) No 575/2013
CRD IV	Directive 2013/36/EU
DG	Directorate General
DGSD	European Directive on Deposit Insurance
EinSiG	Deposit Insurance Act
EBA	European Banking Authority
ECB	European Central Bank
ESA	European Supervisory Authority
ESFS	European System of Financial Supervision
ESM	European Stability Mechanism
ESMA	European Securities and Market Authority
ESRB	European Systemic Risk Board
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pension Authority
FICOD	Financial Conglomerates Directive
FinDAG	Act on Financial Supervisory Authority
FinStabG	Financial Stability Act
FSC	Financial Stability Committee
FMSA	Federal Agency for Financial Market Stabilization
GCGC	German Corporate Governance Code
G-SIB	Global Systemically Important Bank
G-SII	Globally Systemically Important Institution
ILAAP	Internal Liquidity Adequacy Assessment Process
ICAAP	Internal Capital Adequacy Assessment Process
ITS	Implementing Technical Standards
JST	Joint Supervisory Team
KWG	German Banking Act (Kreditwesengesetz – KWG)
LCR	Liquidity Coverage Ratio
LSI	Less significant institutions or banking groups (LSIs)

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MaRisk	Minimum requirements for risk management (Mindestanforderungen an das Risikomanagement - MaRisk)
MoF	Federal Ministry of Finance
NCA	National Competent Authority
NCB	National Central Bank
NDA	National Designated Authority
NRA	National Resolution Authority
OGAW	<i>Organismus für gemeinsame Anlagen in Wertpapieren</i> or UCITS (Undertakings for Collective Investments in Transferable Securities),
PrüfbV	Audit Report Regulation
RAS	Risk Assessment System
RMF	Risk Management Framework
RTS	Regulatory Technical Standard
SAG	German Act for Recovery and Resolution of Institutions and Financial Groups
SEP	Supervisory Examination Plan
SREP	Supervisory Review and Evaluation Process
SRB	Single Resolution Board
SI	Significant Institution
SRM	Single Resolution Mechanism (Regulation (EU) No 806/2014 of 15 July 2014
SSM	Single Supervisory Mechanism
SSMR	SSM Regulation (Council Regulation (EU) No 1024/2013 of 15 October 2013
SSMFR	Regulation (EU) No 468/2014 of 16 April 2014 – SSMFR)
STE	Short Term Exercises (STEs).
WCCA	Written Coordination and Cooperation Arrangement
WpHG	Securities Trading Act (Wertpapierhandelsgesetz - WpHG).
VwVfG	Administrative Procedures Act (Verwaltungsverfahrensgesetz – VwVfG)

SUMMARY AND MAIN FINDINGS¹

1. **Since the last FSAP, German banking supervision has undergone profound changes, with the approval of the CRD IV and CRR framework, the establishment of the European Banking Authority (EBA) and the creation of the Single Supervisory Mechanism (SSM).** The German legal framework has been amended to transpose CRD IV, and CRR and the regulatory technical standards developed by EBA and issued by the European Commission became directly applicable. Additionally, the ECB took over direct supervision of 21 of Germany's largest banks, including one G-SIB.

2. **The last FSAP (2011) found the banking system supervision to be generally sound with some areas in need of improvement—while some of these issues have been addressed, others remain.** Recommendations were made for improvements to the framework for major acquisitions, capital adequacy assessment by the supervisors, risk management processes, capital definition, liquidity risk management, risk oversight, stress testing capabilities, and timely supervisory remedial action. More progress was made regarding strengthened resources and capacity for on- and off-site supervision of risks, more detailed guidance to banks on supervisory expectations regarding risk management, and establishment of internal ladder of actions to foster more timely and consistent supervisory response. Little or no progress was made on recommendations regarding the level of reporting to the MoF, related party exposures, country risk, and topics that depend mainly on the EU-wide framework, such as capital requirements, major acquisitions, and supervisory reporting.

3. **The legal and regulatory framework is extensive; however, important gaps exist, which affect effectiveness of corporate governance and controls.** While the KWG establishes fit-and-proper standards for supervisory and management board members; defines the oversight function of the supervisory board and the functions of the management board, in practice the focus of governance is placed on the management board. All risk functions report directly to the management board. As a result; the core function of corporate governance, which should be the responsibility of the oversight body (establish a risk culture, risk appetite, code of conduct, business plans) has been assigned to management, whose oversight by the supervisory board is very light. In particular, the independence of the internal audit and compliance is compromised as they report to the management board.

4. **The establishment of the SSM has fundamentally changed the supervision of German banks, both large and small.** For the SIs, day-to-day supervision is conducted by Joint Supervisory Teams (JSTs) led by ECB staff with sub-coordinators from BaFin and Bundesbank (and from countries where the bank has significant subsidiaries). The JSTs are composed by staff from supervisory agencies from all countries where banks have operations, therefore involving supervisors with vastly different backgrounds, supervisory cultures, and languages. The coordination and integration of these multinational teams present many operational and motivational challenges which will need to

¹ This Detailed Assessment Report has been prepared by Fabiana Melo and Christopher Wilson, (both Monetary and Capital Markets Department, IMF), and Jose Tuya (IMF External Expert).

be addressed by the SSM in the long run. For the smaller German SIs, the shift from local supervision to the ECB supervision seems to have represented a deep change in terms of reporting, minimum level of engagement with supervisors, intrusiveness, and supervisory requirements – including capital add-on resulting from the SREP process. For larger SIs, which were already under intensive supervision before, the supervisory approach seems to benefit from better cross-country views and benchmarking, however on the other hand supervisory response seems to have been reduced given the complex decision making procedures in the ECB.

5. Over 1500 LSIs continue under the direct supervision of BaFin and Bundesbank, under general guidance of the ECB supervision. The ECB has designated some LSIs as High Priority for which enhanced supervisory monitoring and reporting have been adopted. The ECB is currently developing joint standards for different elements of the Supervisory Review Process to ensure elements of the SSM supervisory manual are applied to LSIs. The increased emphasis in reporting and SREP, in particular on assessment of credit risk valuation, is a welcome development. However, the increased reporting and monitoring might increase the need of resources for LSI supervision – authorities will need to balance the supervisory objectives to the resources needed for the supervision of very small entities.

6. LSIs supervision is therefore changing from a more qualitative and relationship-based approach to a more quantitative and SREP-based approach. BaFin and Bundesbank have traditionally put a great emphasis on processes for risk management and controls, counting on the work of external auditors for the verification of compliance with nearly all aspects of the BCP. Auditors present to the supervisors an extensive report that should cover all material risks according to the MaRisk framework,² and supervision conducts the risk assessment using this and other information available, obtained through on-site inspections, reports, and direct contact with banks. Nevertheless, this approach allows gaps, in particular regarding areas where little guidance exists, such as related party lending, country risk, concentration risk, and operational risk.

7. Two issues affect day-to-day functions of the ECB supervision: the ECB must execute much of its tasks according to national legislation, and all decisions need to be approved by ECB's Governing Council, which creates a time-consuming and cumbersome supervisory decision making process. Every supervisory decision, after consideration and approval by the Supervisory Board, is submitted to ECB's Governing Council for approval under a no-objection procedure. In addition, for LSIs and SIs alike, the ECB needs to comply with local legislation to execute many of its tasks. For instance, licensing applications must be filed with national authorities in compliance with national legislation, and then submitted for analysis and decision by the ECB. All fit-and-proper authorizations of SIs are assessed against national fit-and-proper criteria and then submitted to the ECB. Enforcement and sanctioning powers of the ECB are also largely based on what is available under national legislation, and although the ECB has some direct enforcement powers, it mostly needs to act by giving instructions to BaFin on measures to be taken under German legislation. It is crucial that decision making processes in ECB day to day supervision are

² Minimum requirements for risk management (Mindestanforderungen an das Risikomanagement - MaRisk).

streamlined to the extent possible so that timely supervisory response isn't further hindered in this already inescapably complex legal framework.

8. While the supervisory landscape in Germany evolves, it is crucial that supervisors communicate their expectations to banks and develop guidelines and regulations that can be used to substantiate enforceable measures. All aspects that are not harmonized within the EU or on which EU or German regulatory is silent or provide only too general rules need to be developed into guidelines or regulations that can both inform the banks of supervisory expectations and substantiate legal action by the supervisors. In the German framework some of that is done through circulars, ordinances, and guidelines. SSM wide, it is important that the good practices and process engrained in the internal SSM procedures are made public in structured instruments which can help substantiate supervisory measures. This is particularly relevant in the case of guidance related to loan portfolio management (specifically providing bank management with guidance on when setting loan classification parameters and provisioning, collateral valuation considerations, and elements of effective credit risk management), concentration risk, country and transfer risk, related party risk, and operational risk.

A. Main findings

Responsibility, Objectives, Powers, Independence, Accountability (CPs 1–2)

The legal framework for banking supervision is well established by German laws and regulations, directly applicable EU regulation, and SSMR. While the division of responsibilities between BaFin and Bundesbank regarding LSIs supervision is well established, the framework for the SSM is evolving and there are still uncertainties regarding the specific operational roles of each agency in the new environment. These uncertainties reflect the complex legal and operational framework but do not to affect the overall understanding of responsibilities by the market or authorities. The three supervisory agencies enjoy operational independence, in the sense that there is no government or industry interference in individual supervisory decisions. However, there is potential for indirect influence of government and industry in the execution of BaFin's supervisory objectives through the budget approval process and the mandatory approval of BaFin's internal organization and structure by the MoF. Decision making process at the ECB is complex and does not foster effectiveness and timeliness of day-to-day supervisory decisions (although there are processes in place for emergency decisions).

Ownership, Licensing, and Structure (CPs 4–7)

9. The ECB is the licensing authority, who makes decisions on the basis of applicable German and EU laws. While criteria and procedures are well established, in general the financial suitability of shareholders is limited to the availability of the initial capital, and the assessment of the supervisory board does not play a relevant role in the licensing process, although assessors noted these elements are gradually being incorporated in the licensing process. In addition, there is no requirement for the bank to notify the supervisor when they become aware of events that may cause a significant shareholder to no longer be fit-and-proper. The review of fit-and-proper

qualification would benefit from expanded requirements and standards. In that sense, the team welcomes the new guidelines issued by BaFin in January 2016, which emphasize the prudential importance of the professional qualification of the Board.

10. There is no need for prior supervisor approval of investments below a 10 percent threshold, other than investments in other German institutions (significant holdings regime).

This may create situations where acquisitions occur that increase the risk to the banking group beyond management skills and have a negative impact on the group that greatly exceeds the amount of the investment. While the regulator requires higher capital or may be able to force the bank to unwind the investment, it is more prudent to require ex-ante review.

Methods of Ongoing Supervision (CPs 8–10)

11. The transition to the SSM for SIs has had many benefits, although some aspects of the supervision methodology still undergoing implementation. A lot has been achieved in a short space of time and the supervision framework lays the foundation for a risk-based approach with the SREP as the core element. Elements of the framework are still being implemented and will take time to mature and be applied consistently across banks.

12. The supervisory approach for LSIs is established but evolving and scope exists for greater verification of compliance with regulations to complement current activities. On-site examinations verify adherence with MaRisk and are undertaken by BBk and BaFin through testing and interviews of management. The MaRisk Inspection Guide used by LSI supervisors lays the foundation for a consistent examination process and the use of the external auditor is also a key aspect of the supervision architecture to confirm compliance. Annual meetings with the Management Board, analysis of the ICAAP, and the risk profile form core elements of a sound framework. However, much reliance is placed on the external audit long form report and while rich in detail, greater emphasis is needed to verify the reliability, accuracy, and integrity of the information used for risk assessments as inputs into a forward looking view of risk.

13. Supervisory reporting is not sufficiently granular to support off-site supervision. Not all data needs are covered by EBA ITS reporting. To fill the gaps, short-term exercises (STEs) and surveys are used, such as, e.g., concentration, liquidity, and IRRBB. While the data contributes to the risk assessment process, using peer group analysis and benchmarks is not systematic. Currently, supervisors are challenged by differences between reporting based on nGAAP and IFRS data which complicates systematic and consistent comparisons between different account treatments. Technical work is underway to address this issue. Timely and accurate data is fundamental to effective supervision and the issues with data identified by the assessment need to be addressed as a matter of priority.

Corrective and Sanctioning Powers of Supervisors (CP 11)

14. German law and SSMR provide a broad range of actions that can be taken by supervisors in their respective responsibilities. Direct enforcement powers and sanctions of ECB

are limited; however, the ECB can make use of the enforcement and sanction powers available to BaFin. Assessors had access to evidence of such indirect actions, however the complex legal framework may make it operationally difficult and time consuming for ECB to impose enforcement actions. The actual use of formal powers by both BaFin and ECB in practice is not intensive.

Cooperation, Consolidated and Cross-Border Banking Supervision (CPs 3 – 12 – 13)

15. Collaboration and coordination framework with domestic and cross-border supervisors is highly developed. The EU has adopted a supervisory coordination process that is based on joint supervision through the SSM, colleges of supervisors led by the home country coordinator and signed MOUs with third country supervisors and nonbanking sector regulators.

16. A consolidated supervisory approach is in place at both the SI and LSI level. A detailed planning approach is in place through supervisory colleges and MOUs that result in a comprehensive review for the consolidated group. Additionally, ring-fencing powers are available to ensure that the group can be insulated from related companies that may adversely impact the group. Banking groups may be required to close reorganize to correct a non-transparent structure.

Corporate Governance (CP 14)

17. Currently, in Germany, the role of supervisory boards is weak and passive with most policy, and risk management duties and responsibilities placed on the management board. In the past few years there has been some evolution on supervisors' focus on the supervisory board within the SREP process. A thematic review on Risk Governance has been conducted which resulted in recommendations addressed to banks aimed at making the supervisory board involvement more robust. Additionally, MaRisk is being amended and will include code of conduct requirements.

18. Supervisory guidance should clearly delineate that ultimate responsibility for establishing the risk culture, developing business plans and risk appetite statement rests with the supervisory board. The fit-and-proper process is streamlined for supervisory board members as are technical knowledge requirements. As established by KWG, the primary responsibility for internal controls, governance, business strategy, and internal audit is assigned to the management board.

Prudential Requirements, Regulatory Framework, Accounting and Disclosure (CPs 15–29)

19. While risk management standards are generally sound, the reporting line between the internal risk control function and the Supervisory Board should be strengthened. Reporting of risk management is through the Management Board and the CEO which is responsible for setting the business plan and risk taking. The risk function does not report directly to the Supervisory Board but to the Management Board and therefore the CEO. This approach may weaken the independence of the risk management function and the CRO to raise issues, as also highlighted by the SSM methodology. In particular, the reporting line to the management body (with supervisory and management function) was a topic assessed within the thematic review on Risk Governance and Risk

Appetite. While banks had in place formal “whistle-blowing” processes, the structure may inhibit the independence of the CRO and the risk function to report weaknesses in the Risk Management Framework (RMF). This is further aggravated by the ex-post notification of removal of the CRO by the management board which is the prescribed minimum of MaRisk.

20. Banks are well capitalized and supervisors have the powers to impose additional requirements. The deviations of the EU capital framework in relation to the Basel standards regarding the definition of capital do not seem to be material for German banks in general, although some may be for specific banks (deduction of participation in insurance, for instance). Regarding the calculation of risk weighted assets, a few elements for which the RCAP found deviations may be significant for Germany, such as sovereign exposures under the permanent and temporary partial use, lower risk weights for covered bonds, and the counterparty credit risk framework. Assessors observed some cases where these deficiencies were being addressed by banks’ internal capital adequacy assessments and supervisory action, it is impossible to determine that that existing framework is not in general resulting in overstated CET1 ratios. Both ECB and BaFin can require banks to hold capital in excess of the minima under Pillar 2; however, the practice was not commonly used by German authorities. ECB as a supervisor has only concluded one SREP cycle, in which some banks were required to implement Pillar 2 add-ons. Leverage is specifically taken into account in the SSM SREP methodology, while for BaFin it is not yet systematically incorporated in the analysis.

21. Supervisors have not provided guidance on their expectations on loan portfolio management. For example, broad guidelines on general characteristics of various loan risk buckets; definitions of non- performing, restructured, forborne, and cured loans. Providing guidance that outlines supervisory expectations would aid managers and improve compatibility between banks. Granularity of data on credit portfolios is limited.

22. The role of the supervisors in loan classification and supervision in Germany primarily involves a review of policy and procedures. The focus of supervision is to provide bank management with considerations when setting loan classification parameters and provisioning such as items to consider for residential mortgages and commercial real estate classification triggers. Important are collateral valuation considerations; such as conservative valuations of realizable net values.

23. Loan classification and provisioning have been viewed as an accounting issue; however, supervisors recently conducted a thematic review of loan valuation and impairment. To implement a supervisory approach that asks supervision staff to review loan files and value loans and determine adequacy of provisions in a market where the practice was not present, ex-ante discussions with bankers and accountants should take place and supervisor expectations on loan valuation and provisioning communicated. It is also important to provide staff with training and support to be able to challenge management valuation of collateral or failure to rate an asset as impaired. The process of developing the capacity of supervisors to challenge bank management valuation of loans has started.

- 24. Market risk management standards are generally sound and supervisors take an active approach.** MaRisk establish the requirements for banks to implement effective risk management frameworks to measure and manage market risk. For the larger more systemic and risk-oriented banks with a trading bias, greater supervisory intensiveness and intrusiveness takes place. Market risk has been a focus of the supervisors during 2014 and 2015. In addition; a targeted review of banks' internal models will be carried out over several years. Supervisors periodically review banks to assess that their market risk management processes are consistent with the risk bearing capacity and the market risk management framework. Banks with the largest trading books are subject to enhanced focus (mostly SIs) and the remaining banks are on a normal cycle based upon their SREP score and risk profile. Assessors observed supervisory practices for both SIs and LSIs and verified compliance with this principle.
- 25. IRRBB has received a significant amount of the supervisor's attention during the last several years and features as a key priority for both SIs and LSIs.** Banks are required to measure, calculate, and report their exposure to IRRBB on a quarterly basis. Banks are also required to conduct regular stress testing using both standardized and bespoke scenarios, especially for those banks with more complex business models and optionality in the portfolio. Supervisors make an assessment of IRRBB through the SREP process and it is a key topic in discussions with bank senior management. The German authorities have also conducted short term data collection exercises in the last several years to deepen the understanding of the systems exposure.
- 26. Concentration risk and country risk are generally considered as part of credit risk.** The definition of concentration risk is limited to credit exposures, and not in a broader sense including different types of exposures. The expectations of the supervisors with respect to concentration risk and country risk management are not clearly communicated to the banks. There is no requirement that all material concentrations to be regularly reviewed and reported to the bank's supervisory board. Reporting and monitoring of country risk and concentrations can be improved, and their inclusion in banks' stress tests specifically required.
- 27. The framework for transactions with related parties is weak, although the definition of related parties is wide and detailed.** The framework covers loans in a broad definition that includes off-balance sheet exposures and leasing operations, albeit not dealings such as service contracts, asset purchases and sales, and construction contracts. Related party loans must be granted on market terms, but there is no requirement that individuals with conflict of interest are excluded from the whole process of granting and managing such exposures. There is no requirement that related party exposures are monitored and controlled separately and in aggregate. There is no regular reporting of exposures to related parties. Supervision of related party risk is mostly carried out by external auditors, whose analysis of related party risk is very limited. No limits on related party are imposed by laws, regulation, or the supervisor.
- 28. Supervisors have stepped up the frequency and intensity of interaction with credit institutions regarding their management of liquidity risk, contingency plans, and funding requirements.** Supervisors have built-up in-depth understanding of liquidity funding risks at individual institutions. Supervisors periodically meet with treasury staff and receive monthly

monitoring of LCR data. Funding plans and results of stress testing are reported and evaluated periodically. The LCR adopted in EU has a number of elements which are less stringent than the Basel agreed rule, most notably a wider definition of HQLA. German banks make use of the wider definition of HQLA mainly in covered bonds included as Level 1 assets. Guidance for assessing ILAAPs will be implemented for 2016 which will help strengthen the assessment of liquidity risk management as part of the SREP, which was under improvement at the time of the mission. To this regard, SSM issued a letter in the beginning of the year on Supervisory Expectations on ILAAP and harmonized information collection on ILAAP to enhance its analysis and integration in the SREP. Benchmarks for liquidity risk indicators will be developed during 2016.

29. While operational risk has undergone several enhancements since the time of the last FSAP, more attention is needed of ongoing monitoring of the effective implementation of operational risk management frameworks. The area of operational risk has undergone several enhancements since the time of the last FSAP, most notably in the strengthening of dedicated IT risk specialists that mainly conduct on-site examinations but also develop supervision approaches for IT risk more generally. This team has been successful at deepening the institutional knowledge of IT risks and vulnerabilities and identify where standards need to be raised. The most recent example is in the area of data centers where IT risk specialists have attended DR testing for several of the larger LSIs.

30. The independence of the internal audit and compliance is undermined as they report to the management board. The internal audit function, as an instrument of the management board, is under its direct control and has to report to management board members. The internal auditor can also be subject to the direct control of one management board member, who could be the chairperson. Additionally, the supervisory board is only informed ex-post of a replacement of the internal auditor, compliance officer, and risk officer.

31. Banking supervisors do not have legal power to access external auditors' work papers. Although this is not an essential requirement, Germany chose to be assessed against the best international practices, and given the heavy reliance on external auditors for reviewing not only the reliability of financial statements but also reporting on whether the banks comply with all risk management guidelines, this gap should be addressed.

32. Overall, the AML/CFT framework appears strong, but some weaknesses remain, mainly in supervisory practices. BaFin has established a risk-based framework to discriminate banks' risk profiles and exposure to risks from AML/CFT. The framework is designed to help identify those institutions where enhanced monitoring and attention is required. While the framework should help focus supervisory attention on the highest risk institutions, inputs into the process need to be refined to be fully risk-based. The framework is heavily reliant on the EA report to identify deficiencies or weaknesses in risk management. Ongoing monitoring of banks' compliance with the regulations needs to be more systematic through the ongoing receipt of a range of inputs. Lastly, coverage of the banking sector through on-site examinations needs to be expanded.

INTRODUCTION AND METHODOLOGY

A. Introduction

33. This assessment of the current state of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) in Germany has been completed as a part of the Financial Sector Assessment Program (FSAP) mission undertaken by the International Monetary Fund (IMF) during March of 2016 at the request of the German authorities. It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework, which are addressed in other parts of the FSAP.

34. An assessment of the effectiveness of banking supervision requires a review of the legal framework, and detailed examination of the policies and practices of the institutions responsible for banking regulation and supervision. In line with the BCP methodology, the assessment focused on BaFin, Deutsche Bundesbank (BBk), and the European Central Bank as the joint supervisors of the banking system, and did not cover the specificities of regulation and supervision of other financial intermediaries. It is important to note, however, that to the extent that BaFin is a unified supervisor responsible for other entities of the financial sector, the assessment of banking supervision in Germany may provide a useful picture of current supervisory processes applicable to other financial institutions supervised by it.

B. Information and Methodology Used for Assessment

35. Germany requested to be assessed according to the Revised Core Principles (BCP) Methodology issued by the BCBS (Basel Committee of Banking Supervision) in September 2012. The current assessment was thus performed according to a revised content and methodological basis as compared with the previous BCP assessment carried out in 2011. It is important to note, for completeness' sake, that the two assessments will not be directly comparable, as the revised BCP have a heightened focus on corporate governance and risk management and its practice by supervised institutions and its assessment by the supervisory authority, raising the bar to measure the effectiveness of a supervisory framework (see box for more information on the Revised BCP).

36. The German authorities chose to be assessed against the highest standards of supervision and regulation, choosing to be assessed and rated against both the Essential Criteria and the Additional Criteria. To assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle. The essential criteria (EC) were usually the only elements on which to gauge full compliance with a Core Principle (CP). The additional criteria (AC) are recommended best practices against which the authorities of some more complex financial systems may agree to be assessed and rated. The assessment of compliance with each principle is made on a qualitative basis. A four-part grading system is used: compliant; largely compliant; materially noncompliant; and noncompliant. This is explained below in the detailed assessment section. The assessment of compliance with each CP is made on a qualitative basis to

allow a judgment on whether the criteria are fulfilled in practice. Effective application of relevant laws and regulations is essential to provide indication that the criteria are met.

37. The assessment team reviewed the framework of laws, rules, and guidance and held extensive meetings with officials of BaFin, Bundesbank, and ECB Supervision, and additional meetings with auditing firms and banking sector participants. The authorities provided a self-assessment of the CPs rich in quality and comprehensiveness, as well as detailed responses to additional questionnaires, and facilitated access to supervisory documents and files, staff, and systems.

38. The team appreciated the very high quality of cooperation received from the authorities. The team extends its thanks to staff of the authorities who provided excellent cooperation, including extensive provision of documentation and access, at a time when staff was burdened by many initiatives related to the European and global regulatory changes, and still adapting to the new European supervisory framework.

39. The standards were evaluated in the context of the German financial system's structure and complexity. The CPs must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the CP, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the CPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

40. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. Reaching conclusions required judgments by the assessment team. The team assessed the supervisory and regulatory framework in the midst of great changes, and the assessment should reflect the transition phase in which it took place. Nevertheless, the assessment of the current legal and regulatory framework and supervisory practices against a common, agreed methodology should provide the supervisors of German banks with an internationally consistent measure of the quality of its banking supervision in relation to the CPs, which are internationally acknowledged as minimum standards, and point the way forward.

41. To determine the observation of each principle, the assessment has made use of five categories: compliant, largely compliant, materially noncompliant, noncompliant, and non-applicable. An assessment of "compliant" is given when all ECs and ACs are met without any significant deficiencies, including instances where the principle has been achieved by other means. A "largely compliant" assessment is given when there are only minor shortcomings, which do not raise serious concerns about the authorities' ability to achieve the objective of the principle and there is clear intent to achieve full compliance with the principle within a prescribed period of time (for

instance, the regulatory framework is agreed but has not yet been fully implemented). A principle is considered to be “materially noncompliant” in case of severe shortcomings, despite the existence of formal rules and procedures and there is evidence that supervision has clearly not been effective, the practical implementation is weak or that the shortcomings are sufficient to raise doubts about the authorities’ ability to achieve compliance. A principle is assessed “noncompliant” if it is not substantially implemented, several ECs and ACs are not complied with, or supervision is manifestly ineffective. Finally, a category of “non-applicable” is reserved for those cases that the criteria would not relate the country’s circumstances.

Box 1. The 2012 Revised Core Principles

The revised BCPs reflect market and regulatory developments since the last revision, taking account of the lessons learned from the financial crisis in 2008/2009. These have also been informed by the experiences gained from FSAP assessments as well as recommendations issued by the G-20 and FSB, and take into account the importance now attached to: (i) greater supervisory intensity and allocation of adequate resources to deal effectively with systemically important banks; (ii) application of a system-wide, macro perspective to the microprudential supervision of banks to assist in identifying, analyzing and taking pre-emptive action to address systemic risk; (iii) the increasing focus on effective crisis preparation and management, recovery and resolution measures for reducing both the probability and impact of a bank failure; and (iv) fostering robust market discipline through sound supervisory practices in the areas of corporate governance, disclosure and transparency.

The revised BCPs strengthen the requirements for supervisors, the approaches to supervision and supervisors' expectations of banks. The supervisors are now required to assess the risk profile of the banks not only in terms of the risks they run and the efficacy of their risk management, but also the risks they pose to the banking and the financial systems. In addition, supervisors need to consider how the macroeconomic environment, business trends, and the build-up and concentration of risk inside and outside the banking sector may affect the risk to which individual banks are exposed. While the BCP set out the powers that supervisors should have to address safety and soundness concerns, there is a heightened focus on the actual use of the powers, in a forward-looking approach through early intervention.

The number of principles has increased from 25 to 29. The number of essential criteria has expanded from 196 to 231. This includes the amalgamation of previous criteria (which means the contents are the same), and the introduction of 35 new essential criteria. In addition, for countries that may choose to be assessed against the additional criteria, there are 16 additional criteria.

While raising the bar for banking supervision, the Core Principles must be capable of application to a wide range of jurisdictions. The new methodology reinforces the concept of proportionality, both in terms of the expectations on supervisors and in terms of the standards that supervisors impose on banks. The proportionate approach allows assessments of banking supervision that are commensurate with the risk profile and systemic importance of a wide range of banks and banking systems.

INSTITUTIONAL AND MARKET STRUCTURE— OVERVIEW³

42. The banking sector comprises three main “pillars,” private commercial banks, public savings banks, and cooperative banks. While the three-pillar structure has been fairly stable over the past decade, the German banking system has gone through a sustained period of consolidation.⁴ The number of banks has declined by about 100 compared with the time of the last FSAP, with consolidation mainly taking place at local savings and cooperative banks level.

43. The first pillar, private commercial banks, is composed of big banks, regional and other commercial banks as well as branches of foreign banks. While comparatively lower in the number of institutions, private commercial banks represent the largest segment of the banking sector by assets, accounting for 39.4 percent of the system in May 2015, slightly above the share in 2010. The “big banks” tend to operate with large branch networks, both domestically and internationally. They typically cover retail, corporate banking as well as investment banking business, and act as the principal banking partners of Germany’s major industrial enterprises.⁵ The regional and other commercial banks tend to be smaller in size and operate within a particular region, mainly focusing on credit to households and non-financial corporates, with deposits as the primary source of funding (Deutsche Bundesbank, 2015).

44. The second pillar, public savings banks, include both Landesbanken and savings banks (Sparkassen), covering about 27 percent of banking system assets. The savings banks operate under a regional principle, providing a range of banking services to households and small- and medium- enterprises (SMEs) in their own region. While competing with commercial banks, savings banks do not tend to compete with each other and they are mandated to provide public good and to support local economic development. Landesbanken, the central institution of the savings banks, have become increasingly involved in wholesale banking and capital market activities in recent years, in direct competition with commercial banks (Deutsche Bundesbank, 2015). While local savings banks weathered the 2008 financial crisis fairly well, partly due to their conservative business models and strong deposit base, some Landesbanken endured large losses as a result of their involvement in structured finance and derivative products. As a result, several Landesbanken were consolidated and merged after the crisis, with a resulting number of nine institutions in 2015.⁶

45. The third pillar, cooperative banks, includes more than 1,000 financial institutions, accounting for about 13.5 percent of the banking assets. Similar to savings banks, credit cooperatives are subject to a regional principle and operate under an extensive network of regional

³ This part of the assessment draws from other FSAP documents.

⁴ Compared with 1995, the number of banking institutions has declined by about 50 percent.

⁵ The “big bank” group includes Commerzbank, Deutsche Bank, Deutsche Postbank, and UniCredit.

⁶ The savings banks and the Landesbanken were backed by mutual guarantees in the past; however, the guarantees were phased out in 2005.

branches, with mutual guarantees. The cooperative banks are owned by their members, who tend to be their depositors and borrowers, and usually offer core banking services to their customers. The two regional institutions of credit cooperatives, DZ-Bank-AG and WGZ-Bank-AG, act as central institutions for cooperative banks, with the former also being a large commercial bank in Germany. The regional institutions of credit cooperatives play a more active role than the Landesbanken in redistributing liquidity among the affiliated institutions, operating chiefly in the interbank and capital markets (Deutsche Bundesbank, 2015).

46. The remaining twenty percent of the German banking sector comprises mortgage banks, building and loan associations and special purpose banks. Mortgage banks suffered losses during the financial crisis, and subsequently went through restructuring and resolution. Their asset size has declined to under five percent of the banking system in 2015.

47. Asset and liability structures of the German banking sector have been relatively stable since the last FSAP. On the asset side, banks mainly focus on lending to banks and non-banks, with the role of Landesbanken and mortgage banks decreasing over time. On the liability side, banks mainly obtain funding from three sources: liability to non-banks, liabilities to the MFI sector, and securitized debt, with liabilities to non-banks as the primary source of funding for Germany's banking sector as a whole (42.5 percent in March 2015).

48. Banking supervision in Germany is conducted by three authorities: BaFin, Bundesbank, and, since 2014, also the ECB. The Single Supervisory Mechanism (SSM) – the banking supervision mechanism in place in the Euro Area Member States comprising the European Central Bank (ECB) and the national competent authorities (NCAs) – entered into operation on 4 November 2014. In the SSM, credit institutions are categorized as “significant” or “less significant”. The ECB directly supervises the SIs, which includes 21 banking groups in Germany. Among the SIs directly supervised by the ECB, one German bank (Deutsche Bank) is included in the Financial Stability Board list of Global Systemically Important Banks (G-SIBs) for 2016. The NCA – in the case of Germany, BaFin and Bundesbank supervise the LSIs, under the general oversight of the ECB. The institutions supervised by BaFin are divided into four groups: commercial banks (182), institutions belonging to the savings bank sector (425), institutions belonging to the cooperative sector (1,052), and other institutions (121). The group comprising commercial banks include major banks, private commercial banks, and subsidiaries of foreign banks. The savings bank sector comprises public-sector and independent savings banks together with the Landesbanken. In addition to the primary credit cooperatives, the cooperative sector also includes DZ Bank and WGZ Bank due to their financial ties. The group of other institutions comprises building societies (Bausparkassen), Pfandbrief banks, securities trading banks, and development banks operated by the federal government and the federal states. At the close of 2014, BaFin was supervising 12 private and 9 public sector building societies.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION⁷

49. The macroeconomic environment has been favorable with regard to the performance of the German banking industry in recent years. It manifested itself especially in low borrower related credit risk and a low stock of nonperforming loans, particularly when compared to other European countries. Results of the Bank Lending Survey suggest that borrower related risk and the general macroeconomic situation did not alter lending policies in Germany to a large extent in recent years, however these factors had a sizeable impact at the peak of the financial crisis 2008 / 2009. With regard to the low interest rate environment banks active in the traditional banking business managed to keep their interest margins stable so far. At the same time, they have extended their balance sheets and maturity transformation risk. Nevertheless, if the low interest environment prevails the shrinking interest rate margin will force banks to look for alternative business opportunities potentially raising new and unknown risks for the respective banks.

50. The Financial Stability Act provides the legal framework for the Financial Stability Committee (FSC), Germany's macroprudential institution. The Federal Ministry of Finance (MoF), the Federal Financial Supervisory Authority (BaFin) and the Bundesbank each have three voting representatives on the FSC, while the Federal Agency for Financial Market Stabilization (Bundesanstalt für Finanzmarktstabilisierung - FMSA) has one non-voting advisory member. The FSC discusses the factors that are key to financial stability, strengthens cooperation between the institutions represented on it, advises on the handling of warnings and recommendations issued by the ESRB and reports annually to the lower house of Parliament (the Bundestag) on the situation regarding the developments in financial stability as well as on its own activities. In particular, the FSC is able to issue warnings and recommendations to all public bodies in Germany in order to promptly combat any adverse developments which may cause risks to financial stability. As with the ESRB's recommendations, the addressees of these recommendations must adhere to a "comply or explain" mechanism.

51. As the German credit market is dominated on the supply side by Sparkassen and Volks- und Raiffeisenbanken (co-operative banks) which typically conduct retail business and SMEs on the demand side, the credit culture can be assessed as a more traditional one where collateralization e.g., by mortgages prevails. However, more recently one can see the tendency of larger corporates, the typical clients of the bigger banks, to fund themselves directly on the capital market. This might be driven by an increased willingness of investors to take these risks while funding costs of larger banks went up due to rating downgrades.

52. Germany has a well-developed public infrastructure, including a comprehensive legal system covering in particular areas relevant for the banking system. These laws relate, e.g., to corporate law setting out the requirements regarding the setting up and winding down/liquidating

⁷ This section draws from other documents produced for the FSAP, some of which at the time of this assessment were not yet finalized. A complete analysis of the macroeconomic framework is contained in Article IV reports.

of joint stock companies, limited companies, partnerships, cooperatives, etc., their internal governance structures, detailed accounting provisions as well as rules regarding mergers and acquisitions.

53. The financial sector regulation in Germany covers all relevant areas (banking, insurance, and securities). As a member state of the EU, large parts of the German framework are rooted in the transposition or implementation of EU directives and directly applicable EU regulations. Specific national rules exist where topics considered relevant are not regulated by EU law or where EU law leaves room for additional national rules. Furthermore, BaFin as an integrated supervisory authority is member of the European Supervisory Authorities (EBA, ESMA, and EIOPA). In this context, BaFin is obliged to cooperate with and support the work of the ESAs. This also includes the implementation of ESA guidelines and recommendations. The same applies to the cooperation of BaFin and ECB within the SSM.

54. Germany enjoys a system of independent external audits and comprehensive accounting principles and rules, which are contained in the German Commercial Code (HGB). All German public accountants are organized in the Chamber of Public Accountants (WPK), a corporation under public law. The requirements on the profession of a certified public accountant are stringent. The Auditor Oversight Commission (AOC), comprised entirely of persons independent from the profession, carries out public oversight on the Chamber of Public Accountants (WPK), and all auditors associated in the WPK.

55. In Germany terms and conditions of contracts in general are not regulated in supervisory law but in civil law. The Civil Code (Bürgerliches Gesetzbuch - BGB) for example sets legal framework for consumer credits including consumer protection regulations and the act on insurance contracts (Versicherungsvertragsgesetz - VVG) also stipulates consumer protection regulations. Recently the German legislator adopted a new law to improve the protection of retail investors ("Kleinanlegerschutzgesetz"). Moreover, BaFin supervises compliance of financial market players with consumer protecting provisions in supervisory laws, e.g., German Banking Act (Kreditwesengesetz – KWG), Insurance Supervision Act (Versicherungsaufsichtsgesetz – VAG), and Securities Trading Act (Wertpapierhandelsgesetz - WpHG).

56. On July 3, 2015 the Deposit Insurance Act (Einlagensicherungsgesetz - EinSiG) entered into force. Thus, Germany has transposed the European directive on deposit guarantee schemes (DGSD) into national law. Under the Directive, all credit institutions have to be allocated to a statutory guarantee scheme or an institutional protection scheme that is officially recognized as a deposit guarantee scheme. Customers of all institutions have a legal claim to compensation for their covered deposits up to an amount of € 100,000.

57. The German Act for Recovery and Resolution of Institutions and Financial Groups (SAG) spells out the different responsibilities and tools available in crisis management and for bank resolution which complement the powers and measures granted by the Banking Act (KWG). The Federal Agency for Financial Market Stabilization (FMSA) was appointed as resolution authority on a national level. The supervisory authority reviews and assesses the recovery plan in

consultation with the Bundesbank. Banks that are deposit taking institutions as defined in section 1 (3d) first sentence KWG also have to be members of a deposit insurance scheme which further bolsters public confidence in the stability of the financial system. For further details, please refer to the Einlagensicherungsgesetz (EinSiG) that went into force on July 3, 2015 and amended the former Deposit Guarantee and Investor Compensation Act (EAEG).

58. The main legislation aimed at maintaining adequate flows of information to market participants as condition for effective market discipline is the German Corporate Governance Code (GCGC). Information on stock option programs and similar securities-based incentive systems of the company must be given either in the Corporate Governance Report, the Annual Financial Statements, the Consolidated Financial Statements or the compensation report. All material new facts made known to financial analysts and similar addressees must also be disclosed to the shareholders. Other disclosure provisions cover remuneration issues. According to Art. 450 CRR, SIs must disclose specific information regarding the remuneration policy and practices of the institution for those categories of staff whose professional activities have a material impact on its risk profile, such as information concerning the governance process, information on link between pay and performance, the most important design characteristics of the remuneration system, the ratios between fixed and variable remuneration, aggregate quantitative information on remuneration, and the number of individuals being remunerated EUR 1 million or more per financial year. This is complemented by HGB provisions which establish the disclosure of the total remuneration of every management board and the supervisory board member in fiscal year (salaries, profit sharing, options and other stock-based compensation, expense allowances, insurance charges, commissions, and fringe benefits of any kind) has to be part of the annex of the profit and loss account and the consolidated profit and loss account respectively.

59. Another tool to maintain effective market discipline is provided by the Securities Trading Act (Wertpapierhandelsgesetz - WpHG). WpHG requires listed companies to disclose immediately—i.e., ad hoc—facts about their company that are not public knowledge if such information has the potential to influence the price of the financial instrument and if it relates directly to the issuer. WpHG requires publicly traded companies to prepare annual financial statements and half-yearly financial reports as well as interim management statements. The annual financial statements and half-yearly financial reports of publicly traded companies must include a compliance statement by the company's legal representatives.

DETAILED ASSESSMENT

A. Supervisory Powers, Responsibilities and Functions	
Principle 1	Responsibilities, objectives and powers. An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. ⁸ A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns. ⁹
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision ¹⁰ are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	<p>In Germany there are three authorities with responsibilities regarding banking supervision: the ECB, BaFin and Deutsche Bundesbank (BBk). The European Central Bank (ECB), in cooperation with national authorities, is generally responsible for the supervision of credit institutions established in the participating EU Member States (the “participating Member States” are those whose currency is the euro or a Member State whose currency is not the euro but has established close cooperation with the ECB). Together, the ECB and the various national competent authorities (NCA) form the Single Supervisory Mechanism (SSM). The objectives and responsibilities of the SSM are defined in the SSM Regulation (Council Regulation (EU) No 1024/2013 of 15 October 2013 – SSMR) conferring “specific” tasks to the ECB relating to the prudential supervision (some tasks, such as the supervision of AML related issues, are not under the jurisdiction of ECB). The SSM Regulation is supplemented by the SSM Framework Regulation (Regulation (EU) No 468/2014 of 16 April 2014 – SSMFR) establishing the framework for cooperation within the SSM, which provides the legal basis for the operational arrangements related to the prudential tasks of the SSM.</p> <p>The respective tasks of the ECB and of the national authorities are listed in Articles 4, 5, and 6 of the SSM Regulation and further detailed in the SSMFR. Banks are qualified as significant (SI) or less significant (LSI) on the basis of defined criteria, mainly: their size, the importance for the economy of the Union or a specific Member State, the importance of their cross-border activities. SIs are under the direct supervision of the ECB. BaFin and Bundesbank assist the ECB in the performance of these tasks.</p>

⁸ In this document, “banking group” includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

⁹ The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

¹⁰ Such authority is called “the supervisor” throughout this paper, except where the longer form “the banking supervisor” has been necessary for clarification.

	<p>Less significant institutions or banking groups (LSIs) are under the direct supervision of the BaFin and Bundesbank. For these LSIs, the ECB is responsible for exercising oversight over the functioning of the system. When necessary to ensure consistent application of supervisory standards, the ECB may, on its own initiative and after consulting with the NCAs (or upon request by a NCA), decide to exercise directly itself all relevant powers for one or more credit institutions, including in the case where financial assistance has been requested or received indirectly from the EFSF or the ESM. The ECB published its <i>Guide to banking supervision</i>, which aims at explaining to the public how the SSM functions and at giving guidance on the SSM's supervisory practices.</p> <p>The responsibilities and objectives of the German authorities for the purpose of banking supervision are defined in sections 6 and 7 of the German Banking Act (Kreditwesengesetz – KWG). The Federal Financial Supervisory Authority (BaFin) exercises in cooperation with Bundesbank, supervision over banks according to KWG, the second level regulation enacted in connection with it, Regulation (EU) No 575/2013 (CRR) and legal acts enacted on the basis of the CRR and Directive 2013/36/EU (CRD IV). BaFin is the competent/designated authority for the application of Article 458 of CRR (macroprudential responsibilities) as well as the competent authority pursuant to Article 4 (1) of CRD IV. Bundesbank is also a competent entity pursuant to Article 4 (1) CRD IV within the scope of the functions assigned to it by section 7 KWG. BaFin and Bundesbank cooperate as stipulated in section 7 KWG. As far as national competent authorities participate in the SSM, BaFin and Bundesbank maintain their national distribution of tasks established in section 7 (1a) KWG.</p> <p>Additionally, BaFin, in consultation with Bundesbank, issued a Supervision Guideline which regulates the division of tasks of both authorities in detail. The agreement is designed to avoid duplication of work and ensure cost-effectiveness on the national level. Since the introduction of the SSM it is in a sense only applicable for the cooperation in supervision of LSIs. Under the guideline, the Bundesbank is assigned most of the operational tasks in banking supervision. In the ongoing monitoring process, the Bundesbank's responsibilities include evaluating the documents, reports, annual accounts and auditors' reports submitted by the institutions as well as regular inspections of banking operations. It holds both routine and ad hoc prudential discussions with the institutions (with BaFin). BaFin is responsible for all decisions and measures. Only in exceptional cases BaFin does audits/inspections of banking operations, either together with the Bundesbank or on its own.</p>
EC 2	<p>The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.</p>
Description and findings re EC2	<p>Article 1 of the SSM Regulation states the objectives of the ECB in the performance of its supervisory tasks: <i>"This Regulation confers on the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions, with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State, with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory arbitrage."</i></p> <p>Article 25 of the SSM Regulation further specifies that, when carrying out its supervisory tasks, the ECB shall pursue only the objectives set by the SSM Regulation. The same provision also sets a framework in order to separate the supervisory function of the ECB from its monetary policy function. The purpose of this separation principle is to ensure that each function is strictly exercised in accordance with its respective objectives, therefore avoiding conflicts between these objectives. The separation principle covers, among other</p>

	<p>things, the separation of objectives, the separation of decision-making processes and tasks, including the organizational and procedural separation at the level of the Governing Council.</p> <p>In order to ensure full separation of objectives, the decisions taken by the ECB in the area of banking supervision are prepared by an independent Supervisory Board before being submitted to the Governing Council for final adoption, mainly under the “non-objection procedure” according to which the Governing Council is deemed to have adopted the decision unless it objects within a specific timeframe. Moreover, the ECB’s Rules of Procedure were amended to regulate organizational and procedural aspects related to the Supervisory Board and its interaction with the Governing Council. This included the rule that the Governing Council’s deliberations on supervisory matters would be kept strictly apart from those on other issues, with separate agendas and meetings. Additionally, as required under Article 25(5) of the SSM Regulation, a Mediation Panel was established by Regulation ECB/2014/26 of June 2, 2014 with a view to resolve differences of views expressed by the NCAs regarding an objection of the Governing Council to a draft decision by the Supervisory Board. On September 17, 2014 the ECB adopted a Decision on the implementation of separation between the monetary policy and supervision functions of the ECB (Decision ECB/2014/39).</p> <p>BaFin’s objectives are set down by law and are legally binding. As the competent administrative authority pursuant to section 6 (1) KWG, BaFin exercises supervision of institutions in accordance with the KWG. The primary objectives of banking supervision are summarized in section 6 (2) of the KWG: BaFin shall counteract undesirable developments that may endanger the safety of institutions’ assets, impair proper conduct of banking business or entail major disadvantages for the economy as a whole. BaFin is governed according to its Mission Statement whereas its highest priority is to seek to discharge its statutory mandate to the very best of its ability. Section 4 (1a) of the Act Establishing the Federal Financial Supervisory Authority, (Finanzdienstleistungsaufsichtsgesetz – FinDAG) also empowers BaFin with the legal task of collective consumer protection.</p> <p>The Bundesbank’s mandate for banking supervision follows from a mandate to safeguard financial stability, as laid down in the Act concerning the BBk (<i>Gesetz über die Deutsche Bundesbank</i>), as well as from the KWG, that highlights Bundesbank’s responsibilities for the ongoing monitoring of German institutions. As explained on the website of the Bundesbank, “owing to its business relationships with credit institutions, its local presence and its general proximity to the market, the Bundesbank has deep insights into the financial sector and knowledgeable staff qualified to deal with issues relating to the financial market and its stability.”</p>
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile ¹¹ and systemic importance. ¹²
Description and findings re EC3	For regulatory powers of BaFin and ECB, see EC 4.

¹¹ In this document, “risk profile” refers to the nature and scale of the risk exposures undertaken by a bank.

¹² In this document, “systemic importance” is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

In accordance with Article 4(1)(f) of the SSM Regulation, the ECB is competent to carry out supervisory reviews, including where appropriate in coordination with EBA, stress tests, in order to determine whether the arrangements, strategies, processes and mechanisms put in place by credit institutions and the own funds held by these institutions ensure a sound management and coverage of their risks. On the basis of that supervisory review, the ECB may impose on credit institutions specific measures from the list laid down in Articles 9-18 SSM Regulation, in CRR, as well as instruct NCAs to use their powers under national law (see CP 11). The outcome of the SREP is the basis for determining the capital and liquidity adequacy of the credit institution.

There are specific supervisory powers directly available to ECB listed in Article 16 of the SSMR. If the bank does not meet the requirements of relevant EU law, is likely to breach these requirements within 12 months, or if, based on the SREP, the ECB determined that the arrangements, strategies, processes and mechanisms implemented by bank and the own funds and liquidity held by it do not ensure a sound management and coverage of its risks, the ECB has, inter alia, the following powers (applicable to both SIs and LSIs):

- to require the reinforcement of the arrangements, processes, mechanisms and strategies;
- to require institutions to present a plan to restore compliance with supervisory requirements and set a deadline for its implementation, including improvements to that plan regarding scope and deadline;
- to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements;
- to restrict or limit the business, operations or network of institutions or to request the divestment of activities that pose excessive risks to the soundness of an institution;
- to require the reduction of the risk inherent in the activities, products and systems of institutions;
- to require institutions to limit variable remuneration as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base;
- to require institutions to use net profits to strengthen own funds;
- to 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; and
- to impose additional or more frequent reporting requirements, including reporting on capital and liquidity positions.

For institutions directly supervised by the German authorities, Article 92 CRR on own fund requirements applies. Further, in accordance with section 10 (3) KWG, BaFin may issue an order requiring an institution, group of institutions, financial holding group or mixed financial holding group to meet own funds requirements in respect of risks and risk elements not covered by Article 1 CRR which go beyond the own funds requirements pursuant to the CRR (see CP 16). In addition, and in accordance with section 10f KWG BaFin will order global systemically important institutions to maintain a capital buffer for global systemically important institutions (G-SII buffer) on a consolidated basis consisting of Common Equity Tier 1 capital. In accordance with section 10g KWG BaFin may order other systemically important institutions to maintain a capital buffer for other systemically

	important institutions (O-SII buffer) of up to 2.0 percent of the total risk exposure amount determined pursuant to Article 92 (3) CRR on a consolidated, sub-consolidated or individual basis consisting of Common Equity Tier 1 capital.
EC4	Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.
Description and findings re EC4	<p>European legislation and regulation are updated and subject to public consultation. EBA technical standards and guidelines are also subject to the formal public consultations. ECB regulation and guidelines are also subject to public consultation.</p> <p>Since its adoption in 1961, the KWG has been regularly updated and amended in order to take into account developments in the banking industry and advancements in supervisory practices. Also, the supplementary regulations have been regularly updated, e.g., major amendments by the act transposing CRD IV into national law in 2013 or the BRRD in 2014</p> <p>In accordance with Article 4(3) of the SSM Regulation, the ECB may adopt guidelines, recommendations and decisions. It may also adopt regulations. Before adopting a regulation, the ECB conducts open public consultations and analyses the potential related costs and benefits. So far, the ECB held public consultation on the following documents:</p> <ul style="list-style-type: none"> • Draft ECB Regulation on reporting of supervisory financial information; • Draft ECB Regulation on supervisory fees; • Draft ECB SSM Framework Regulation; • Draft ECB Regulation on the exercise of options and discretions and draft ECB Guide on options and discretions available in Union law; and • Draft ECB Guide on the approach for the recognition of institutional protection schemes for prudential purposes. <p>BaFin is empowered to issue both prudential regulations and guidelines. Regulations are legally binding. In order to issue a regulation BaFin requires a specific mandate in the KWG or another supervisory law. This reservation follows from the principle that all legislation, in particular if it may affect basic rights, has to be issued by the legislative body (Parlamentvorbehalt). Thus, binding regulatory acts issued by an executive body need at least a legal mandate in a parliamentary act which clearly determines the possible/allowed content of the regulation. Most mandates in the German banking act are primarily addressed at the Ministry of Finance (MoF) but allow for a sub-delegation to BaFin. The MoF has frequently made use of this option, delegating such authority (for instance, through the Regulation Concerning Reports and the Submission of Documentation under the Banking Act – AnzV). As a rule, regulations supplement individual sections of the KWG or other supervisory acts where additional provisions are required but are too detailed or too technical. Guidelines are generally non-binding, however, when they are published they document BaFin’s understanding of certain provisions and its respective administrative practice they have a binding effect on BaFin itself; the same applies to circulars, guidance, opinions. As guidelines are non-binding BaFin can issue them at its own discretion whenever it considers it necessary. Draft regulations and guidelines are publicly consulted. While public consultation is mandatory for regulations it is also customary for guidelines. As guidelines are non-binding, institutions cannot be forced to comply with them, however, as they often provide supplementary rules for legal provisions, non-compliance with the guideline can also indicate a breach of these provisions.</p>

EC5	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) Supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings re EC5	<p>In accordance with Article 10 of the SSMR the ECB may require credit institutions, financial and mixed financial holding companies and mixed-activity holding companies, established in the SSM area all information that is necessary to its supervisory tasks, including information to be provided at recurring intervals and in specified formats for supervisory and related statistical purposes. The ECB may also request all information to persons belonging to these entities or third parties to whom those entities have outsourced functions or activities.</p> <p>In addition, pursuant to Article 11 of the SSM Regulation, the ECB may conduct all necessary investigations of any of these entities, persons or third parties, when those are established or located in the SSM area. To that end, the ECB is empowered to (i) require the submission of documents; (ii) examine the books and records of the persons involved and take copies or extracts; (iii) obtain written or oral explanations from any person or their representatives or staff; (iv) interview any other person who consents to be interviewed for the purpose of collecting information relating to the subject. The ECB may also conduct all necessary on-site inspections according to Article 12 of the SSMR, and may, for that purpose, enter any business premises and land of the legal persons subject to an investigation.</p> <p>Regarding the institutions directly supervised by the German authorities, sections 44 et seq. KWG grant BaFin and Bundesbank a number of information and audit rights which they can make use of at any time either routinely or for specific reasons. Although both institutions are entitled to information rights, the right to order audits by an administrative act is reserved exclusively to BaFin. According to section 44 (1) sentence 1 KWG, information and audit rights are directed to the institution itself as well as the members of its governing bodies and its employees. The institutions have to provide information and submit documents concerning all business activities. The authorization also extends to third persons and facilities that BaFin utilizes in the performance of its functions. The audit right includes enterprises to which an institution has out-sourced major operational units, and the holders of qualified participating interests are also required to provide information. This duty applies both to information relating to business activities and to the submission of documentation. Section 44 (2) KWG grants the supervisory authorities information rights vis-à-vis subordinated enterprises that are included in the banking supervisory consolidation, as well as financial holding companies.</p> <p>The ECB has direct supervisory competence in respect of significant groups comprising credit institutions, financial holding companies, mixed financial holding companies established in the SSM area, and branches in the SSM area of credit institutions established in the EU that are significant branches. However, the ECB has very limited powers to supervise the branches mentioned above, as it has a very limited capacity to request information from the bank in question and it cannot undertake on-site inspections of such EU branches (except in the context of a college under article 159 CRD IV). Similarly, non-EU banks establishing an affiliate in the SSM area are authorized by the ECB and supervised by the ECB when classified significant. Credit institutions from non-EU countries only</p>

	<p>establishing a branch or providing cross-border services in the Union remain supervised by BaFin (Recital 28 of the SSMR). For LSIs, BaFin will be responsible e.g., for cross-border inspections (section 8a (1) no. 2 KWG). The KWG contains a large number of reporting and submission requirements designed to enable BaFin and Bundesbank to judge the structure of institutions at group level.</p>
EC6	<p>When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to:</p> <ul style="list-style-type: none"> (a) take (and/or require a bank to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the bank's license; and (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.
Description and findings re EC6	<p>See EC 3 and CP 11. The ECB has available a range of possible measures to take corrective actions. Those tools include supervisory powers as well as administrative measures and administrative penalties. The assessment whether an institution "infringes or is likely to infringe in the near future" the applicable requirement is carried out by the ECB on the basis of the outcome of the SREP. The ECB has somewhat limited direct sanctioning power but can avail itself of the sanctioning powers available to German supervisors (see CP 11) The ECB also has the powers to withdraw the authorization for both SIs and LSIs.</p> <p>Resolution of SIs, since January 2016, involves the new European resolution authority, the Single Resolution Board (SRB). The resolution process is being initiated by the determination of an institution failing or likely to fail by the ECB and respective communication to the SRB and the determination by the SRB that the conditions for resolution are met. Other external stakeholders have to be informed as well (Art. 81 and 83 BRRD/section 138 and 140 SAG) such as relevant national resolution authorities, deposit guarantee scheme(s), the competent ministries, the European Systemic Risk Board (ESRB) and the designated national macro-prudential authority. Moreover, to support any resolution action(s) taken by the SRB/NRAs, the ECB coordinates supervisory tasks during the resolution stage and necessary follow-up actions, e.g., authorization of a bridge bank and withdrawal of license of the 'old' institution, where appropriate. Once a bank is in resolution and under the control of the SRB, there is a general obligation for the ECB to cooperate with all its requests.</p> <p>If an institution which is under direct supervision of BaFin violates legal requirements, or if its business is not conducted properly, BaFin has a series of measures aimed either at the institution itself, or at the managers of the institution. Material decisions regarding LSIs must be communicated to the ECB (Articles 97 and 98 SSMFR). All administrative penalties imposed on LSIs in connection with the exercise of supervisory tasks must be communicated to the ECB (Article 135 SSMFR). Violations of the KWG or other banking supervisory regulations can be subject to written admonition, a formal order in accordance with sections 6 (3) or 25 a (2) KWG to establish or restore a situation complying with the law, the imposition of a fine in accordance with section 56 KWG, the (partial) transfer of the powers incumbent upon the institution's governing bodies to a special representative in accordance with section 45 c KWG or, as a last resort, the revocation of the institution's license in accordance with section 35 (2) KWG (the actual revocation of license would be</p>

	<p>proposed by BaFin and decided by the ECB). In such cases, measures can also be taken against the managers in accordance with section 36 (2) KWG.</p> <p>Regarding cooperation and collaboration to achieve an orderly resolution, the German Recovery and Resolution Act (Sanierungs- und Abwicklungsgesetz, SAG) provides for certain powers as well as obligations for BaFin, respectively the ECB, as the competent supervisory authority. The competent authority is responsible for recovery planning (section 13 – 21 SAG) and the imposing of early intervention measures (section 36 SAG). Furthermore, the competent authority after hearing the resolution authority or the resolution authority after hearing the supervisory authority are able to decide that an institution is failing or likely to fail (section 62 (2) SAG). For resolution the Financial Market Stabilization Agency (Bundesanstalt für Finanzmarktstabilisierung – FMSA) acts as the national resolution authority according to section 3 SAG.</p>
EC7	The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.
Description and findings re EC7	<p>In accordance with Article 4(1)(g) of the SSMR, in relation to SIs, the ECB has the task to “carry out supervision on a consolidated basis over credit institutions’ parents established in one of the participating Member States, including over financial holding companies and mixed financial holding companies, and to participate in supervision on a consolidated basis, including in colleges of supervisors without prejudice to the participation of national competent authorities in those colleges as observers, in relation to parents not established in one of the participating Member State”. Similarly, the supervisory powers conferred on the ECB by Article 16 of the SSMR allow the ECB to require credit institutions as well as financial holding companies and mixed financial holding companies to take necessary measures.</p> <p>The KWG contains a large number of reporting and submission requirements designed to enable BaFin and Bundesbank to judge the structure of institutions as a whole at group level. One reason for refusing the license is that facts are known, which warrant the assumption that the institution is associated with other individuals or enterprises through corporate ties which impair the effective supervision of the institution (section 33 (2) no. 1 KWG). In accordance with section 24 (3a) sentence 2 KWG, financial holding companies must annually submit to BaFin and Bundesbank an aggregated report of subordinated institutions, financial enterprises and ancillary services undertakings. The establishment of, changes to or discontinuation of such participating interests or corporate relationships must be reported to BaFin and Bundesbank - section 24 (3a) sentence 4 KWG.</p>
Assessment of Principle 1	Compliant
Comments	<p>The legal framework for banking supervision is established by directly applicable EU regulation, German laws and regulations, and SSMR. All banks are subject to supervision and can be subject to individually determined prudential requirements based on their risk profile and systemic importance.</p> <p>While the division of responsibilities between BaFin and Bundesbank regarding LSIs supervision seems to be clear, the framework regarding supervision of SIs is still evolving and although the responsibilities of each authority are described in published laws and regulations there are still uncertainties regarding the specific operational roles and powers of each agency in the new environment and many questions need to be addressed in practice as they appear. These uncertainties reflect the complex legal and operational</p>

	<p>framework of the SSM, in particular on imposition of sanctions and enforcement actions, but do not seem to affect the overall understanding of responsibilities by the market or authorities.</p> <p>BaFin's responsibilities regarding consumer protection have been recently expanded by the Retail Investor Protection Act (Kleinanlegerschutzgesetz). Retail Investor Protection Act (Kleinanlegerschutzgesetz) . While consumer protection duties are also related to banks, consumer protection staff and responsibilities are located in the securities and conduct supervision directorate, which has recently been restructured. These shifts may affect available resources for banking supervision. (see CP 2)</p>
Principle 2	Independence, accountability, resourcing, and legal protection for supervisors. The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
Essential criteria	
EC1	The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings re EC1	<p>The ECB's functional, institutional, and financial independence is defined in accordance with Article 130 of the Treaty on the Functioning of the European Union. The ECB's independence extends to its supervisory tasks. Article 19 of the SSMR provides that <i>"When carrying out the tasks conferred on it by this Regulation, the ECB and the national competent authorities acting within the SSM shall act independently. The Members of the Supervisory Board shall act independently and objectively in the interest of the Union as a whole and shall neither seek nor take instructions from the institutions or bodies from the Union, from any government of a Member State or from any other public or private body."</i></p> <p>BaFin's governance structure and inner office's organization are defined in the FinDAG, the Rules of Internal Procedures (Geschäftsordnung), the Organizational Statute of BaFin (Organisationsstatut für die BaFin - OsBaFin) and the Articles of Association (Satzung der BaFin). According to section 1 FinDAG, BaFin operates as a legal person in the form of an institution of public law that is functionally and organizationally independent from the MoF. Pursuant to Article 19 SSMR the national competent authorities as well as the ECB acting within the SSM, shall act independently when carrying out the tasks conferred on the SSMR.</p> <p>As far as LSIs are affected, BaFin is subject to legal and supervisory control by the MoF as defined in section 2 FinDAG and further elaborated in the "Guidelines for the control of BaFin by the MoF" (Grundsätze für die Ausübung der Rechts- und Fachaufsicht des BMF über die BaFin 16.02.2010). For this control, MoF relies on information that is in the public domain, as well as on reports from BaFin on <i>"internal organizational matters, significant events occurring in the exercise of financial services supervision and important topics in connection with activities at an international level"</i>. More specifically, BaFin is to report to MoF on: (i) supervisory measures intended and introduced <i>"that are of material importance in the exercise of supervision"</i> (defining the term "matters of material importance" as <i>"noteworthy events occurring at systemically important institutions and noteworthy developments on the major financial markets"</i> as well as <i>"extreme events occurring at smaller institutions"</i>. (ii) contacts with foreign supervisory authorities and on the conclusion</p>

	<p>of cooperation agreements with foreign supervisory authorities; (iii) its advisory activities in connection with the development and support of supervisory systems outside Germany; and on (iv) topics discussed in and results of meetings of relevant European supervisory bodies and other international groups in which BaFin is represented.</p> <p>BaFin must also notify the MoF <i>“if it becomes aware of possible threats to systemically important credit institutions, financial services institutions, investment funds or insurance undertakings under its supervision, of impending disruptions on regulated stock exchanges and securities markets or other financial difficulties looming in the financial services field”</i>; and of audits by the Federal Court of Audit (<i>Bundesrechnungshof</i>). In addition to the written reports, the Guidelines provide for technical discussions on various topics, as well of the exchange of specialized knowledge. Regulations issued by BaFin on the basis of the KWG are to be submitted to the MoF prior to publication, and the MoF needs to be informed prior to publication about any BaFin announcement and/or notice with regard to <i>“their regulatory content and their impact on the institutions and undertakings under supervision”</i>, as well as on BaFin’s annual report, press briefings, interviews and other publications.</p> <p>It should be noted that neither the KWG, nor the FinDAG or the Guidelines provide for any direct instruction rights for the MoF vis-à-vis BaFin; the Guidelines do not provide for an <i>ex ante</i> involvement in individual supervisory decisions and/or actions, nor for <i>ex post</i> powers to rescind decisions taken by BaFin. In practice, there is no evidence of MoF influencing day-to-day supervisory decisions of BaFin.</p> <p>The Bundesbank, as a national central bank in the Eurosystem, operates independently. In the performance of its banking supervision tasks, the Bundesbank is required to observe guidelines set forth by ECB or BaFin. Bundesbank’s independence as regards instructions from the Federal Government of Germany is explicitly confirmed in section 12 Bundesbank Act.</p>
EC2	<p>The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.</p>
Description and findings re EC2	<p>According to article 283 of the European Treaty, the President, the Vice-President and the other members of the Executive Board of the ECB are appointed by the European Council, acting by a qualified majority, from among persons of recognized standing and professional experience in monetary or banking matters, on a recommendation from the Council, after it has consulted the European Parliament and the Governing Council of the ECB. Their term of office is eight years, not renewable. The Supervisory Board of the ECB is composed of a Chair, a Vice-Chair, four ECB representatives and one representative of each NCA, who can be accompanied by one representative of the NCB if the NCA is not the NCB (e.g., in Germany, BaFin and Bundesbank). The process for the appointment of the Chair and Vice-Chair of the Supervisory Board as well as of the four ECB representatives to the Supervisory Board is described in Article 26 of the SSMR, the ECB Rules of Procedure and Decision ECB/2014/4 of 6 February 2014 on the appointment of representatives of the ECB to the Supervisory Board. The Chair is chosen on the basis of an open selection procedure from among individuals of recognized standing and experience in banking and financial matters and who are not members of the Governing Council. The Inter-Institutional Agreement with the European Parliament and the MoU with the Council provide that the ECB shall specify and make public the criteria for the selection of the Chair and describe arrangements for</p>

the involvement of the EP and Council in the procedures. The Vice Chair of the Supervisory Board is chosen from among the members of the Executive Board of the ECB.

The Chair and Vice-Chair are proposed by the ECB to the European Parliament for approval, after a public hearing has been held by the relevant Parliament Committee. Following approval of the Parliament, the Council adopts an implementing decision appointing them. The four ECB representatives are appointed by the Governing Council, on a proposal from the Executive Board. The term of office of the Chair, the Vice-Chair and the four ECB representatives is 5 years, non-renewable. The Council may, following a proposal of the ECB which has been approved by the European Parliament, adopt a decision to remove the Chair from office, if he/she no longer fulfils the conditions required for the performance of his/her duties or has been guilty of serious misconduct. Under similar conditions, the Court of Justice of the EU may, on application by the Governing Council or the Executive Board, compulsorily retire the Vice-Chair from his/her function as member of the Executive Board. In such case, the Council may, following a proposal by the ECB, which has been approved by the European Parliament, to remove him/her as well from his/her office as Vice-Chair. Although the decisions are to be published, the disclosure of reasons for dismissal is not explicitly required.

Regarding BaFin, the president and the chief executive directors of BaFin are appointed by the Federal President on proposal of the German Government according to section 9 FinDAG. The minimum term for the president and the chief executive directors generally lasts for eight years, in exceptional cases for a shorter term, but at least for five years. The process for removal of the head(s) of the supervisory authority and members of its governing body is set in section 9 paragraph 2 FinDAG. According to FinDAG, the official relationship shall end upon expiry of the term of office or upon the member being discharged. The Federal President shall discharge a member of the Executive Board upon his/her request or upon resolution of the Federal Government for good cause. Public disclosure of reasons for dismissal, however, is not required. Furthermore, there are no legal barriers to transferring the BaFin's President and Executive Board members to other branches of the Federal government.

Regarding Bundesbank, the President, the Deputy President and the four other members of the Executive Board of the Bundesbank are appointed by the President of the Federal Republic of Germany. The President, the Deputy President and one other member shall be nominated by the Federal Government; the other three members shall be nominated by the Bundesrat (i.e. the upper house of parliament representing the federal states) in agreement with the Federal Government, cf. section 7 (3) Bundesbank Act. The Bundesrat may forward a proposal for the nomination of the Deputy President to the Federal Government. The Federal Government and the Bundesrat shall consult the Executive Board with regard to their nominations. The members of the Executive Board shall be appointed for 8 years or in exceptional cases for a shorter term of office, but not for less than 5 years.

The president of the Bundesbank may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct (Art 14.2. of the Statute of the European System of Central Banks and of the ECB). Although the decisions are to be published, the disclosure of reasons for dismissal is not explicitly required. According to Art. 130 TFEU and Art. 7 of the ESCB statute, a national central bank, including the Bundesbank, and the members of their decision-making bodies, shall not seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body.

EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. ¹³
Description and findings re EC3	<p>Article 1 of the SSMR clearly states the objectives of ECB's banking supervision. As a European institution, the ECB is primarily accountable to the European Parliament and the European Council, as mentioned in Article 20 of the SSMR. The practical arrangements of this accountability are described in the <u>Inter-institutional Agreement</u> concluded with the European Parliament and in the Memorandum of Understanding with the European Council. For example, the Chair of the Supervisory Board participates in hearings in the European Parliament or in the Eurogroup, the ECB replies to questions by Members of the European Parliament (which are published on the ECB <u>website</u>) and the ECB publishes an annual report dedicated to the banking supervision tasks. The first one was published on March 31, 2015. Furthermore, the ECB has the duty to cooperate in case of any investigations by the European Parliament, and the operational efficiency of the management of the ECB while exercising its supervisory tasks may be examined by the European Court of Auditors (Article 20 of the SSMR).</p> <p>On top of this accountability towards European institutions, the SSMR (Article 21) caters for a number of possible interactions and reporting requirements from the SSM to national parliaments: the SSM annual report is transmitted simultaneously to the EP and NPs; Members of NPs can ask the ECB written questions in respect of its tasks and there is a possibility to invite the Chair or a Member of the Supervisory Board for an exchange of views in NPs regarding national SIs. Five of these exchanges of views in National Parliaments have taken place so far.</p> <p>BaFin is governed according to its Core Objectives and Mission Statement which are built and described out of its legally defined tasks whereas its highest priority is to seek to discharge its statutory mandate to the very best of its ability. BaFin's objectives are published in its website. BaFin publishes an annual report of its activities, provides regular reporting to the MoF (see EC 2) and is subject to audits by the Federal Court of Audit (<i>Bundesrechnungshof</i>).</p> <p>As a central bank, the main mission behind all of the Bundesbank's activities is to safeguard the stability of the general price level and the financial system. Therefore, banking supervision is a core business area for the Bundesbank. Here, the Bundesbank performs a key operational task by helping to secure a financially sound banking industry and, ultimately, the stability of the financial system. Bundesbank's objectives in banking supervision are published, and it publishes an annual report which includes a summary of its supervisory activities.</p>
EC4	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	The internal governance of the ECB and the SSM are laid down in the SSMR, the SSMFR, the ECB Rules of Procedure and the Rules of Procedure of the Supervisory Board (in accordance with According to Art. 130 TFEU and Art. 7 of the ESCB statute). The internal (communication) processes are specified further in the SSM Supervisory Manual which has been approved by the Supervisory Board and is available to all ECB/SSM staff. In addition, there is a general obligation to exchange information within the SSM, as introduced by Article 21 of the SSMFR. Under the current framework (which does not foresee the delegation of decision-making

¹³ Please refer to Principle 1, Essential Criterion 1.

	<p>power), all legally binding acts, including all supervisory decisions, need to be submitted to the Supervisory Board for approval and to the Governing Council for adoption on a non-objection basis. Consequently, both bodies are confronted with a very high number of supervisory decisions to be adopted, including many routine decisions. This structure has a considerable impact on the complexity and the duration of the decision-making process, and is particularly challenging if supervisory decisions need to be taken within defined legal deadlines. The timelines for decision-making reflect the procedural steps laid down in the legal framework. These timelines must be reasonable (i) to ensure a proper interaction between the ECB and NCAs, (ii) to allow the Supervisory Board and the Governing Council to properly review draft decisions and to take reasoned decisions and (iii) to respect the rights of the addressees of decisions. The ECB endeavors to streamline the decision-making process to the extent possible by adopting uncontroversial decisions by written procedure and by standardizing and simplifying the documentation to be submitted to the decision-making bodies. In addition, if need be, the timelines for decision-making are shortened to the extent possible or decisions are taken at teleconferences. To address emergency situations, the decision would likely be approved by the Supervisory Board in a teleconference, which may include the Governing Council or be held back-to-back with a Governing Council teleconference where the decision is adopted, and in this case this emergency process may also be combined with the postponement of the hearing after the adoption of a provisional decision (Article 31(4) of the SSM Framework Regulation).</p> <p>As regards the avoidance of conflicts of interests, Art. 7 of the ESCB statute applies to ECB decision making bodies. The Supervisory Board has adopted on November 12, 2014 its own Code of Conduct, which provides a general framework of high ethical standards which the members and the other participants in Supervisory Board meetings are to observe and to set up specific procedures to deal, among other things, with potential conflicts of interest. The Code requires Supervisory Board members to disclose in writing any situation that could cause or could be perceived as causing a conflict of interest (and consequently these members will not participate in any deliberation or vote in relation to that situation conflicts of interest). A high level Ethics Committee has been established to support and advise the Supervisory Board members in the application of the ethics rules.</p> <p>BaFin's decision processes are explicitly determined and described in an internal supervisory manual whose provisions are directly binding for all BaFin employees. The internal procedures will be adjusted to incorporate new SSM processes. The Bundesbank employees act according to a corresponding internal supervisory manual.</p> <p>For emergency purposes, BaFin has developed a crisis management handbook that includes working, decision and information processes as well as their corresponding responsibilities. All BaFin-internal significant decisions are supposed to be taken in line with the (at least) four-eye principle. The internal rules of procedures ("GoBaFin") provide for supervisory decisions to be taken at a level appropriate to the significance of the issue. In addition to that, BaFin's governing body consists of five members (president and four chief executive directors) and its competences and decision rules are defined in the binding document "Rules of Procedures of the Executive Board of the Federal Financial Supervisory Authority" ("GoDirBaFin"), which include processes to avoid fraud or conflicts of interest. Bundesbank also has an internal Code of Conduct, and civil servants in Germany are subject to various requirements regarding conflict of interest and impartiality.</p>
EC5	<p>The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.</p>

Description and findings re EC5	<p>The ECB's revised Ethics Framework entered into force on January 1, 2015. It strengthens, in particular, the rules on avoiding conflicts of interest, as well as the rules on gifts and hospitality, private financial transactions and professional secrecy. It also establishes a Compliance and Governance Office, which advises all ECB staff and monitors compliance.</p> <p>The SSM adopted ethics rules to avoid conflicts of interests during the recruitment phase and during the ECB employment. Restrictions have been established to avoid conflicts of interest arising from subsequent occupational activities. To avoid the inappropriate use of information obtained through work, there are strict rules on private financial transactions. Staff are prohibited, even after their duties have ceased, from making unauthorized disclosure of any information that they have received in the performance of their duties. Disciplinary measures may be adopted in case of breach of professional duties, intentionally or by negligence.</p> <p>Rules on the acceptance of gifts for all civil servants are laid down in section 71 <i>Bundesbeamten-gesetz</i> (BBG). For BaFin staff a code of conduct exists to prevent corruption (<i>Dienstanweisung zur Korruptionsprävention</i>). There is also a code of conduct governing share-dealing and investing in supervised companies (<i>Dienstanweisung zur Überwachung der Mitarbeiter-geschäfte</i>). In addition, employees are required to be committed to the conscientious performance of their duties in accordance to section 1 of the Act on the Formal Obligation of Persons without Civil Servant Status (<i>Verpflichtungsgesetz – VerpflG</i>).</p> <p>Internal rules and regulations of the Bundesbank (<i>Dienstbestimmungen – DB 1-11, Annex 17</i>) provide rules of conduct for staff with regard to accepting benefits and gifts. These rules state that, as a general rule, Bundesbank staff members are not allowed to accept benefits and gifts in relation to an official function or official duty performed for the Bank. The internal rules and regulations also stipulate that Bank staff who, in the performance of their work or owing to their position at the Bank, have access to market-relevant information which is not yet general knowledge may not use this information to gain any economic benefit for themselves or third parties until this information has become generally available.</p> <p>Additionally, special internal rules contained in DB 1-11 section 38 govern conflicts of interest in relation to the salaried employment activities of a spouse or life partner for staff of the Banking and Financial Supervision Department.</p> <p>Staff of BaFin and the Bundesbank are liable for prosecution if they disclose confidential bank information to third parties without authorization.</p>
EC6	<p>The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:</p> <ul style="list-style-type: none"> (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised; (b) salary scales that allow it to attract and retain qualified staff; (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks; (d) a budget and program for the regular training of staff;

	<p>(e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and</p> <p>(f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).</p>
Description and findings re EC6	<p>The SSMR provides that the ECB must be able to dispose of adequate resources to carry out its supervisory tasks effectively. It further requires that these resources are to be financed via a supervisory fee that will be borne by the entities subject to the ECB's supervision. In accordance with the ECB's Rules of Procedure, the budgetary authority of the ECB is vested in its Governing Council. This body adopts the ECB's annual budget, which encompasses the budgetary needs of the supervisory directorates, following a proposal put forward by the Executive Board of the ECB after consultation with the Chair and the Vice-Chair of the Supervisory Board. The Governing Council is assisted in matters related to the budget by the Budget Committee (BUCOM) consisting of members from all national central banks of the Eurosystem and the ECB. BUCOM evaluates the ECB's reports on budget planning and monitoring and directly report to the Governing Council.</p> <p>The ECB's annual expenditure comprises all the necessary expenses such as salaries and benefits, rent and buildings, consultancy, statistical services, IT services, business travel and training required. The original headcount for the ECB supervisory functions were estimated in 2013 on the basis of best efforts and assumptions when the organization was still in its start-up phase and only limited operational experience was available. After the SSM became operational, a clearer need for resources for some supervisory task was detected and the Governing Council approved new resources to be implemented over the next two years.</p> <p>The ECB's salary and benefit structure has so far proven sufficiently attractive to hire and retain supervisory staff. The level of qualifications and experience is taken into account when determining the entry salary.</p> <p>The ECB can hire external consultants, who are subject to the same professional secrecy requirements as ECB staff.</p> <p>A dedicated SSM training curriculum has been developed. Training activities are centrally coordinated by the Task Force on Training and Development of the European System of Central Banks (ESCB) and are open to staff from all member institutions of the ESCB and NCAs.</p> <p>BaFin is entirely financed by levies and fees paid by the institutions it monitors (sections 14 to 16j FinDAG). BaFin receives no funding from the federal budget. BaFin also charges fees for certain official services in accordance with FinDAGKostV and on the basis of specially defined legal parameters.</p> <p>The annual budget of BaFin is drawn up by the Executive Board and presented to the Administrative Council, which has 17 voting members. The MoF appoints six members, who can be "stakeholders" or persons in positions in financial industry associations or supervised entities, or scientific experts. Prior to appointing a member, the MoF consults with the financial industry associations, which are entitled to recommend three of the six members. In addition, the Administrative Council has representatives from the MoF, the Ministry for Economic Affairs and Energy, and the Ministry of Justice and Consumer Protection.</p> <p>BaFin employed end of December 2014 about 2,535 staff members, of whom 72 percent are civil servants. In 2014, BaFin recruited 187 new staff members, mainly fully qualified lawyers and graduates of higher education institutions. Professionalism is rewarded by a system of</p>

	<p>bonuses and better professional opportunities within the legal frame for civil servants or the BBG. BaFin selects its staff through interviews and assessment centers. In order to promote skills, BaFin offers various in-house and external training opportunities.</p> <p>As at 31 December 2014 Bundesbank employed 1,301 staff members in the area of banking supervision, of whom 68.4 percent were civil servants. In 2014, Bundesbank recruited 70 new staff members in the area of banking supervision, mainly at graduate level (bachelor, master or comparable). Bundesbank selects its staff through interviews and assessment centers. Bundesbank as part of the federal public administration is bound to the provisions of the federal public service regulations. Hence, Bundesbank's salary structure and career opportunities correspond with these regulations. The salary schemes are defined in the Civil Servants Remuneration Act (<i>Bundesbesoldungsgesetz</i>) for civil servants and in the respective collective agreements for public employees. An additional Legal Order regulating the legal relationships applying to Bundesbank staff (<i>Bundesbankpersonalverordnung</i>) stipulates a bank allowance and a performance bonus system based on the individual performance of staff members. The individual salary grade of staff members is based on the grading of the hold position which is mainly depending from the job requirements.</p> <p>Salaries at Bundesbank and BaFin are relatively low, and it is reportedly difficult to retain staff, especially those with highly technical skills, when the market is strong, in particular in the Frankfurt area. BaFin and Bundesbank salaries are also lower than ECB salaries.</p> <p>BaFin and Bundesbank design and offer training courses not only for their employees, but also for supervisory staff across Europe. They are founding members of the European Supervisory Education Initiative (ESE). In order to secure and further promote skills, BaFin and Bundesbank meets the training needs of its banking supervision staff with various in-house, ESCB-wide and external training opportunities (including ECS and FSI in Basel). Training budget calculation lies within the responsibility of each business unit or department. There is no indication for a shortage of funds in order to provide adequate training for banking supervision staff.</p>
EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings re EC7	See EC 6. The ECB benefits from the assistance of the NCAs and consequently from the skills and competences available at national level. The ECB has recently conducted a comprehensive assessment of the resource and skills requirements for the supervisory function. A dedicated training curriculum has been developed, and is to be reviewed annually. BaFin and Bundesbank regularly offer relevant trainings and other relevant activities to its employees. These trainings and activities are planned periodically based on competency requirements and adjusted to supervisory needs. Assessors had access to training plans aimed at bridging identified gaps in skills for emerging supervisory practices.
EC8	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	See CPs 8 and 9. The SSM defines a Supervisory Examination Program (SEP) for the institutions it supervises. As far as SIs are concerned, the responsibility for defining the SEP lies with the ECB since 4 November 2014, with the respective NCA contributing. The individual SEPs and the SSM consolidated SEP build upon the Supervisory Priorities for 2015, the SSM Supervisory Principles and the Supervisory Manual. Two complementary

	<p>Consolidated SEPs have been developed in parallel: the SEP for the on-going supervision activities by the JSTs and the SEP for the on-site inspections and internal model investigations. The SEP is prepared in coordination with the NCAs and approved by the Supervisory Board. It translates the Supervisory Priorities into detailed activities that will be carried out and that go beyond the defined minimum engagement levels, taking into account the specific risk profile of each institution. Within the SEP for the on-going supervision, each SI is classified in each risk category according to a level of engagement (Intense, Enhanced, Standard or Basic) that depends on the risk score and its size and complexity. JSTs and NCAs are also strongly involved the drawing up of the SEPs for On Site Inspections and Internal Model Investigations. ECB Horizontal functions reviewed proposals by the JSTs, taking into account the resources available both in the ECB and in the NCAs.</p> <p>In relation to LSIs, the ECB also receives on annual basis information from NCAs with respect to their priorities and SEPs, while the final responsibility for the supervisory planning remains with the NCA.</p> <p>BaFin focuses on and allocates its resources on risk-profile and systemic importance measurements. These are expressed in its annual on-site inspection planning, and further resources are allocated based on risk-matrixes which include rules for the intensity of supervision determined via criteria like systemic importance and economic key performance indicators. In Germany, BaFin and Bundesbank jointly conduct the SREP. Under the basic division of labor, Bundesbank is responsible for the ongoing monitoring of credit institutions and prepares at least once a year a bank-by-bank risk assessment ("risk profile") incorporating the results and evaluations from ongoing monitoring as well as on-site-inspections. Based this risk profile and other information, BaFin finalizes the risk profile and decides on supervisory measures accordingly. The supervisory process follows a cyclical pattern. In the regular annual individual risk assessment, a risk profile is generated and an annual SEP defined. The individual risk assessment can always be adjusted during the year, as well as the SEP, when new information becomes available. Criteria for minimum engagement levels include scope and complexity, overseas and interbank ties, market significance (or a relevant sub-segment of the market), and the institution's overall risk situation. Intensive supervision is applied to institutions relevant to the stability of the financial system.</p>
EC9	<p>Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.</p>
Description and findings re EC9	<p>In accordance with Article 39 of the ESCB Statutes EU Protocol No 4), "The ECB shall enjoy in the territories of the Member States such privileges and immunities as are necessary for the performance of its tasks, under the conditions laid down in the Protocol on the privileges and immunities of the European Union". Pursuant to Article 11(a) of the Protocol on the Privileges and Immunities of the European Union (Protocol no 7, which is part of the Treaty on the Functioning of the European Union), ECB staff are "immune from legal proceedings in respect of acts performed by them in their official capacity, including their words spoken or written. They shall continue to enjoy this immunity after they have ceased to hold office."</p> <p>The ECB is however liable for its actions and is subject to judicial control by the European Court of Justice of the European Union. ECB decisions may be annulled by the Court of Justice. Actions may be brought by any legal or natural person, within a time limit of 2 months. According to Article 340 TFEU, the ECB shall make good any damage caused by it or by its servants in the performance of their duties. This is without prejudice to the liability of national competent authorities to make good any damage caused by them or by their</p>

	<p>servants in the performance of their duties in accordance with national legislation (Recital 61 of the SSM Regulation).</p> <p>There is no specific legal protection to BaFin or Bundesbank staff against lawsuits; however as civil servants exercising a public office they cannot individually be held liable for actions taken and/or omissions made while discharging their duties in good faith. The legal threshold for liability is high; under the German Civil Code (<i>Bürgerliches Gesetzbuch</i>, BGB) liability can only be presumed if they “<i>willfully or negligently commit a breach of official duty incumbent upon him against a third party</i>”. Even in that case, Article 34 of the Constitution allocates liability of any person that is exercising a public office to the employing authority. As such, any liability attaches to BaFin/Bundesbank instead of individual supervisors. In case of gross negligence or willful intent, BaFin/Bundesbank may seek compensation from the employee.</p>
Assessment of Principle 2	Largely compliant
Comments	<p>The three supervisory agencies responsible for German banks enjoy operational independence, in the sense that there is no government or industry interference in individual supervisory decisions. Public disclosure of reasons for dismissal of the heads of the supervisory agencies, however, is not explicitly required. Legal protection and, in the case of BaFin and Bundesbank staff, the status of civil servants, further reduces the scope for regulatory capture.</p> <p>As mentioned in the 2011 FSAP, the reporting requirements currently defined by the Guidelines for the control of BaFin by the MoF, in particular the various ex-ante notifications, seem to go beyond the necessary for the oversight function and systemic stability responsibilities of the MoF. In addition, the fact the MoF is responsible for approving minutely all of BaFin’s organizational matters may indirectly affect the execution of supervisory priorities. For example, in its recent restructuring, the approval or not by the MoF of reorganizing resources to different sectors and topics (SIs, LSIs, consumer protection, AML, insurance, market conduct) would ultimately affect the constraints under which BaFin executes its supervisory responsibilities. In addition, while BaFin does not depend on government funding, its budget is approved by a committee composed of government and industry representatives, chosen by the MoF in consultation with the associations of supervised entities. Through the budget, this committee is also able to affect supervisory priorities – for instance, in the recent budget BaFin resources didn’t reflect increased responsibilities with consumer protection, and there might have been an underlying assumption that resources would be freed when supervisory authority for SIs was transferred to ECB (which has not been the case). In an environment where a sizeable proportion of banks are government owned, all attention should be made to preserve the reputation of the banking supervisor.</p> <p>Decision making process in the newly established SSM does not foster effectiveness and timeliness of supervisory decisions. The current framework does not foresee the delegation of decisions, even routine decisions which need to be taken on a daily basis by supervisory authorities. All legally binding acts need to be submitted to the Supervisory Board for approval and to the Governing Council for adoption. This has created a large impact not only on the processes within the ECB but also in BaFin and Bundesbank where new structures had to be created to support analysis of all draft decisions that are submitted to the Supervisory Board. In addition, although the ECB has sought to streamline and simplify processes to the extent possible, some of these decisions involve strict timelines which impose a very short turnaround time for NCAs to respond.</p>

Principle 3	Cooperation and collaboration. Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information. ¹⁴
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	<p>An extensive framework of laws, regulations and collaboration agreements is in place in Germany to ensure appropriate cooperation/collaboration with relevant domestic authorities. BaFin is responsible for the supervision of banks, insurance and investment firms and collaborates closely with the Bundesbank which performs on-site activities at banks and investment firms. Section 7 of KWG establishes the division of responsibilities for BaFin and the Bundesbank including information exchanges. ECB is the home supervisory for SIs and participates in MOUs already signed by BaFin/BBk and has extensive collaboration through its membership of member states in the JSTs.</p> <p>The Financial Stability Commission (FSC) commenced operations in March, 2013, replacing the Standing Committee on Financial Market Stability. The purpose of the FSC is the macroprudential oversight of the German financial system. The FSC is composed of three representatives from the MoF, three from Bundesbank, three from BaFin and one representative from the Financial Market Stability Agency (FMSA) (no voting rights). The FSC meets quarterly. The European Systemic Risk Board (ESRB) was set up for the same purpose at the EU level in January 2011. The agencies involved have an established history of collaboration, particularly BaFin and the Bundesbank. BaFin, as part of the BMF also has regular exchanges with the MoF. All three entities are represented in the FSC.</p>
EC2	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC2	CRD Article 6 establishes that NCAs should cooperate with the other authorities within the European System of Financial Supervision (ESFS). CRD Article 7 establishes that NCAs should consider the impact of their decisions on the financial stability of other EU members. CRD Article 50 establishes that NCAs should cooperate with each other supplying information on management and ownership of institutions, and all information that can facilitate supervision and monitoring. EBA drafted, and the EC issued, a regulatory standard (Regulation 524/2014) that specifies the information that NCAs must exchange with each other according to Article 50, in particular, covering the following areas: management and ownership; liquidity and supervisory findings; solvency; deposit guarantee schemes; limitation of large exposures; internal control mechanisms. The regulation introduced some additional areas where NCAs must exchange information, such as leverage, general non-compliance, supervisory measures and sanctions, and preparation for emergency situations. In addition, the EC issued an Implementing Regulation (Regulation 620/2014) that outlines operational procedures and sets out standard forms and templates for information sharing requirements, which are likely

¹⁴ Principle 3 is developed further in the Principles dealing with “Consolidated supervision” (12), “Home-host relationships” (13) and “Abuse of financial services” (29).

	<p>to facilitate the monitoring of institutions that operate through a branch or through the exercise of the freedom to provide services. The regulation sets out the procedures for information exchange during (i) going concern and (ii) liquidity stress situations and is supplemented by two annexes containing templates for the information exchange. The quantity and frequency of information to be provided is based on the proportionality principle, depending on whether a branch is deemed as significant.</p> <p>EBA RTS (Delegated Regulation (EEU) 2016/98) and ITS (Implementing Regulation (EU) 2016/99), approved in January 2016, specify the general conditions for the establishment and functioning of supervisory colleges, and establish important procedures to structure and facilitate the interaction and cooperation between the consolidating supervisor and the relevant competent authorities. In particular, they detail the conditions for the establishment and functioning of supervisory colleges, coordination and cooperation arrangements between competent authorities of cross-border banking groups and exchange of information necessary for performing key supervisory tasks in a joint and coordinated manner in both going concern and emergency situations. These standards aim at facilitating the interaction and cooperation between authorities at EU and global level, recognizing possible involvement of third-country supervisory authorities, and strengthening supervision of cross-border banking groups across the EU.</p> <p>The establishment of the SSM has consolidated the supervision of SIs and LSIs even further. The Supervisory Board of the SSM includes members of the ECB and one representative per competent authority of the participating member states. The joint supervisory teams (JST) include staff from both the ECB and the NCA that jointly undertake supervisory activities.</p> <p>BaFin/Bundesbank have completed a number of memorandums of understanding (MOU) with third countries to exchange information. According to Article 152 of the SSM Framework Regulation the ECB may participate in existing MOUs with the NCA or negotiate a new MOU. Third countries participate in supervisory colleges. ECB becomes automatic participant in SSM member NCAs' MOUs, and is negotiating MOUs with non SSM NCAs that lack MOU with member NCAs.</p> <p>Cross-border exchange of information and collaboration is well established and is evidenced in the SREP documentation process and in participation in the supervisory colleges.</p>
EC3	<p>The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.</p>
Description and findings re EC3	<p>If the ECB/SSM determines that the institution is failing or likely to fail, or if the ECB receives such a determination from an institution itself, the ECB/SSM will have to notify, inter alia, the relevant resolution authorities: the resolution authority for the institution, the resolution authority of any branch of the entity. Likewise, before it makes a determination that an institution is failing or likely to fail, the SRB must first inform the ECB/SSM that it intends to make this determination, and allow the ECB 3 calendar days to make an assessment.</p> <p>In light of the above, the ECB and SRB have signed a MoU, which should ensure early and effective coordination and information sharing.</p> <p>Germany implemented the relevant articles of CRD in section 9 (1) KWG, which entitles BaFin (or the ECB, where it applies the national implementation of CRD IV) to share information with a foreign banking supervisory authority provided that the foreign supervisor will treat</p>

	<p>the information confidentially. Accordingly, section 9 (1) KWG sets forth that BaFin shall treat information obtained from foreign supervisory authorities confidential.</p> <p>BaFin will pass on information received from a foreign supervisory authority to Bundesbank to the extent that such information is necessary for the performance of the functions of Bundesbank as outlined in section 7 KWG on the basis that Bundesbank shall only use the information for lawful supervisory purposes and shall not disclose the information to any other person without the prior written consent of the foreign supervisory authority. The confidentiality obligation of section 9 KWG also applies to Bundesbank. This holds also true with regard to the exchange of information on the basis of institution-specific MoUs and Cooperation Agreements.</p>
EC4	<p>The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.</p>
Description and findings re EC4	<p>Section 9 (1) KWG entitles BaFin to share information with a foreign banking supervisory authority provided that the foreign supervisor will treat the information confidentially. Accordingly, section 9 (1) KWG sets forth that BaFin shall treat information obtained from foreign supervisory authorities confidential. As BaFin's employees are only entitled to share information in the cases set out in section 9 KWG, BaFin is able to deny any demand from other bodies than those set out in said provision. Information that originates in another country shall not be disclosed without the expressed agreement of the competent authorities which have disclosed it and solely for the purposes for which those authorities gave their consent (section 9 (1) sentence 8 KWG). The confidentiality obligation of section 9 KWG also applies to Bundesbank.</p>
EC5	<p>Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.</p>
Description and findings re EC5	<p>A well-developed legal framework and specialized institutions are in place for the management of possible recovery and resolution of banks.</p> <p>The SAG provides for the cooperation between BaFin and FMSA, in their capacity as competent supervisory authority and competent resolution authority for LSIs that do not fall in the remit of the SRB, such as the exchange of information (section 6 SAG).</p> <p>These legal duties are supplemented by a cooperation agreement between BaFin and FMSA defining principles and the appropriate processes for the cooperation and coordination with regard to recovery and resolution.</p> <p>The competent supervisory authority has to involve the resolution authority at an early stage where there is a potential gone-concern situation and shares all supervisory information that is relevant for resolution. The resolution authority has to consult with the supervisory authority on all matters falling within their competence that might have repercussions on the</p>

	<p>going-concern, in order to strike the right balance between supervisory and resolution objectives.</p> <p>The competent supervisory authority is responsible for recovery planning (Article 9 of the cooperation agreement; section 13 – 21 SAG) and the imposing of early intervention measures (section 36 SAG). Moreover, the competent authority provides the recovery plan to the resolution authority, in order to give the resolution authority, the opportunity to examine the recovery plan with a view to identifying any actions in the recovery plan which may adversely impact the resolvability of the institution and make recommendations to the competent authority with regard to those matters (section 15 (1) SAG).</p> <p>Furthermore, the resolution authority assesses, in consultation with the competent authority, the resolvability of each LSI that is not part of a group which is subject to consolidated supervision (article 11 of the cooperation agreement; section 57 – 60 SAG). In addition, the resolution authority, draws up a resolution plan in coordination with the competent authority, as well, for those institutions (Article 10 of the cooperation agreement; section 40 - 48 SAG). The resolution plan shall provide for the resolution actions which the resolution authority may take where the institution meets the conditions for resolution. To effectively fight a potential systemic threat resulting from the failure of an institution, the resolution authority can intervene when an institution is failing or likely to fail and additional conditions are met (Article 13 of the cooperation agreement, section 62 – 66 SAG). The competent supervisory authority after hearing the competent resolution authority or the competent resolution authority after hearing the competent supervisory authority are able to decide, that an institution is failing or likely to fail (Article 13 (1) of the cooperation agreement; section 62 (2) SAG).</p>
Assessment of Principle 3	Compliant
Comments	Cooperation channels are highly developed and effective.
Principle 4	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word “bank” in names is controlled.
Essential criteria	
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	At the European level, there is not definition of the term “bank”. CRR and CRD IV uses the term “credit institution,” which is defined as “an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account” (CRR Article 4.1 (1)). In Germany, the KWG defines the "banking business" by specifying the range of permitted activities to credit institutions. According to section 1 (1) sentence 1 KWG, credit institutions are enterprises which conduct banking business commercially or on a scale which requires a commercially organized business undertaking. As a criterion for determining whether banking business is conducted commercially, it is sufficient that there is an intention that the business should be conducted over a certain period of time and that the party conducting the business is doing so with the aim of making a profit. Section 1 (1) sentence 2 KWG provides a definitive list of what comprises banking business: besides the traditional activities of deposit business and lending business, the list includes discount business, principal broking services, safe custody business, guarantee business and underwriting business. A credit institution may in principle engage in all, several or single categories of banking business.

EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	<p>The types of activities that credit institutions can carry out are not exhaustively determined at the EU level, although the activities must include at least the taking deposits or other repayable funds from the public and granting credits for its own account. A bank license can only be granted if the proposed activities in which the applicant will be engaged at least fulfill the essential elements of the definition of credit institution in the CRR. This would mean that authorization to undertake the business of a credit institution is required if at least both activities 1 and 2 of CRD IV Annex I are included in its business plan (Taking deposits and other repayable funds; lending including, inter alia: consumer credit, credit agreements relating to immovable property, factoring, with or without recourse, financing of commercial transactions). CRD IV Recital 14 stipulates that “this Directive should not affect the application of national laws which provide for special supplementary authorizations permitting credit institutions to carry out specific activities or undertake specific kinds of operations.” In addition, CRD IV Annex I provides a list of activities that can be performed by credit institutions authorized in one of the member states without acquiring additional authorization from the host authorities (mutual recognition), although this does not restrict a Member State from allowing credit institutions to perform less or other activities in the jurisdiction. CRD IV Article 10 obliges Member States to require applications for authorization to be accompanied by a program of operations setting out the types of business envisaged and the structural organization of the credit institution.</p> <p>National law defines whether a credit institution is allowed to undertake activities other than the taking of deposits or other repayable funds from the public and the granting of credits for its own account. In Germany, in addition to the legal definition of banking business, section 1 (1a) KWG defines the financial services which provide the basis for qualifying as a financial services institution. Financial services comprise investment and contract broking, investment advice, operation of multilateral trading facility, placement business, portfolio management, proprietary trading, non-EEA deposit broking, foreign currency dealing, factoring, financial leasing, asset management and limited custody business. Here, too, the KWG gives a definitive list of those activities that require a license. There are specific rules concerning licensing for payment services and e-money businesses laid down in the Payment Services Supervision Act (Zahlungsdiensteaufsichtsgesetz - ZAG). In the course of transposing the new E-Money Directive (2009/110/EC) into national legislation by April 30, 2011, rules concerning e-money business were transferred from the KWG into the ZAG. Conducting e-money business does no longer require a license as a credit institution but as an e-money issuer under ZAG.</p> <p>The procedure for authorization to take up the business of a credit institution as entrusted to the ECB applies to all activities allowed to credit institutions including activities subject to mutual recognition within the meaning of CRD IV Annex 1 as well as other regulated activities which under national law require authorization to undertake the business of a credit institution. SSMFR Article 78(5) makes clear that “the decision granting authorization shall cover the applicant’s activities as a credit institution as provided for in the relevant national law, without prejudice to any additional requirements for authorization under the relevant national law for activities other than the business of taking deposits or other repayable funds from the public and granting credit for its own account.”</p>

EC3	The use of the word "bank" and any derivations such as "banking" in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	<p>There are no EU level restrictions regarding the use of the word "bank" and any derivations. Such restrictions are placed at national level. CRD IV Article 19 provides that "for the purposes of exercising their activities, credit institutions may, notwithstanding any provisions in the host Member State concerning the use of the words 'bank,' 'savings bank' or other banking names, use throughout the territory of the Union the same name that they use in the Member State in which their head office is situated," and "in the event of there being any danger of confusion, the host Member State may, for the purposes of clarification, require that the name be accompanied by certain explanatory particulars." In Germany, under section 39 (1) KWG, the use of the term "bank" or "banker" or an expression that includes the word "bank" or "banker" in a firm name or as an addition thereto or to describe the object of the business or for advertising purposes is restricted to a) credit institutions that are in possession of a license under section 32 KWG or branches of enterprises when home state is a member state of the EEA; b) other enterprises which, on entry into force of the KWG, were using such a term legally under the existing regulations. The KWG also protects the use of terminology for certain types of credit institutions, i.e., "cooperative bank" [Volksbank], "savings bank" [Sparkasse], "building and loan association" [Bausparkasse] and "savings and loan bank" [Spar- und Darlehenskasse].</p> <p>According to section 41 KWG, sections 39 and 40 KWG do not apply to enterprises that use the words "bank", "banker," or "savings bank" in a context which precludes the impression that they conduct banking business. The use of the word "bank" in domain names therefore is not specifically named in this context. The interpretation of whether the domain name may be used by enterprises may be a question of consumer protection. Nevertheless, assessors had access to a case where BaFin acted regarding domain names.</p> <p>Credit institutions, whose head office is located abroad, may, when operating in Germany, use the terms specified in section 39 (2) KWG and in section 40 KWG only if they are entitled to do so in their home country and provided that they add a reference to their home state when using such terms. References are not necessary in case of activities of enterprises or branches where the home state is a member state of the EEA.</p> <p>With regard to the restrictive and designated use of the word 'bank', no powers are conferred on the ECB. BaFin's powers in this regard are conferred by KWG. Section 39 (3) KWG specifically grants BaFin the power to determine that enterprises may not use the terms specified in section 39 (1) KWG, if the nature and scope of the activities do not justify their use. According to section 42 KWG, BaFin decides in doubtful cases whether an enterprise is entitled to use the protected terms specified in sections 39 and 40.</p>
EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks. ¹⁵
Description and findings re EC4	CRD IV Article 9 stipulates that "Member States shall prohibit persons or undertakings that are not credit institutions from carrying out the business of taking deposits or other repayable funds from the public". As explained in BCP 4 EC1, pursuant to CRD IV Article 8,

¹⁵ The Committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

	<p>Member States shall require credit institutions, whose business includes collecting deposits, to obtain authorization before commencing their activities.</p> <p>In Germany the KWG determines that deposit business, i.e., the acceptance of funds from others as deposits or of other repayable funds from the public, except the issuance of order and bearer notes, is, irrespective of whether or not interest is paid, is considered banking business according to section 1 (1) sentence 2 no. 1 KWG and therefore may only be conducted by a credit institution which is in possession of a written license.</p> <p>All authorizations for credit institutions to operate in the SSM participating Member States is granted by the ECB. The SIs will be under direct ECB supervision and the LSIs under direct supervision of BaFin and Bundesbank.</p> <p>The ECB has no power on enforcing the prohibition of the taking deposits or other repayable funds from the public by non-banks. BaFin has broad statutory powers to investigate in and to intervene with unauthorized banking business. These powers are laid down in section 37 and 44c KWG. Over and above that unauthorized banking business is in accordance with section 54 KWG punishable by fine or imprisonment of up to five years.</p> <p>Pursuant to section 44c (1) KWG, staff of BaFin and the Bundesbank are entitled to request information and documents from an undertaking, its governing bodies or a staff member where there is evidence to suggest that they conduct banking business or provide financial services without the authorization required pursuant to section 32 (1) sentence 1 of the KWG. To ascertain the nature and scale of the business or activity, staff of BaFin and the Bundesbank are also entitled to carry out inspections pursuant to section 44c (2) of the KWG on the premises of the undertaking operating without authorization as well as on the premises of the persons and undertakings obliged to provide information and submit documents pursuant to section 44c (1) of the KWG, or to search premises pursuant to section 44c (3) of the KWG. BaFin's investigatory powers are also directed at persons and undertakings in relation to whom there is evidence to suggest that they are involved in the initiation, conclusion or settlement of banking business and provision of financial services under the Banking Act without authorization.</p> <p>Once the nature and scale of the business conducted without authorization has been ascertained, BaFin, in accordance with section 37 (1) of the KWG, can order the undertaking and the members of its governing bodies, as well as those involved, to cease business operations immediately and to settle this business promptly. If necessary, BaFin is also allowed to appoint a suitable person as liquidator.</p> <p>Since the operations of illicit financial undertakings are becoming increasingly internationalized in pursuing unauthorized business, BaFin cooperates not only with the Federal Office of Criminal Investigation and their Länder counterparts but also with the regulatory and criminal prosecution authorities of other member states of the European Economic Area and third countries.</p>
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	CRD IV Article 20(2) requires EBA to publish on its website, and update regularly, a list of the names of all credit institutions that have been granted authorization, although the frequency is not defined. This information is available under the Credit Institution Register of the EBA website, which contains names of (a) institutions set up in the member states, (b) branches of institutions established in EEA countries, and (c) branches of other foreign banks. The Credit

	<p>Institution Register is updated on a real-time basis with notifications of newly licensed institutions or withdrawal of authorization by competent authorities.</p> <p>In accordance with SSMFR Article 49(1) and (2), the ECB publishes on its website a list with supervised institutions and supervised groups directly supervised by the ECB as well as a list of entities supervised by the NCAs. The ECB lists are updated regularly, based on the relevant decisions taken during the past period with regard to authorizations and the withdrawal or lapsing of authorizations, the decisions amending the significance with regard to the SIs (if a change occurred in the composition of the group) or the relevant notifications as received from the NCAs.</p> <p>BaFin maintains on its websites ("www.bafin.de") in accordance with section 32 (5) KWG a current list of licensed banks and furthermore current lists of branch offices, branches of foreign institutions, representative offices and branches of EEA-OGAW-management companies which are updated every month. Branches established under the European passport are supervised by the supervisory authority of the home country and only on a limited basis by BaFin. If a foreign bank has various branches, these branches will be considered on single institution. Supervision of the branch office is carried out by BaFin.</p>
Assessment of Principle 4	Compliant
Comments	<p>Permissible activities are well defined in German legislation and the use of the word "bank."</p> <p>While licensing is done by the ECB (see CP 5), it is BaFin which has the powers to investigate and prosecute the taking of deposits by non-authorized persons. Legislation doesn't specifically cover the use of the term "bank" in domain names, but undue use can be investigated by BaFin. Assessors had access to several cases where the use of the term "bank" or similar by unlicensed institutions was investigated and sanctioned by BaFin, including for a domain name.</p>
Principle 5	Licensing criteria. The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management) ¹⁶ of the bank and its wider group, and its strategic and operating plan, internal controls, risk management, and projected financial condition-(including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the

¹⁶ This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms "board" and "senior management" are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

	<p>supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.</p>
Description and findings re EC1	<p>CRDIV does not mandate which body/bodies are to be responsible for granting authorization. For SSM member countries, in accordance with SSMR Articles 4(1)(a) and 14, and SSMFR Article 78, the ECB is the exclusive competent authority for the authorization of credit institutions. In accordance with SSMR Articles 4(1)(a) and 14, and SSMFR Article 83, the ECB is also the exclusive competent authority for the withdrawal of the authorization. The ECB is also the competent authority for the supervision of significant banks (SSMR, Articles 4 and 6).</p> <p>The analysis of all license applications takes place initially at BaFin, and only viable applications are sent to ECB as a draft decision. ECB decisions are, therefore taken on the basis of applicable German law. Applications must be submitted to the BaFin in accordance with the requirements set out in relevant national law. If the applicant complies with all conditions of authorization, pursuant to Art. 14 (2) SSMR BaFin shall prepare a draft decision to propose to the ECB to grant the authorization. The draft decision is based on the prerequisites for granting a license mentioned in section 32 et seq. KWG, which implement Art. 8 et seq. CRD IV. It shall be deemed to be adopted by the ECB unless the ECB objects. For conditions for rejection, see EC 2.</p> <p>BaFin requires additional own funds of institutions at the commencement of business operations, usually at least during the first three years (section 10 (3) sentence 2 no. 6 KWG).</p> <p>In case of decision-taking on authorization with regard to a less significant institution (LSI) the licensing authority and the supervisor are not the same, as the ECB is the licensing authority and the BaFin the primary supervisor (Articles 4 (1)(a) and 6(4) SSMR). In this respect, the right for the supervisor to have its views on the application and its concerns addressed is secured by mechanism described above. (Article 14(2) SSMR and Article 76 SSMFR). The same applies for withdrawals if the initiative for the withdrawal was taken by BaFin. In case of a withdrawal of the authorization of a German LSI upon initiative of the ECB, the ECB must consult with BaFin, at least 25 working days before the date on which it plans to make the decision, in duly urgent cases reducible to 5 working days (Article 82 SSMFR).</p> <p>Article 6(2) SSMR underlines that the ECB and NCAs are subject to a duty of cooperation in good faith, and an obligation to exchange information (see CP 3). The current SSM approach for authorizations require that the ECB and BaFin share all relevant findings during the assessment of an application for an authorization. Therefore, any information that is with the ECB in its capacity of licensing authority which may be material to BaFin in its capacity of supervisory authority, is shared with the latter.</p>
EC2	<p>Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or-supervisor determines that the license was based on false information, the license can be revoked.</p>
Description and findings re EC2	<p>Relevant articles of CRD IV were transposed in Germany through the KWG, as described below. As the final decision on authorizations is based on BaFin's draft proposal thereto, in practice the ECB actually applies licensing criteria as included in the German law.</p> <p>In Germany, Sections 32 et seq. KWG governs the licensing of institutions comprehensively. According to section 32 (1) sentence 1 KWG, anyone wishing to conduct one or more of the banking businesses listed in section 1 (1) sentence 2 KWG, or to provide one or more of the financial services listed in section 1 (1a) sentence 2 KWG in Germany requires a written license. Section 32 (1) sentence 2 KWG sets out in detail the particulars that the license</p>

application must contain. The reports and documents that must be submitted are specified in greater detail in section 14 AnzV. The ECB may make the granting of the license subject to conditions, consistent with the purpose of the KWG (section 32 (2) sentence 1 KWG).

According to section 32 (2) sentence 2 KWG, the license may also be restricted to particular types of banking business or financial services. Before granting the license - respectively submitting the draft granting of the license to the ECB -, BaFin consults the deposit guarantee scheme appropriate to the institution (section 32 (3) KWG) and Bundesbank.

An application for an authorization may be rejected by BaFin, according to the provisions of Section 33 KWG, and by the ECB. The ECB may only object to BaFin's draft proposal to grant an authorization – and thus reject the authorization – where the conditions for the authorization set out in relevant EU law are not met (see SSMR Article 14(3)).

Section 33 KWG governs the refusal of the license by BaFin. For these purposes, the KWG distinguishes between mandatory reasons for refusing the license (section 33 (1) sentence 1 KWG), where the license must be refused in all cases, and other reasons, where BaFin may refuse to grant the license (section 33 (2) KWG).

The mandatory reasons include a) the resources for initial capital are not available in Germany, b) facts are known which suggest that an applicant or an executive board member is not trustworthy, c) facts are known which warrant the assumption that the holder of a qualified participating interest is not trustworthy or fails to satisfy the requirements of the sound and prudent management of the institution, d) facts are known which suggest that the proprietor or executive board member does not have the necessary professional qualifications, e) facts are known which suggest that an executive board member does not have sufficient time to perform tasks, f) the applicant will become subsidiary of a financial holding company or a mixed financial holding company and facts are known, which warrant the assumption that an executive board member of these companies is not trustworthy or does not have the professional qualifications necessary for managing the company, g) a credit institution does not have at least two full-time executive board members (principle of dual control), h) the institution has its head office or domicile outside Germany and/or is not prepared or not in a position to make the organizational arrangements necessary for the proper operation of the business, and i) the applicant is a subsidiary of a foreign credit institution and the foreign supervisory authority responsible for this credit institution has not given its consent to the establishment of the subsidiary.

Section 33 (2) KWG, on the other hand, sets out the circumstances in which BaFin may refuse the license at its own discretion, after due consideration of the facts. For these purposes, it must exercise its discretion under the purpose of the powers vested in it and observe the statutory limits imposed upon its discretion according to section 40 of the Administrative Procedures Act (Verwaltungsverfahrensgesetz – VwVfG). This means that BaFin must base its decisions on objective criterion and a just and equitable balancing of the public interest and the interests of the institutions; in particular, it must observe the principles of practicality and proportionality. According to section 33 (2) sentence 1 KWG, BaFin may refuse the license if facts are known which warrant the assumption that effective supervision of the institution would be impaired. In particular, this would be the case if: a) the institution is associated with other individuals or enterprises in a corporate network or is closely linked to such a network which impairs effective supervision of the institution owing to the structure of the cross-shareholdings or to inadequate commercial transparency, b) effective supervision of the institution is impaired by the legal or administrative provisions of a non-EEA member state applicable to such individuals or enterprises, c) the institution is a subsidiary of an institution domiciled in a non-EEA member state that is not effectively supervised in its home country or whose competent authority is not prepared to cooperate satisfactorily with BaFin,

	<p>d) the application (for the license) contains insufficient information or documents. A license may not be refused for any other reasons.</p> <p>The power to revoke an authorization found to have been granted based on false information or other irregular means is set out in CRD IV Article 18(b). If the ECB becomes aware of such, pursuant to SSMFR Article 82(1), it may thus withdraw the license. Section 35 (2) KWG, which governs the expiry and revocation of licenses, refers to the provisions of the VwVfG. A license, which represents an administrative act conferring a benefit within the meaning of section 48 (1) sentence 2 VwVfG, may be withdrawn only subject to the qualifications of section 48 (2) to (4) VwVfG. Of particular importance in this context is the fact that the beneficiary of the administrative act (the holder of the license) cannot invoke protection of confidence if he procured the administrative act through fraudulent misrepresentation, menaces or bribery or by providing information that was materially false or incomplete.</p>
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	<p>Pursuant to CRD IV Article 18, one of the possible reasons for withdrawing the authorization is that the credit institution 'no longer fulfils the conditions under which authorization was granted.' As minimum requirements, the criteria that have to be met in order to be licensed must be met at any time. The license may be revoked if the criteria cease to be met. Accordingly, the conditions under which a license may be revoked also include all reasons for refusing the license in the first place (section 35 (2) no. 3 KWG). The ECB may withdraw the authorization in the cases set out in relevant Union law on its own initiative, following consultations with the NCA, or on a proposal from the NCA (SSMR Art 14(5)).</p>
EC4	The licensing authority determines that the proposed legal, managerial, operational, and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. ¹⁷ The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	<p>See EC 2. A banking license can be refused if the institution's structures hinder effective supervision (section 33 (2) sentences 1 and 2 KWG). Especially concerning the operational and ownership structures within a group, section 33 (2) sentence 2 no. 1 KWG authorizes BaFin to refuse the license, if an effective supervision of the institution on the solo as well as on the consolidated basis would be impaired due to the structure of the group. According to section 35 (2) no. 3 KWG, the supervisory authority may revoke a license, if it becomes aware of facts which would warrant refusal of authorization pursuant to section 33 (2) numbers 1 to 3. Furthermore, according to section 2b (1) KWG, a credit institution may not be operated in the form of sole proprietorship. This requirement is meant to ensure a clear distinction between the institution's capital and the personal assets of the proprietor. Assessors reviewed files where issues were raised by the licensing authority and had to be addressed by the applicant prior to authorization.</p>
EC5	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings re EC5	Also see CP 6. According to CRD IV, major shareholders are qualifying holdings or the 20 largest shareholders in case there are no qualifying holdings. The suitability requirements

¹⁷ Therefore, shell banks shall not be licensed. (Reference document: BCBS paper on shell banks, January 2003.)

	<p>themselves are very generally listed in article 23, which includes reputation, knowledge, skills and experience, and financial soundness. The ECB has developed guidance to all SSM members to assist in the assessment of the fit and proper criteria, which was still under discussion at the time of this assessment.</p> <p>Section 32 (1) sentence 2 nos. 6 a) to c) KWG, if qualified participating interests are held in the institution, the license application must provide the names of the holders of qualified participating interests, the amount of these participating interests and the data required to assess the trustworthiness of the holders or of the legal representatives or of the general partners. If these holders are required to draw up annual accounts, according to section 32 (1) sentence 2 no. 6, d) KWG, the license application must include the annual accounts for the last three financial years, together with audit reports compiled by independent external auditors. Furthermore, according to section 32 (1) sentence 2 no. 6, e) KWG, if these holders are part of a group, the license application must include particulars of the group structure and, if applicable, the consolidated group accounts for the last three financial years, together with auditor's reports compiled by independent external auditors. If applicants or holders of qualified participating interests are members of groups, according to section 14 (5) AnzV in conjunction with section 11 no. 1 a) InHKontrollV, the license application must also describe the group structure, with an organizational chart of the group being attached. Where no qualified participating interests are held in the institution, the license application must provide the names of the up to 20 biggest shareholders. Furthermore, the license application must include any facts which indicate a close link between the institution and other natural persons or other enterprises (please refer to section 32 (1) sentence 2 no. 7 KWG).</p> <p>The existing reporting system makes it possible for BaFin to understand the ownership structures and to take appropriate measures as individual circumstances dictate. According to section 1 (9) KWG in conjunction with article 4 (1) no. 36 CRR, a qualified participating is also deemed to exist if a significant influence can be exercised on the management of the enterprise, in which a participating interest is held. In association with section 22 (1) no. 2 of the Securities Trading Act (Wertpapierhandelsgesetz - WpHG), the regulations concerning an acquisition of a qualified participation are applicable to the legitimate owner as well as to the beneficial owners. If the trustworthiness of holders of participating interests cannot be established beyond doubt, the doubts will count against them, i.e., – procedurally – the regulation legislates for a reversal of the normal burden of proof. BaFin calculates indirect qualified holdings up the chain for the purposes of assessing fitness and propriety, until the holding no longer meets the qualifying thresholds. Assessors saw cases when the authority required two or more shareholders, for example, to have their participation added up as to become a qualified holding due to evidence that they were acting in concert.</p> <p>BaFin requires only evidence that the necessary initial capital is available. In the case of qualified participating interests, section 33 (1) no. 3 in conjunction with section 2c (1b) sentence 1 no. 1 KWG stipulates that, within three months of receiving the complete reports, BaFin may prohibit the intended acquisition or increase in the qualified participating interest if facts are known which warrant the assumption that the funds used were obtained by criminal offences.</p>
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	CRD IV Article 12 sets out a minimum amount of EUR 5 million, and in some particular cases (mainly grandfathering of banks that had less than the threshold amount in 1992, paragraph 4) it might be of EUR 1 million. The initial capital must be held in the form of common equity tier 1 (this is via a cross reference to the CRR Article 26(1)(a)). The initial capital is a floor – a bank may not fall below the amount of EUR 5 million of CET1. In Germany, the initial capital

	<p>for deposit-taking credit institutions is an amount equivalent to at least EUR 5 million; and for institutions which conduct only e-money business, EUR 1 million. In addition, minimum requirements are sometimes contained in separate special Acts. For example, a mortgage bank/ship mortgage bank may only be granted a license if the paid in original own funds amount to at least EUR 25 million according to section 2 (1) sentence 2 no. 1 Pfandbrief Act (Pfandbriefgesetz – PfandBG). If the resources required to conduct business, in particular adequate initial capital, are no longer available, the license may be revoked (section 35 (2) no. 3 KWG in conjunction with section 33 (1) sentence 1 no. 1 KWG).</p>
EC7	<p>The licensing authority, at authorization, evaluates the bank’s proposed Board members and senior management as to expertise and integrity (fit-and-proper test), and any potential for conflicts of interest. The fit-and-proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.¹⁸ The licensing authority determines whether the bank’s Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.</p>
Description and findings re EC7	<p>See footnote to the CP. In Germany there is a two-Board structure, where the Supervisory Board exercises the oversight function and the Management Board the Executive function. For the purposes of the assessment therefore, “Board” will mean the oversight function, i.e., the Supervisory Board, and “senior management” will mean the executive function, i.e., the Management Board. Also see CP 14.</p> <p>Under section 32 (1) sentence 2 nos. 2 to 4 KWG, the license application must include the names of the executive board members (Geschäftsleiter), the information necessary for assessing the trustworthiness of the applicants including certificates of good conduct and information regarding their professional qualifications and experience. Under section 1 (2) KWG, executive board members are natural persons who are appointed by law, the articles of association or the partnership agreement to represent and manage the business of an institution organized in the form of a legal person or partnership. The information provided in the license application is used to assess whether the license has to be refused for mandatory reasons under section 33 (1) sentence 1 KWG. This is the case, for example, if facts are known which suggest that an applicant or executive board member is not trustworthy or that the proprietor or executive board member does not have the professional qualifications. A potential for conflicts of interest is of a particular importance concerning the judgment of a manager’s trustworthiness. Another mandatory reason for refusing the license is if a credit institution does not have at least two full-time executive board members.</p> <p>The requirements for the professional qualifications of the management board are specified in section 25c (1) KWG, which states that they must have the necessary professional qualifications, be trustworthy and dedicate sufficient time to performing their functions. A prerequisite for the professional qualifications is that they have adequate theoretical and practical knowledge of the business concerned and managerial experience. According to section 25c (1) sentence 3 KWG, a person will have the professional qualifications required if he/she can demonstrate a three-year record of working in management capacity at an institution of comparable size and type of business. It is mandatory that he/she should have carried external powers of representation and appropriate internal decision-making powers in the previous job. The job must also have involved the independent management of large</p>

¹⁸ Please refer to Principle 14, Essential Criterion 8.

	<p>organizational units (a major branch, a main department or the like). The areas the candidate was in charge of must have covered the main spectrum (most importantly, lending and securities business) of the whole banking business. Only for institutions with several executive board members, in exceptional cases candidates with specialist skills e.g., from the IT field are also accepted as executive board members, even though they do not have sufficient knowledge of lending and securities business. Furthermore, for the purposes of observing the principle of dual control, in practice great attention is paid to ensuring that a minimum of two executive board members fulfill these requirements.</p> <p>Requirements for Supervisory Board are not as strict. According to section 25(d), the members of the supervisory board must be trustworthy, have the necessary expertise to fulfill their function, and devote sufficient time to performing their duties. KWG does establish that “the supervisory board as a whole shall have the necessary knowledge, skills and experience to fulfill its control function as well as to assess and monitor the management board of the institution”. However, the collective knowledge of the supervisory board is not customarily assessed in the licensing process.</p>
EC8	<p>The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.¹⁹</p>
Description and findings re EC8	<p>According to section 32 (1) sentence 2 no. 5 KWG, the license application must include a viable business plan, which should include details of the nature of the institution's proposed business, its organizational structure, risk management and internal control procedures. According to section 14 (7) AnzV, the business plan accompanying the application must contain the following information: a) the nature of the planned business, with a substantial indication of its future course; for this purpose, projected balance sheets and profit and loss accounts for the first three full financial years following commencement of operations must be submitted, b) a description of the organizational structure of the institution, with an organization chart attached showing, in particular, the respective responsibilities of the managers; the description must also state whether and where branches are to be established, c) a description of the institution's planned internal monitoring procedures. According section 14 (2) sentence 2 AnzV, license applications must also be accompanied by certified photocopies of the formation documents, partnership agreement or articles of association and management's proposed Internal Rules of Procedure.</p> <p>Section 25a KWG imposes special organizational requirements that institutions must meet. For example, according to section 25a (1) sentences 1 to 3 KWG, an institution must have in place suitable arrangements for managing, monitoring and controlling risks and compliance with the statutory provisions and appropriate arrangements by means of which the financial situation of the institution or group can be gauged with sufficient accuracy at all times. The bank must have a proper business organization, an appropriate internal control system and appropriate security precautions for electronic data processing (section 25a (1) sentence 3 KWG). The requirements also include, according to section 25a (1) sentence 6 no. 2 KWG, that the records of the business transactions permit full and unbroken monitoring by BaFin. Banks must also have in place safeguards to protect against money laundering and other fraudulent activities. If an institution intends to outsource operational areas to another enterprise, section 25b KWG applies. The outsourcing may impair neither the proper conduct of the</p>

¹⁹ Please refer to Principle 29.

	business being carried on or the services being provided nor the manager's ability to manage and monitor them nor BaFin's right to audit and ability to monitor them. In particular, the institution must ensure by contractual means that it has the necessary powers to issue instructions to the external service provider in question and must include the outsourced areas in its internal monitoring procedures. BaFin has expanded upon the requirements of sections 25a and 25b KWG in the MaRisk.
EC9	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
Description and findings re EC9	When a license application is submitted, according to section 32 (1) sentence 2 no. 5 KWG it must include a viable business plan which, pursuant to section 14 (7) no. 1 AnzV, must set out the nature of proposed business, including well-founded details of its future development. Projected balance sheets and profit and loss accounts for the first three full financial years following commencement of operations must also be submitted. These documents form the basis for assessing the institution's financial capacity. As evidence of the resources required to conduct business (section 32 (1) sentence 2 no. 1 KWG), according to section 14 (3) AnzV a confirmation by a deposit-taking credit institution domiciled in an EEA member state must be submitted to the effect that the initial capital has been paid up, is unencumbered by rights of third parties and is freely available to the managers. As part of licensing procedure, BaFin also obtains financial information on the bank's principal shareholders via section 32 (1) sentence 2 no. 6 KWG.
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.
Description and findings re EC10	Section 33 (1) sentence 1 no. 8 KWG stipulates that a license must be refused if the applicant is a subsidiary of a foreign credit institution and the foreign supervisory authority responsible for this credit institution has not given its consent to the establishment of the subsidiary. Licensing for subsidiaries (of EU or non EU institutions) is the responsibility of the ECB. According to section 53 (2a) KWG, this provision also applies to branches of an enterprise domiciled abroad. Pursuant to section 53d KWG, BaFin has to assess the appropriateness of supervision on a consolidated basis of a foreign supervisory authority of a non-EEA member state if a foreign institution wants establish a subsidiary or a branch in Germany in order to determine the adequate measures to ensure supervision on a consolidated basis according to the German standards. Authorization for branches is under the responsibility of BaFin In the case of branches of deposit taking credit institutions domiciled within the EEA plans about setting up a branch in Germany are forwarded to BaFin (and then to the ECB) by the competent authorities which can be regarded as approval (section 53b (1) KWG).
EC11	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.

Description and findings re EC11	There is no particular mention in laws or regulations of special monitoring mechanisms for new entrants. In BaFin, in the first years of their existence new institutions are subject to enhanced surveillance, and based on section 10 (3) sentence 2 no. 6 KWG, institutions are granted licenses subject to the condition that their solvency ratio should not fall below 12 percent in their first three financial years.
Assessment of Principle 5	Largely Compliant
Comments	<p>The ECB, which is the licensing institution for new banks and for subsidiaries of foreign banks establishing in Germany, and BaFin, which is the licensing institution for branches of non-EEA banks, have available a clear set of criteria and are able to reject applications that not meet it. The analysis of all license applications takes place initially at BaFin, and only viable applications are sent to ECB as a draft decision. ECB decisions are, therefore taken on the basis of applicable German law. From the time of the start of the SSM to the time of the assessment, 9 licensing procedures for Germany had been initiated.</p> <p>BaFin analyses the ownership structure of applicants and assesses the suitability of shareholders through various documentation requirements. In general, financial suitability of shareholders is limited to the availability of the initial capital, the legal and regulatory framework do not foresee that an applicant can be denied for lack of financial capacity to provide additional capital, as required by EC5. Nevertheless, assessors had access to one case where a “no objection” was informed conditional to the shareholder demonstrating additional available capital for the initial three years.</p> <p>The assessment of the supervisory board does not play a relevant role in the licensing process; in particular, ensuring the professional qualification and collective knowledge of the supervisory board was not customarily assessed. BaFin issued in January 2016 new guidelines which emphasize the prudential importance of the professional qualification of the supervisory board. The assessors have reviewed samples of more recent licensing files at the ECB and observed there is a growing concern with the collective qualification of the board and with the availability of additional resources in the first years of the project; therefore it seems the deficiencies regarding this CP will reduce as these elements are increasingly incorporated in the routine licensing process.</p>
Principle 6	Transfer of significant ownership. The supervisor ²⁰ has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of “significant ownership” and “controlling interest.”
Description and findings re EC1	<p>Under the KWG, a “significant holding” is a “qualifying holding” pursuant to Article 4 (1) of the CRR. Rules on significant ownerships, which third parties may hold in a given institution, i.e., relating to the controls exercised on the institution's shareholders, are to be found, in particular, in section 1 (9), section 2c and section 44b KWG.</p> <p>According to section 290 of the German commercial code (HGB) a controlling interest of a parent always exists if a parent</p>

²⁰ While the term “supervisor” is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

	<ul style="list-style-type: none"> • holds the majority of shareholder voting rights of another enterprise; • has the right, related to another enterprise, of appointment or removal of the majority of the members of the administrative, management body or supervisory corporate body which controls the financial and business policy and simultaneously is a shareholder; • has the right to exercise a controlling influence with regard to the financial and business policy by reason of a control agreement concluded with this enterprise or by reason of a provision of the statutes of this enterprise, or • carries, in economic terms, the majority of risks and opportunities of an enterprise, which serves to achieve a narrowly confined and clearly defined objective of the parent (special purpose entity).
EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	<p>Section 2c of KWG transposes relevant CRD articles. CRD Article 22(8) requires ex-ante notification to BaFin and BBk and permits the supervisor to object to the acquisition. Article 22 (8) states that member states cannot impose notification or approval requirements which are more stringent than those in the CRD. Articles 22 and 25 of CRD IV address acquisitions, increases and divestitures of qualifying holdings. It is required that legal and natural persons wishing to acquire, directly or indirectly, a qualifying holding in a credit institution or to further increase, directly or indirectly, such a qualifying holding as a result of which the proportion of the voting rights or of the capital held would reach or exceed 20, 30, or 50 percent seek pre-approval from the supervisor.</p> <p>In determining ultimate beneficial owners (UBO), BaFin reviews ownership structure of acquirers and continues to trace until it identifies all qualifying holders. An example of a case was provided to assessors.</p>
EC3	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.
Description and findings re EC3	<p>Article 23(2) of CRD was transposed in Section 2c KWG and the Holder Control Regulation out the conditions under which an application may be rejected, namely if there are reasonable grounds for doing so on the basis of the criteria set out in Article 23(1) of CRD IV or if the information provided by the proposed acquirer is incomplete. The criteria are reputation, knowledge, skills and experience of senior management, financial soundness, group structure, compliance with prudential requirements, suspicion of money laundering activities or terrorist financing. Because Article 22(8) applies a maximum harmonization standard, only the criteria used in Article 23 may be used to assess a change in ownership. Hence, if the criteria used to assess an initial licensing application include elements that are not included in the standards set out in Article 23, then these additional criteria cannot be used as a basis for rejecting the proposed acquisition.</p> <p>Article 26(2) of CRD IV deals with the suspension of voting rights, the nullity of votes cast and the possibility of their annulment, in cases where the proposed investment was objected-to</p>

	<p>by the supervisor, as well as with the suspension of voting rights for acquirers having failed to comply with the notification requirements. An example of a case was provided where a significant holding was acquired without ex-ante notification. The acquirer was asked to submit the information required for review and when the acquisition was objected-to by BaFin, the shares were placed in a trust and the exercise of the voting rights was suspended. The shares were sold by the acquirer.</p> <p>In another case a proposed manager board member was initially rejected due to failure to report sanctioning by Bank of Italy in a prior position. The information was not disclosed in the application but was flagged upon review by ECB supervisory board. Ultimately he was approved due to expiration of the statute of limitations in Germany (five years) for the type of action taken by Bank of Italy. And the infraction was not considered significant by BaFin after discussing with Bank of Italy.</p> <p>Article 66(1) of CRD IV stipulates that Member States shall ensure that their laws, regulations and administrative provisions provide for administrative penalties and other administrative measures at least in respect of, inter alia, the acquisition, directly or indirectly, of a qualifying holding in a credit institution or a further increase, directly or indirectly, of such a qualifying holding as a result of which the proportion of the voting rights or of the capital held would reach or exceed the thresholds referred to in Article 22(1) of CRD IV or so that the credit institution would become its subsidiary, without notifying in writing the competent authorities of the credit institution in which they are seeking to acquire or increase a qualifying holding, during the assessment period, or against the opposition of the competent authorities, in breach of Article 22(1). The sanctions for such breach are described in Article 66(2) and include possible pecuniary penalties, order to cease the conduct and desist, suspension of voting rights. (See EC 5).</p>
EC4	The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.
Description and findings re EC4	<p>According to section 24 (1) no. 10 and (3c) KWG an institution is obliged to notify the competent authority (BaFin or ECB) and Bundesbank (and BaFin if the competent authority is the ECB) about the acquisition or disposal of a significant ownership in its own institution, the reaching, exceeding or falling below the thresholds for significant ownerships of 20 percent, 30 percent and 50 percent of the voting rights or capital, and the fact that the institution becomes or ceases to be the subsidiary of another undertaking, as soon as the forthcoming change in these participatory relationships comes to its attention.</p> <p>On an annual basis, institutions have to provide the name and address of any holder of a significant ownership in the reporting institution and in subordinated enterprises according to section 10a KWG that are domiciled abroad, as well as the amounts of these participating interests (section 24 (1a) no. 3 KWG).</p> <p>Section 44b (1) sentence 1 KWG in conjunction with section 44 (1) sentence 1 KWG stipulates that the proposed acquirer is obliged to provide information and present documentation to BaFin and Bundesbank and ECB on their request to supplement the information originally provided.</p>
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.

Description and findings re EC5	BaFin has the power to nullify the acquisition by transferring the voting rights to a trustee according to section 2c (2) KWG. BaFin may commission the trustee to sell the shares insofar as they establish a significant ownership if the holder of the significant ownership does not provide BaFin with proof of a trustworthy buyer within an appropriate deadline set by BaFin (section 2c (2) sentences 1 to 3 KWG). Example of a relevant case was discussed with the mission.
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	CRD IV remains silent on this issue. Article 22(8) deals with acquisitions and does not address on-going notification requirements applicable to all shareholders. At the country level, there are no specific laws or regulations stipulating that institutions must notify BaFin of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest. However, according to section 29 (3) sentence 1 KWG the external auditor has to inform BaFin and Bundesbank immediately about facts he learns in the course of his audit, which warrant the assumption that a holder of a significant ownership in an institution is not trustworthy.
Assessment of principle 6	Compliant
Comments	There is no requirement for the bank to notify the supervisor when they become aware of events that may cause a significant shareholder to no longer be fit-and-proper. However, the annual external audit reviews trustworthiness and a report to regulator is required on fit-and-proper deficiencies. Detailed fit-and-proper requirements have been issued in early 2016. Issues concerning this issue are incorporated into CP 5 rating.
Principle 7	Major acquisitions. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	Laws or regulations clearly define: (a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and (b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.
Description and findings re EC1	The acquisition of a non-EU bank is not covered by the CRR or CRD. However, when German law provides for specific criteria or diligence requirements which are applicable in case of acquisitions by German banks, and if the acquiring banking group is a SI, the ECB may instruct BaFin to enforce such national requirements (Article 9(1) 3rd subparagraph of SSMR, e.g., section 12a KWG). The term institution covers credit and financial service institutions.

	<p>The KWG contains no rule requiring a German credit institution to obtain prior approval of the competent authority (BaFin or ECB) before making acquisitions or investments. Section 24 (1) no. 13 KWG, however, requires institutions to notify the competent authority and Bundesbank immediately after the acquisition of a significant ownership in another enterprise or if the amount of such a significant ownership changes or if it has been disposed. Acquisitions or investments other than significant ownerships in institutions do not normally need to be specifically notified. BaFin and ECB will be informed through the audits of the annual accounts or its own special audits.</p> <p>Only in cases where the institution acquires a significant ownership in another German regulated entity, there is a requirement to notify BaFin and Bundesbank in advance. In these cases, the institution has to wait and see whether the competent supervisor or in the case of a SI ECB prohibits the acquisition within the timeframe set out in section 2c KWG, as the German transposition of Articles 22-27 of CRD IV before it can proceed.</p> <p>Even if there is no prior approval requirement ECB may withdraw the license pursuant to section 35 para 2 no. 3 in conjunction with section 33 para 2 KWG if—due to the acquisitions—the resulting corporate affiliations or structures hinders effective supervision.</p> <p>As stated above, in general there is no obligation for prior approval by the competent authority for major acquisitions or investments under German banking law, except for the acquisition of a significant ownership in a regulated entity. However, there are several provisions which ensure notification of the competent authority and the Bundesbank after such acquisitions or investments and which set limitations for such acquisitions or investments.</p> <ul style="list-style-type: none"> • Section 24 (1) no. 13 KWG requires institutions to notify the competent authority and Bundesbank immediately after the acquisition of a participating interest in another enterprise or if the amount of such a participating interest changes or if it has been disposed. • In accordance with Article 89 (3) CRR, BaFin has decided by general decree in March 2013 that in cases of an acquisitions by a bank in an undertaking outside the financial sector for the purpose of calculating the capital requirements institutions have to apply a risk weight of 1,250 percent to the greater of either the amount of such significant ownerships in excess of 15 percent of the eligible capital of the institution or the total amount of such significant ownerships that combined exceed 60 percent of the eligible capital of the institution. • According to section 12a (1) sentence 3 KWG, the institution, financial holding company or mixed financial holding company must notify BaFin and Bundesbank of the establishment, modification or discontinuation of a significant ownership or of corporate ties. This applies, however, only to acquisitions and ties with companies whose head office is located abroad and which become subordinated enterprises and hence part of the consolidated banking group, e.g., for the purposes of calculating capital adequacy or regarding the observance of large exposure limits.
EC2	Laws or regulations provide criteria by which to judge individual proposals
Description and findings re EC2	<p>The acquisition of participating interest in other enterprises does not require a supervisory approval; the KWG does not contain any criteria for judging the individual proposals.</p> <p>Section 2c KWG sets out criteria for the prohibition of the acquisition of significant ownerships in an institution.</p>

EC3	Consistent with the licensing requirements, among the objective criteria used by the supervisor there is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future. ²¹ The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.
Description and findings re EC3	Regarding investments in institutions, section 2c KWG allows supervisor to prohibit the acquisition of a significant ownership if it would create non-transparent structures and thus impede effective supervision. The provision applies, however, only to acquisitions in institutions domiciled in Germany and not on cross-border acquisitions by German institutions. Regarding investments in non-financial institutions, neither KWG nor CRR grant the competent authority the power to prohibit new acquisitions or investments by an institution as mentioned above.
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.
Description and findings re EC4	As there are strict rules to cover risks with liable capital if the limits according to Article 89 of CRR are exceeded, a participating interest can only be acquired by institutions which have enough capital to cover this risk. In addition, section 25a KWG requires institutions to have an organizational structure and risk management adequate to its size, complexity and business structure on a single entity basis and on a group-wide basis. Any short comings can be adequately addressed (see previous EC).
EC5	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	Due to the compulsory notification of the acquisition of a participating interest in another enterprise (section 24 (1) no. 13 KWG) immediately after the acquisition, the competent authority (BaFin or ECB) is able to discuss the acquisition with the institution when considering the acquisition as problematic. However, there is no general legal possibility to prohibit the participation.
AC1	The supervisor reviews major acquisitions or investments by other entities in the banking group to determine that these do not expose the bank to any undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future. ²² Where necessary, the supervisor is able to effectively address the risks to the bank arising from such acquisitions or investments.

²¹ In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

²² Please refer to Footnote 33 under Principle 7, Essential Criterion 3.

Description and findings re AC1	<p>Section 24 (1) no. 13 KWG requires institutions to notify the competent authority (BaFin or ECB) and Bundesbank immediately after the acquisition of a participating interest in another enterprise or if the amount of such a participating interest changes or if it has been disposed. This requirement applies for direct participating interests as well as for indirect participating interests.</p> <p>According to section 25a KWG institutions are required to have an organizational structure and risk management adequate to its size, complexity and business structure on a single entity basis and on a group-wide basis. BaFin may take measures to ensure the integration in the risk management system (section 25a (2) sentence 2 KWG) to ensure the reduction of risks (section 45b KWG) or to stipulate higher capital charges (section 10 (3) No. 10 KWG).</p>
Assessment of Principle 7	Materially Noncompliant
Comments	<p>There is no need for prior supervisor approval of significant investments, other than investments in other German supervised institutions (significant holdings regime). This may create situations where acquisitions occur that increase the risk to the banking group due to financial products that exceed the bank's risk appetite or managing ability having a negative impact for the group that greatly exceeds the size of the investment. While the regulator may be able to force the bank to unwind the investment, it is more prudent to ex-ante discuss the investment.</p> <p>For acquisition of EU banks, CP6 applies, that is, acquisition of a qualifying share in a bank is governed solely by requirements surrounding the change of shareholding of the target, therefore there is nothing in place to ensure that the relevant supervisor(s) (it may or may not be the same NCA for the target and acquirer) to consider whether the acquiring bank is capable of managing the absorption of the target. Even though the NCA responsible for the target undertaking will take a view on the suitability of the acquirer, this does not necessarily encompass a clear consideration of whether the acquirer has the capacity to manage and absorb the target. It is more likely that a careful consideration, from both sides of the transactions, will take place when the same authority is responsible for supervising both target and acquirer but it is not guaranteed in law.</p> <p>Investment by a bank in an undertaking outside the financial sector (in this case, financial sector includes activities ancillary to banking, and leasing, factoring, managing of trusts, and data processing) are governed, both in respect of type and amount, by Articles 89 to 91 of CRR. Neither approval nor pre-notification is required.</p> <p>The acquisition of a non-EU bank is not covered by the CRR or CRD or German law (except for the notification under art 24(1) of 13 KWG). For the acquisition of non-banks (in the EU or outside the EU except for other supervised German entities of the financial sector such as insurance companies), there is no requirement for authorization, or approval but for notification starting from a 10 percent threshold. At EU level, for acquisition of non-banks within the thresholds or above the thresholds, as long as the RW/deduction is observed, there are no criteria or requirement or risk assessment by the supervisor prior to the acquisition. There is no requirement of risk assessment at EU level for acquisition on non-EU banks.</p>
Principle 8	<p>Supervisory approach. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place</p>

	for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
Essential criteria	
EC1	<p>The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks:</p> <p>(a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and</p> <p>(b) which banks or banking groups present to the safety and soundness of the banking system</p> <p>The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.</p>
Description and findings re EC1	<p>The main tool for assessing on an ongoing basis the nature, impact and scope of risks for German SIs is the SREP. The ECB as the competent authority for SIs is required to carry out a SREP and to take decisions for SIs. Within a group, this applies at the consolidated, sub-consolidated and single-entity levels unless an entity has been waived from supervision on an individual basis in accordance with Articles 7, 8, 10 of the CRR. In the case of a financial conglomerate, the SREP decisions also needs to take into account the outcome of the supplementary supervision as required by FICOD (see also CP12 for discussion of consolidated supervision and the responsibilities for consolidated supervision and supervision for individual entities, material entities and sub-consolidations between the wider group).</p> <p>The SSM SREP is a harmonized methodology developed along the lines of the EBA GL on SREP (Guideline on common procedures and methodologies for the supervisory review and evaluation process (EBA/GL/2014/13)). According to the framework, it is applied in a proportionate manner to institutions depending on the nature, scale, and complexity of their activities, and, when relevant, on their situation within a group, its overseas and interbank ties, its significance for the overall market or a relevant sub-segment of the market, and the institution's overall risk situation, taking into account all relevant risks, its risk management processes and its capital and liquidity.</p> <p>The SREP methodology as applied to SIs relies on quantitative and qualitative analysis. It combines data and expert judgment following a principle of "constrained judgment". The assessment of the risks which banks or banking groups present to the safety and soundness of the banking system is based on the clusters used by the JST to identify banks' riskiness. The SREP framework is built around four key analytical modules:</p> <ul style="list-style-type: none"> • Business model analysis; • Assessment of internal governance and institution-wide control arrangements; • Assessment of risks to capital and adequacy of capital to cover these risks; and • Assessment of risks to liquidity and adequacy of liquidity resources to cover these risks. <p>The assessments performed for the four elements result in an overall SREP assessment, which underpins a wide range of possible supervisory actions, including the decisions on the</p>

institution's capital (Pillar 2) or liquidity adequacy or other qualitative or quantitative measures.

Regular monitoring of key indicators is used to identify material changes in the risk profile of an institution. The indicators are derived from ITS reporting based off FinRep and CoRep templates and Short Term Data exercises (STEs). Risk indicators are generated from the ITS and STE data and used on the SREP assessment. STE data exercises are used to complement COREP data for special purpose analytical processes. In addition to the risk indicators, JST members perform periodic analysis based on data reported. Assessors saw examples of two ongoing monitoring reports on credit risk and operational risk. Both examples demonstrated a forward looking analysis of risk that prompted follow-up with the institution. According to the framework, changes in risk profile should be reflected in the ratings methodology prescribed by the SREP framework scored on a scale of 1–4 (1 equating to 'no discernible risk' and 4 'high risk') and one negative grade (F) for an institution that is failing or likely to fail (within the meaning of Article 32 BRRD). To assist with the scoring process, the SREP guidelines contain detailed descriptions to help with the assignment of a rating which is considered better practice and helps to achieve consistency of risk profiling. Although the newness of the SREP framework and that the JST has only had one cycle of conducting the SREP consistency of ratings has been enhanced to the extensive horizontal analysis carried out. The ECB is working hard to ensure consistency through training, etc.

The frequency and intensity of supervisory activities is determined in large part by the outcome of the supervisory risk assessment including the risk assessment (RAS) and the SREP. SIs are assigned a minimum engagement level (MEL) and a supervisory examination program (SEP). The MEL prescribes the engagement with the SI (e.g., meetings, etc.) to be performed during the supervisory cycle whereas the SEP is a plan of on-site examinations for the next 12 months. Each of the four elements of the SREP are assigned a rating as well as an overall SREP score which underpins a wide range of possible supervisory actions, including the decisions on the institution's capital or liquidity adequacy or other qualitative or quantitative measures. In addition to the SREP rating, the other key driver of supervisory activities is the strategic priorities of the ECB which are applied to all SIs directly supervised by the ECB. In this way the SEP for German SIs achieve a bottom up and top down approach to risk identification and analysis.

Assessors saw evidence of a direct link between off-site supervision and follow up with the institution reflected in the SEP. There was less evidence to demonstrate that the SREP score had been adjusted during the supervisory cycle to reflect results of supervisory activity.

From an operational perspective, a risk assessment system (RAS) supports JST's day to day supervisory work. It is used for evaluating banks' risk levels and controls, their business model, their internal governance, their capital adequacy and their liquidity adequacy on an ongoing basis. The assessment of an institution's capital and liquidity needs is based on the outcome of the ongoing RAS, supplemented with a periodic more comprehensive review of the institution's capital and liquid positions, in the light of the latter's own assessments (ICAAP/ILAAP) taking into account normal and stressed conditions.

According to the framework, new information is updated in the RAS and documented in the information management system (IMAS) on an ongoing basis. However, at least one a year, a SREP decision is undertaken. At the core of the SREP, the review and evaluation process has ten modules, including:

1. Categorization of the institution and period review of this categorization
2. Monitoring of key indicators
3. Business model analysis

4. Assessment of internal governance and institution-wide controls
5. Assessment of risks to capital
6. Assessment of risks to liquidity and funding
7. Assessment of the adequacy of own funds
8. Assessment of the institutions liquidity resources
9. The overall SREP assessment
10. Supervisory measures

The SREP methodology includes instructions for the assessment of group-wide risks. Specifically, at the consolidated level, NCA should assess organizational and legal structure, effectiveness of group-wide MI, group RAS and effectiveness of group-wide risk management frameworks. The guidance for the JST to make this assessment is EBA ITS on joint decision on institution specific prudential requirements (EBA/ITS/2013/06). At the time of the field mission, the SREP methodology was in the process of being applied to material entities. While there was a sound knowledge of group-wide risks and frameworks a formal SREP for material entities within the group had not been consistently conducted for German SIs. Supervisors were well aware of the need for this approach and had included this in their plans for 2016.

For the LSI sector, the risk assessment methodology is shared between the ECB (through the SSM), BaFin and the BBk. The ECB carries out its oversight tasks in line with Article 6 SSM Regulation and Part VII of the SSM Framework Regulation, following a proportionate, risk-based approach. Direct supervision of LSIs is conducted jointly by BaFin and BBk with periodic reporting to the ECB (through DGIII). BaFin and BBk apply established methodologies to identify and assess the risk profile of banks.

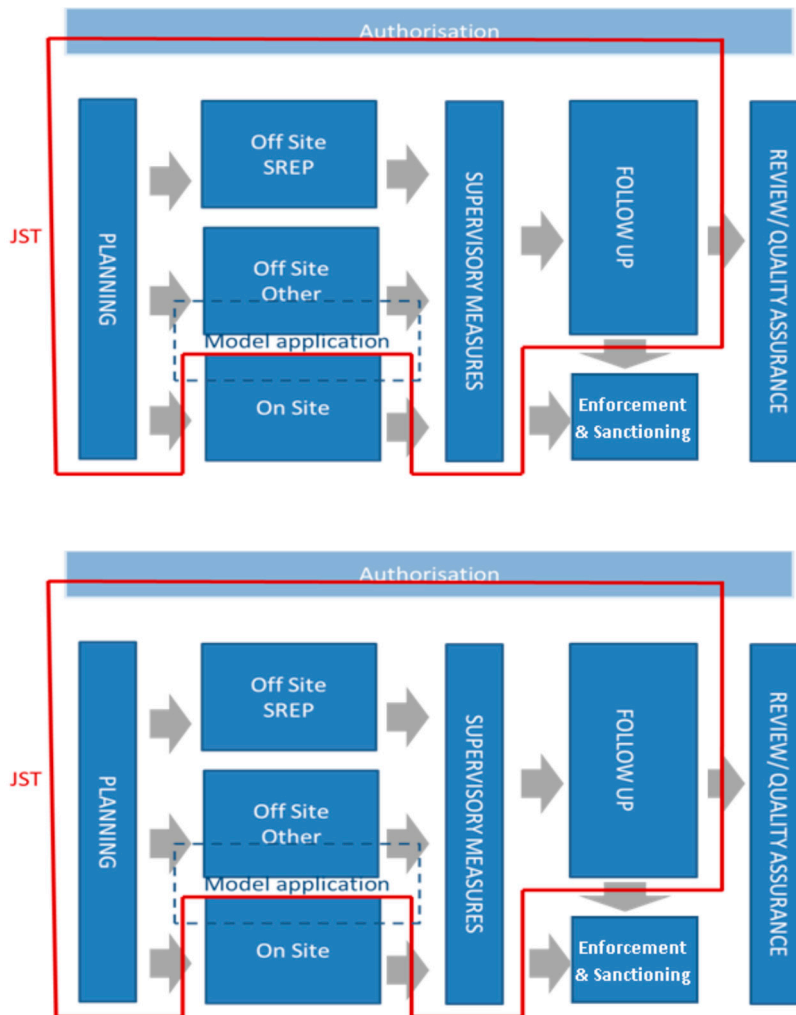
Commencing in 2016, the BBk and BaFin will implement the SREP as part of their supervision framework based on the EBA SREP guideline. Discussions with BBk and BaFin confirmed that preparations had commenced to begin the process. BaFin and BBk will conduct the SREP jointly. Cooperation between the two institutions is governed by section 7 KWG. The Supervisory Guideline (Aufsichtsrichtlinie zur Durchführung und Qualitätssicherung der laufenden Überwachung der Kredit- und Finanzdienstleistungsinstitute durch die Deutsche BBk) specifies the cooperation between BaFin and BBk. Under the basic division of labor in the context of SREP, BBk is responsible for the ongoing monitoring of credit institutions and prepares at least once a year a bank-by-bank risk assessment ("risk profile") incorporating the results and evaluations from ongoing monitoring as well as from on-site-inspections. BBk also suggests supervisory measures based on the assessment and based upon this BaFin decides on the finalization of the risk profile as well as on final sovereign supervisory measures accordingly.

The supervisory process follows a cyclical pattern, the result of which is an annual risk assessment for each LSI. Nevertheless, the individual risk assessment can always be adjusted during the year if this is deemed necessary due to new information. Corresponding to the length of the supervisory process, supervisory planning is coordinated annually between ECB, BaFin and BBk. However, this involves only a rough plan of the following year's supervisory activities, which can be adapted at any time to take new information into account.

The overall risk assessment is based on (i) the evaluation and assessment of the institutions' risks, (ii) on how an institution's risk situation is internally assessed, and (iii) on its importance for financial stability. The risk profile forms the basis for deciding whether or not to take supervisory measures or implement any other of the responses available to BaFin and ECB. The supervisory planning process conducted on the basis of the risk profiles encompasses not only supervisors' inspections but also meetings with the senior management, prioritizing

	<p>the evaluation of external audit reports and, if necessary, setting audit priorities pursuant to section 30 KWG.</p> <p>Two features allow the risk profile to be a decisive instrument in planning and conducting supervisory measures:</p> <ul style="list-style-type: none"> • First, the risk matrix helps supervisors to deploy their resources efficiently and in a risk-oriented manner by helping to identify those institutions which, owing to their risk profile classification, represent a heightened risk to the stability of the financial sector (principle of proportionality). • Second, risk profiling reveals those areas of institutions where weaknesses have either come to light or which cannot be judged owing to a lack of information. <p>In both cases, the risk profiles show supervisors the areas to be specifically targeted for their actions. Intensive supervision, which consumes additional resources, is applied to institutions owing to their individual risk situation or where the type and scope of their business activities is relevant to the stability of the financial system.</p> <p>With the introduction of the SREP framework for LSIs, the assessment of ICAAP and governance will be structured according to the EBA guidelines. In the past, the ICAAP assessment had been conducted annually and is a well-established process. A new feature, however, will be the Pillar 2 decision at the end of the process. As before, meetings with the management Board will take place to discuss the results of the ICAAP assessment and other key risk issues. Assessors reviewed several example files of ICAAP assessments and results of the annual meeting with the management board which was demonstrated to be an effective process.</p> <p>The ongoing process of monitoring LSIs' risk profile and risk to the banking system should place greater emphasis on verification of compliance with risk management and assessment of risk management. Currently, there is a reliance placed on results from the external audit report as opposed to first-hand verification by the BBk to make an assessment of a bank's risk profile and risk to the banking system. Greater emphasis on first-hand verification will allow the supervisor an opportunity to detect emerging risks earlier and to make more accurate assessments of risk profile.</p>
EC2	<p>The supervisor has processes to understand the risk profile of banks and banking groups and employs a well-defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.</p>
Description and findings re EC2	<p>See also EC1. The EBA SREP guidelines establish a framework to assess the risk profile of banks and banking groups. The guideline is based on a forward-looking view of risk with a focus on business model analysis and strategy. The RAS framework includes key risk indicators which are submitted by banks on a quarterly basis and are intended to input into the overall assessment of risk and annual SREP.</p> <p>The ECB's supervisory process starts with the planning of the regular supervisory activities, which are laid down in the SEP. The SEP covers the tasks and activities related to ongoing supervision and on-site missions, in line with available resources. Ongoing supervision can entail a range of potential activities aimed at checking compliance with prudential regulation and assessing the overall risk profile. For SIs, these tasks fall under the responsibility of the JSTs. In addition to ongoing supervision, it may be necessary to conduct in-depth reviews on certain topics by having a dedicated on-site mission (inspection or internal model investigation). The on-site inspections are typically carried out by an inspection team, which – while organizationally independent – works in close cooperation with the JST (see also EC9).</p>

On-site activities will typically result in supervisory measures (e.g., recommendations, requirements, decisions) aimed at the supervised credit institution. Final decisions are taken at the level of the Supervisory Board and the Governing Council. Supervisory activities and decisions are typically followed by a number of routine steps including communication to the credit institution, the hearing of the credit institution, the monitoring of compliance and, if necessary, enforcement and sanctioning. See below as a general overview of the process:



The systemic importance of institutions is taken into account via a clustering approach which feeds into the MELs. According to the SSM framework, supervision ought to be risk-based and proportionate. This leads to different intensity and frequency of supervisory work for different institutions. At the same time, there is a need to ensure that a common set of core supervisory activities is systematically performed for any given SI.

To achieve this goal and harmonize supervision across SIs, the Supervisory Priorities are translated into practical and simple guidelines addressed to JSTs in the form of MELs and are expressed in terms of activities, frequency and intensity. They take into account systemic impact of SIs and assessment of risks. They define the basic level of supervisory activity beyond which JSTs are expected to carry out additional activities in accordance with the principle of proportionality. Four categories of minimum engagement levels are defined: basic, standard, enhanced and intense. For each risk category, the MEL is driven by two

inputs: the cluster of the SI and the score that has been assigned to the SI for a given risk category. The following matrix²³ is used to determine the MEL for each RAS category – see below.

		Combined Risk scores			
		4	3	2	1
Cluster	1	I	I	E	E
	2	I	E	E	E
	3	I	E	S	S
	4	I	S	S	B
	5	I	S	B	B

Engagement levels	
I: Intense	
E: Enhanced	
S: Standard	
B: Basic	

Through the segmentation in clusters, the impact of each SI on financial stability is taken into account. The biggest and most complex banks are in cluster 1, while the smallest and less complex banks are in cluster 5. MELs are implemented by individual risk category and the overall risk profile, which encompasses activities beyond one single risk category, such as meetings with the CEO.

A set of supervisory activities has been defined for each risk category and classified in three broad categories: regular, thematic and additional. Regular activities refer to core supervisory activities that have to be performed every year irrespective of the economic environment. Thematic activities reflect specific focus areas of the Supervisory Priorities for a given year. Regular and thematic activities form the minimum set of activities to be performed by the SEP for each SI. Their proposed frequency varies according to the minimum engagement level. For instance, if the level of engagement for credit risk is intense for an SI, then the JST in charge should produce at least quarterly a monitoring report on credit risk. Activities deemed as additional are not included in minimum engagement levels. JSTs have discretion to decide on their frequency based on the institution's risk profile.

For SIs, the SREP assesses an institution's viability at a 12-month horizon, in the medium term (3 to 5 years), and over the cycle. To do so, the ECB relies on a wide range of backward and forward-looking, quantitative and qualitative information, such as e.g., stress testing. From an operational perspective, the RAS supports JST's day to day supervisory work. It is used for evaluating banks' risk levels and controls, their business model, their internal governance, their capital adequacy and their liquidity adequacy on an ongoing basis.

The assessment of an institution's capital and liquidity needs is based on the outcome of the ongoing RAS, supplemented with a periodic more comprehensive review of the institution's capital and liquid positions, in the light of the latter's own assessments (ICAAP/ILAAP) taking into account normal and stressed conditions. To that purpose, supervisors challenge the ICAAP/ILAAP of the bank based on its own quantification (supervisory "proxies") as well as supervisory stress tests (such as those conducted by the EBA or ECB's comprehensive

²³ The MEL matrix is reviewed at least annually and can thus be subject to updates.

<p>assessments). These various dimensions provide supervisors with both a static and forward-looking perspective on the bank.</p> <p>According to the framework, SIs regularly submit supervisory data (mainly FINREP and COREP). The data is compiled and will generate risk indicators. There is scope to increase the analysis of this data and to use the outputs of the analysis in the ongoing assessment of a bank's business model. For example, comparisons of trends against business plans and against peer group data. Analysis of data should be strengthened with the development of a broader suite of peer group benchmarks which would allow JSTs to compare and contrast financial results against industry benchmarks and competitors. To date, the development and application of peer group benchmarks is a work in progress. JST staff confirmed that the development of this data will help understand the risk profile of banks and emerging risks.</p> <p>The on-going supervision that is conducted by the JST and supported by the ECB and NCAs' horizontal divisions. With regard to providing a forward-looking assessment of an institution's capital positions, the supervisor relies on an institution's internal stress test, on the supervisor's micro stress and sensitivity analysis, and on system-wide supervisory stress-tests when available.</p> <p>With respect to LSIs, the oversight activities focus especially on riskier and larger LSIs, while sectoral oversight captures the interconnections within the German LSI sector. The planning process for SIs and LSIs is a shared activity broadly structured along the three stages: (i) the individual risk profile, (ii) the importance of the institution for the stability of the financial markets, and (iii) the anticipated urgency of the need for individual cases to be dealt with. During the stage of strategic planning, BaFin and BBk jointly set up a supervisory strategy. The supervisory strategy defines those central risk areas that will form the focal point of supervision in the subsequent calendar year and is one of two central input factors for the further planning process. The other one is the individual risk profile of an institution (national RAS/SREP) that takes into account both the risk situation and the impact of a potential failure of a given institution. The subsequent operational planning is performed on an institution-specific level. The operational supervisory plans comprise a set of on- and off-site supervisory tools for the following year and together with the supervisory strategy form the overall supervisory plan for the respective institution. However, both the supervisory strategy as well as the institution specific plans are designed to allow enough flexibility to adapt to current developments and unexpected events (e.g., changes in the market environment or new regulatory requirements as well as potential unexpected individual incidents).</p> <p>On-site inspections are planned jointly by BaFin and BBk for the year ahead. The intensity of on-site inspections is also characterized by a risk-oriented approach, i.e. it depends on the size of the institution and on the nature, scale, complexity and risks of its business activities and follows the principle of proportionality. The intensity of on-site inspections is reflected in the frequency, duration, expertise and headcount of inspectors as well. On-site inspections are generally conducted by BBk and can focus on any of the risk management requirements that are laid down in Minimum requirements for risk management (Mindestanforderungen an das Risikomanagement - MaRisk), on the approval of internal models or on special topics as well (e.g., remuneration systems).</p> <p>External auditors carry out inspections that are not carried out by the BBk (e.g., due to capacity constraints or because of their specific nature). This particularly related to impairment reviews in the past. In the case of SIs in the sense of SSM-Regulation, on-site inspections are generally carried out at least once (up to several inspections) a year, for LSIs on-site inspections are subject to a minimum frequency of every 3 to 12 years. While the 12-year frequency for on-site inspections is only applied to a limited number of small/low risk</p>
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	<p>LSIs, the length of time between on-site examinations is too long and should be reduced, notwithstanding the work conducted by the external auditor and the annual meeting with senior management (see also EC9 for a fuller discussion). The JST typically meets with management periodically as a way to keep apprised of development. Similarly, the BBk and BaFin meet at least annually with LSIs in a formal setting to discuss the risk profile, business strategy, new developments and supervisory concerns. Assessors confirmed this process to be working effectively.</p>
EC3	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	<p>In accordance with Article 4(1)(d) of the SSM Regulation, the ECB has to ensure that banks comply with the relevant Union law which impose requirements on credit institutions to have in place robust governance arrangements, including the fit-and-proper requirements for the persons responsible for the management of credit institutions, risk management processes, internal control mechanisms, remuneration policies and practices and effective internal capital adequacy assessment processes, including Internal Ratings Based models.</p> <p>According to the framework, the assessment of banks' and banking groups' compliance with prudential regulations and other legal requirements is made on a regular basis in the context of the SREP. In practice, the JST is engaging with SIs on an ongoing basis through regular meetings, on-site examinations, thematic reviews and through the receipt of information sources such as internal and external audit reports. Assessors saw evidence across a number of banks where the engagement with institutions at all layers of management, at the business unit level as well as risk and senior management took place. There was evidence to support strong engagement with banks during these meetings.</p> <p>For those LSIs that are small and with a low risk profile (measured by the RAS), the testing and verification for compliance with the regulations (MaRisk) is undertaken proportionally and on a cycle of approximately 5 - 10/12 years. For the larger more complex LSIs and, especially those with a higher risk profile, the frequency of testing and verification of compliance with regulations is intended to be conducted at least annually for a specific risk type (such as credit risk, market risk, liquidity, etc.). A key input into the assessment of compliance with MaRisk for LSIs is the annual external audit report which is submitted in parts over a period from January to late Spring (and consists of several volumes for the larger SIs).</p>
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	<p>For SIs Article 97 of CRD IV requires the competent authorities to evaluate the risks institutions are or might be exposed to, risks that an institution poses to the financial system, and risks revealed by stress-testing taking into account the nature, scale, and complexity of an institution's activities.</p> <p>An institution's internal arrangements are reviewed as part of the SREP and consist importantly of the ICAAP and the ILAAP. As part of the SREP, the JST analyzes results of a baseline scenario and a stressed scenario, which produce projections of its main balance sheet, profit and loss, and off-balance sheet items in view of the institution's strategic plan, including the capitalized profit, dividends, share issues, subordinated capital issues, and capital charges in line with the expected business growth, changes in the Pillar 1 risk profile, other risks assessed in the ICAAP, regulatory changes, one-off transactions, etc.</p>

According to the framework, stress tests should be conducted as part of the ICAAP to identify those events or changes in the market conditions in which institutions operate that may adversely affect their future solvency. At least one comprehensive adverse scenario, reflecting severe but plausible adverse developments of the institution's operating conditions should be used for capital planning. The assessment is intended to go deep into the underlying assumptions and the adequacy of the translation of these assumptions into stressed capital and risk projections over at least the upcoming 3 years. Furthermore, any embedded management actions should be scrutinized. The JST made an assessment of assumptions of the macro-economy in the process such as GDP, system credit growth, loan growth, asset quality etc. For example, assumptions included on economic growth, credit growth and profitability have an important impact on internal capital generation estimates and are explored and challenged by the JST with the SI.

Moreover, the inclusion of strategic plans and macroeconomic conditions in business model analysis allow for the risk assessment by NCAs to include the broader macroeconomic environment in the assessment. Phase 3 of the RAS, for a given risk category - and for each of the related risk subcategories - JSTs consider (external) micro and macro risks. These risks generally affect multiple institutions and they are assessed in a forward-looking manner. Therefore, RAS Risk Level Phase 3 is the obvious place in the process to include macro-prudential factors as one of the components for the risk assessment of individual institutions. In addition to systemic risks, such assessment would also take into account in a forward-looking manner other risks related to a bank's operating environment, such as, for example, sectoral risks, conduct risk or cybercrime.

Macro factors are taken into account in accordance with the RAS structure which is grouped by risk categories (e.g., credit, market, operational, IRRBB, liquidity). If possible, the macro risks are also classified according to the sub-categories included in the RAS (credit risk currently includes the for example sub-categories non-financial institutions, country risk, and foreign exchange lending). In addition, there are risks that reflect another dimension: global/European (risks that could affect all banks and do not stem from a specific country or sector, e.g., cybercrime or reversal of the search for yield), cross-border sectoral (risk stemming from a specific sector, e.g., credit risk stemming from the global shipping sector), domestic country-wide (non-sectoral risks specific to a country, e.g., a credit-rating downgrade of the government of country Y) or domestic sectoral (sectoral risk in one country, e.g., deteriorating SME loans in country X). In the case of country and/or sector specific risks, JSTs need only assess those risks where the supervised bank has significant exposures.

The Risk Analysis Division within the SSM is responsible for taking into account cross-sectoral developments through quantitative impact studies (that are not covered by the Methodology and Standards Development Division) and cross-sectional analysis of results, and institution-specific quantitative impact analysis of the macro-prudential policies that use micro-prudential instruments (which is generally the case). The Risk Analysis Division and the macro-prudential function cooperate closely by exchanging views on risks and vulnerabilities e.g., in regular meetings. The ECB has also established cooperation arrangements with other regulators—insurance and market regulators—to this regard please also refer to BCP 3.

In terms of LSIs, the more tactical and cross-sectoral aspects of the coordination are considered in the BaFin Risk Committee (BaFin Risikokomitee), established in 2013. This Risk Committee addresses risks arising from a cross-sectoral perspective – both on a micro- and a macro-level and is responsible for connecting micro- and macro-supervision. Besides the banking supervision from BaFin and BBk, also the BaFin insurance as well as the BaFin

	<p>securities supervision are represented in the BaFin Risk Committee). The BaFin Risk Committee also meets at least quarterly.</p> <p>In order to identify and analyze risks on the macro-level and to develop measures to deal with the risks BBk set up a separate financial stability department. This department monitors and encompasses both international and cross-sectoral aspects and is – together with banking supervision department – observer in the BaFin Risk Committee.</p> <p>The analyses of the Financial Stability Department, prepared in cooperation with BaFin, are basis for the discussions in the Financial Stability Committee (AFS). Finally, the representatives of the banking supervision of BaFin and BBk meet quarterly in the Committee on Ongoing Monitoring which is specifically concerned with aggregating macro-risk arising at the micro-level of banking supervision. Furthermore, the secretariat of the Committee on Ongoing Monitoring aggregates, evaluates, and analyses these risks on a regular basis. This Committee plays a key role in the aggregation of risk analysis at the overall system level as a way to help identify systemic risks and supervision priorities for all German banks. Currently the main priority areas include pressures on banks’ business models due to the low interest rate environment, strained earnings potential to internally generate capital and cyber resiliency. Assessors were able to verify that the outputs from this Committee are translated into supervisory actions and adjustment of the supervisory stance. For example, thematic reviews of IRRBB had been performed given many banks exposure to low rates and the impact on capital and earnings, data collections, and stress testing.</p>
EC5	<p>The supervisor, in conjunction with other relevant authorities, identifies, monitors and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks’ problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.</p>
Description and findings re EC5	<p>In regards to the identification of systemic risk through the supervisory review process, Articles 64, 102, and 104 of the CRD provide the basis for relevant problems in banks and banking groups to be acted upon in a timely manner. Specifically, Article 64 provides for the powers to intervene in the activity of an institution. The framework for SIs obliges measures to be taken “at an early stage” to address relevant problems within an institution. Article 104 lists the exercise of relevant powers, including: hold additional own funds; compliance plans; application of specific provisioning; to limit types of business; require a reduction in risk inherent in activities; limit variable remuneration; allocate net profits to build capital buffers; prohibit interest payments to shareholders; impose more frequent reporting; hold additional liquidity; and require additional disclosures.</p> <p>The SREP process is crucial to identify common trends likely to affect all or part of German banks. In relation to German SIs, the process to identify risks is a combination of bottom up analysis of individual banks and strategic priorities across the ECB’s mandate. Moreover, in order to ensure consistency and identify common trends, horizontal analysis is integral to the SSM SREP methodology. These horizontal analyses are performed by the SSM’s horizontal function. Their results are communicated to the Supervisory Board which takes them into account in making final SREP decisions. The role of specialist teams (DGIV) which have the opportunity of seeing risks across large banks throughout in the system allows a cross-cutting identification and assessment of risks. The cooperation between the JSTs and the risk specialist departments is an effective mechanism to help identify the potential build-up of</p>

	<p>risks across the system. Assessors saw evidence that this process was working well. For example, thematic risk reviews have been conducted which focus on topics such as risks from the low interest rate environment, corporate governance and deterioration in asset classes, e.g., shipping.</p> <p>With respect to risks to financial stability detected through the supervisory review process, it is the role of the ESRB for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system and taking into account macro-economic developments, so as to avoid periods of widespread financial distress. Only the ESRB has the power to issue recommendations.</p> <p>Internal committees of each the German authorities are established to assess risks relevant for the banking system as a whole. These groups are also in place to address these risks proactively and to communicate them. At the individual bank level, the risk profile comprises an evaluation of all risks relevant for an institution, its organization and internal control procedures and its risk-bearing capacity. BBk carries out a risk-oriented and forward-looking evaluation of all the information it has collected, taking into consideration all the risks arising from the institution's business activity and its risk management in the risk profile. The risk profile will be compiled on the basis of the structure and evaluation system developed jointly by BaFin and BBk for this purpose.</p> <p>The Committee on Ongoing Supervision is a key group that analyzes risks to the banking system. This Committee meets on a quarterly basis and is represented by both BaFin and BBk. Analysis from the Committee is shared across the two agencies and identifies key strategic priorities for the supervision of banks.</p> <p>With the division of supervision responsibilities between SI and LSI there is a risk that system-wide risks are more difficult to identify and coordinate a subsequent response. The mission had presentations from both ECB and BaFin/BBk on the key strategic priorities in terms of supervision which, on substance, reflected the key supervision priorities for the German banking system. The mission acknowledges the role of DGIII of the SSM in terms of indirect supervision of LSIs as well as the function of the Ongoing Committee for Supervision (joint BaFin and BBk). While all efforts appear to be made to coordinate and share findings, there is risk that issues affecting the broader German banking system (LSIs + SIs) may go unnoticed under the radar.</p>
EC6	<p>Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.</p>
Description and findings re EC6	<p>The legal basis for supervisors to deal with resolvability of SIs lays in Articles 10, 11, 15, 16, 17, 18, 45 BRRD and Article 10(10) SRM Regulation. According to the EU legal framework for resolution planning (e.g., the SRM Regulation and BRRD), it is resolution authority and not the SSM that is responsible for resolution planning, including the assessment of the bank's resolvability and the taking of measures to improve its resolvability. The legal framework does give the ECB, as the competent supervisory authority, a consultative role in the drawing up of resolution plans and in the assessment of resolvability. According to the framework, the</p>

	<p>ECB should cooperate with national resolution authorities and the SRB under the framework of the BRRD and the SRM Regulation for resolution planning.</p> <p>At the time of the mission, this process had not been fully developed and remained a work in progress. Assessors confirmed that recovery plans had been considered and in the case of several larger German banks actively discussed as part of supervisory/crisis management colleges and that, results of analysis of recovery plans of SIs directly supervised by the ECB had been shared with the SRB or the FSMA on a systematic basis. The obligation for the ECB to share systematically the outcome of recovery plans assessment has also been included in the MoU recently signed between the SRB and the ECB. There was no widespread evidence to demonstrate that where bank-specific barriers to orderly resolution were identified, the supervisor had engaged with banks to discuss business strategies, managerial, operational and ownership structures, and internal procedures.</p> <p>For approximately 1,600 LSIs, FMSA is the resolution authority (section 3 SAG) since 1 January 2015 including cross-border institutions that do not fall in the remit of the EU Single Resolution Board (SRB). The FMSA is responsible for developing resolution plans (section 40 to 48 SAG) and is the competent authority to conduct resolvability assessment for the purposes of the drawing up and later on updating of the resolution plans. The FSMA is also entitled to address or remove impediments to resolvability (section 57 to 60 SAG).</p> <p>According to its mandate, if FMSA determines during its assessment significant impediments to the resolvability of the institution, it notifies the relevant institution and the relevant competent authorities including BaFin as well as the EBA in writing. The institution has to propose appropriate measures to remove or at least address the impediments identified. FMSA in consultation with BaFin assesses whether the proposed measures are appropriate in order to remove or at least address the relevant impediments. Should FMSA find in its assessment that the proposed measures are suitable to remove or at least address the relevant impediments; FMSA will require the institution to implement them without delay. Otherwise, FMSA will require the institution to implement other alternative measures in order to eliminate or address the relevant impediments.</p>
EC7	<p>The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.</p>
Description and findings re EC7	<p>The legal basis for handling SIs in times of stress are set out in Articles 97 and 107 CRD IV, Articles 27, 30, 32(1)(a), 81(3) BRRD and; Article 18(1) SRM Regulation (see also the recovery and resolution framework is described in BCP08 EC6). The crisis management framework of the SSM covers a number of phases depending on the specific situation of the SI ranging from preparatory activities in the ongoing supervision to involvement in decisions on resolution. However, during the resolution process, the main decision-makers are the resolution authorities (i.e. the SRB and the NRAs). Within this context, the SSM plays an advisory role and cooperates with NRAs/SRB on any necessary follow-up actions. Preparatory measures in the ongoing supervision include the assessment of recovery plans and the use of stress tests (see relevant BCPs). When the financial situation of an institution deteriorates, the ECB determines the appropriate supervisory action and steps up the supervisory activity for the institution.</p> <p>On the operational side, the ECB has designed an Emergency Action Plan that includes the operational steps for crisis management and crisis mitigation for SIs in the context of ECB/SSM crisis management framework. When the financial situation of an institution is deteriorating, the ECB follows a stylized escalation process.</p>

<p>When deterioration is identified, the JST responds by determining the appropriate supervisory action and stepping up the supervisory activity for the institution. The ECB's intermediate structures and horizontal divisions are informed about the deterioration in the risk profile. In particular, when the JST coordinator sees that the financial situation of a bank deteriorates materially either in a short period of time or gradually with a clear trend, the JST coordinator shall inform the head of the Crisis Management Division, while NCAs will be automatically involved through the JST. The Crisis Management Division, after consulting the JST and in cooperation with other horizontal functions, will develop a common set of early warning indicators and a traffic light approach to inform this procedure.</p> <p>Expert support is provided by the Crisis Management Division as regards both the analysis of the financial situation of the credit institution/banking group and the preparation of a draft decision proposal on remedial actions. In particular, the Crisis Management Division will share its knowledge and experience from other comparable situations and from its interaction and cooperation with the relevant crisis management functions of the NCAs. Before selecting the most appropriate intervention tools, the JST and the Crisis Management Division gather any analysis prepared by the ECBs Risk Analysis Division (DG MS IV) based on their monitoring of the whole SSM banking system (Risk Analysis Division). In a crisis situation, the JST coordinator and the head of the DG MS IV CMD may propose the establishment of an institution specific Crisis Management Team (IS CMT).</p> <p>The IS CMT acts as the central internal coordination body with respect to necessary institution-specific supervisory actions within the SSM to mitigate a crisis situation. It is also the central hub for information sharing and coordination of the ECB supervisory response. While it is not a formal decision making body, the IS CMT allocates concrete tasks and proposes draft decisions to be considered by the ECB decision making bodies, as well as monitors progress, effectiveness and efficiency of crisis management activities at the working level. Further, the IS CMT coordinates interactions with the institution in difficulty via the JST coordinator and relevant Banking Union NCAs. Cooperation with relevant representatives of NRAs and the SRB is then coordinated by CRM. The IS CMT is composed of representatives across the ECB.</p> <p>The SSM follows a specific decision-making procedure. This procedure respects the EU Treaty rules governing decision-making within the ECB, which assign decision-making powers exclusively to the Governing Council and the Executive Board. Under this decision-making procedure, one of the tasks of the Supervisory Board (SB) of the ECB is to propose 'complete draft decisions' to the Governing Council. It must be noted, however, that the Supervisory Board cannot take legally binding ECB decisions of its own initiative, nor can decision-making powers be delegated to it.</p> <p>In case of emergencies, the Chair of the Supervisory Board will convene a meeting of the Supervisory Board in time to take the necessary decisions, as appropriate also by means of teleconferencing by way of derogation from the general rules.</p> <p>The Supervisory Board is responsible for assessing all proposals for complete draft decisions submitted for approval through the Directorates General and to decide on the final proposal to be transmitted to the Governing Council. Then the decision is adopted by the Governing Council in the context of physical meeting, via conference call, or through written procedure. Approval can also occur tacitly in the sense that complete draft decisions proposed to the Governing Council are considered adopted where it does not object within a defined time period ("non-objection procedure"). Overall, in crisis or emergency situations, decision taking is speed up significantly via using a specific "fast-track" procedure. Where process steps are sequential, they are undertaken back-to-back.</p>
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In the case of a cross-border banking group, the ECB, as the consolidating supervisor, plans and coordinates the supervisory activities (e.g., early intervention measures) within the college framework. Where appropriate, the ECB informs resolution authorities of any material deterioration in the financial soundness of an institution and of the implementation of early intervention measures (see Articles 27 and 30 of the BRRD). In line with Article 32(1)(a) of the BRRD and Article 18(1) of the SRM Regulation, the ECB coordinates consultation with SRB/NRAs on the determination of failing or likely to fail. Where a “failing or likely to fail” determination is taken, the ECB informs all relevant stakeholders (e.g., the SRB and the Commission in line with Art 18(1) of the SRM Regulation, other external stakeholders in line with Art. 81(3), e.g., the relevant deposit guarantee scheme(s), the competent ministries, etc.).

The legal and regulatory framework for dealing with LSIs is distinct to that of SIs. The legal basis is established in SAG, entered into force on January 1, 2015. Prior to the SAG, early intervention powers were bestowed upon the BaFin. The purpose of the amendments to the framework is to establish specific recovery and resolution tools with FMSA as the designated as resolution authority.

The SAG, The SAG supplements and strengthens the BaFin’s existing legal powers granted by the KWG for dealing with weak institutions. Moreover, it empowers the FMSA as the German resolution authority for applying a broad range of resolution tools and exercising specific resolution powers for less significant and cross-border institutions that do not fall in the remit of the SRB. The SAG also defines principles for the coordination and cooperation between BaFin, BBk and the FMSA, and for sharing information. These general principles are specified further in an inter-institutional arrangement between BaFin and FMSA, the so-called SAG-Kooperationsvereinbarung.

Pursuant to the SAG, institutions have to prepare and regularly update recovery plans that identify credible measures to be taken by those institutions for the restoration of their financial position following a significant deterioration. LSIs are required to submit their plans to the BaFin and BBk for assessment. BaFin and BBk assess the plans, including the evaluation whether the plans are comprehensive and could feasibly restore an institution’s viability, , based on current legislation and relevant EBA standards (RTS and guidelines) and are also included in the ‘Mindestanforderungen an die Ausgestaltung von Sanierungsplänen’ (‘Minimum Requirements for the Design of Recovery Plans’ - MaSan), which are currently being updated and will be implemented by way of ordinance to give updated guidance , taking into account the systemic relevance of an institution.

At BaFin a dedicated department, the so-called Gruppe R, has been established, that is in charge of performing these assessments both from a line supervisory and a horizontal function’s perspective. At BBk the assessment of the individual recovery plans is performed by line supervisors. BBk’s central office has established a horizontal function that supports the line supervisors and thereby ensures a consistent approach and quality of the recovery plan assessment.

BBk’s central horizontal function and line supervisors work in close cooperation with Gruppe R of BaFin. Based on the joint assessment Gruppe R is in charge of taking corrective action where this is required to enhance the quality of the recovery planning and has been empowered accordingly. In addition, Gruppe R supports its colleagues at BaFin who are in charge of the ongoing supervision of individual institutions in the exercise of their line supervisory role in cases where a deteriorating financial situation of an individual institution triggers the need for implementing recovery measures. Gruppe R is also in charge of supporting the competent line supervisors in the exercise of early intervention measures should the implementation of existing recovery options by an institution prove to not be

	<p>sufficient for preventing the latter from becoming likely to fail or failing. In this regard, section 46 KWG and section 36 SAG provide BaFin with a comprehensive set of regulatory powers, ranging from requiring the management body of the institution to implement measures set out in the recovery plan to a temporary closure of business (for further details concerning individual measures compare section 36 to 39 SAG).</p> <p>The SAG and the SAG-Kooperationsvereinbarung ensure that BaFin involves the FMSA at an early stage, and provides information when appropriate. This is of particular importance in the context of a fast deterioration of the financial situation of an institution. In addition to defining the segregation of tasks and the cooperation between BaFin and the FMSA, the SAG stipulates a number of obligations to inform and coordinate with external stakeholders, in particular with foreign supervisory and resolution authorities, and the relevant colleges (colleges of supervisors and resolution colleges).</p> <p>Is an institution likely to fail or failing despite the implementation of early intervention measures or should imposing early intervention measures not be a viable option as they are unlikely to prevent an institution from failing, it is the FMSA that has the competence for dealing with the failing for less significant and cross-border institutions that do not fall in the remit of the SRB. The determination that an institution is failing or likely to fail can be done either by the FMSA or BaFin after having consulted the other authority. The decision if the conditions for resolution are met as a whole is done by the FMSA.</p> <p>The FMSA is empowered to assess whether or not applying the specific resolution tools are preferable to resorting to normal insolvency proceedings. Resolution is ruled by the principle that shareholders and creditors shall bear losses to the same extent as in case of insolvency proceedings which would have been initiated as of the resolution order. Resolution tools pursuant to section 77 SAG encompass the bail-in of the shareholders and creditors of the failing institution, the sale of the business or shares of the institution under resolution, the setting up of a bridge institution, and the transfer of shares, assets and liabilities. The use of resolution tools and powers may disrupt the rights of shareholders and creditors. Thus, resolution action should be taken only where necessary in the public interest, in particular where liquidation under normal insolvency proceedings might jeopardize financial stability, interrupt the provision of critical functions, and affect the protection of depositors.</p> <p>Recent amendments to the regulatory framework are designed to reduce the likelihood of future crises and enhance the resilience of institutions, in particular through the strengthening of capital and liquidity buffers and by providing better tools for macro-prudential policies. The framework for handling problem banks entered into force on 1 January 2015 and has not yet been tested.</p>
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	Where the ECB becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter or of banks restructuring their activities to avoid the regulatory perimeter, the SSM takes appropriate steps to draw the matter to the attention of the responsible authority. With specific reference to the authorization regime, the SSM expects that the institutions notify them by filing an authorization request when there is a change in the business activities. Moreover, changes in the bank's portfolio, organization and

	<p>activities aimed at avoiding the regulatory perimeter are identified through on-site inspections.</p> <p>For LSIs, supervisory action related to address the potential circumvention of the regulatory framework, as well as any other material supervisory procedures or draft supervisory decisions should, especially for riskier and larger LSIs, be notified to the ECB as part of its oversight function, pursuant to Article 6(5)(c) and 6(7)(c) of the SSM Regulation and Articles 97 and 98 of the SSM Framework Regulation.</p> <p>For LSIs, a credit institution may in general only conduct banking business as defined in section 1 (1) KWG with a written license from BaFin/ECB. The qualification as banking business and the necessity for a license depends on the type of business and its volume. Conducting banking business without having a banking license leads to criminal offence. When the supervisory authority becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisory authority takes appropriate steps to address this strictly within the limits set by law (rule of law).</p>
Assessment of Principle 8	Largely compliant
Comments	<p>Although in transition, new supervision methodologies have had positive benefits for the approach to supervision of German SIs. Examples include: a greater focus on quantitative analysis and application of a SREP process which is aligned with EBA guidelines. While a lot has been achieved, there are aspects of the framework which are still in the process of being fully implemented. The main elements of the supervision methodology - SREP, RAS and SEPs - are still in the process of being integrated to maintain forward looking risk profiles of SIs. Currently the main tool in use by the ECB is the annual SREP, from which derive most supervisory measures. The SREP process is performed once per year where the process is approximately 6 months from start to finish. More time will be needed for the supervision methodology to be fully implemented and the SREP score is used more dynamically in a way to reflect ongoing changes in risk profile and integrated with the RAS and SEPs. Application of the new supervision methodology for SIs should over time achieve a consistent, systematic and risk-based approach to supervision as a way to understand and assess risks to banks and banking systems. To date, much work has been achieved in implementing new approaches and the framework encourages a structured and comprehensive assessment.</p> <p>The approach for the LSI sector is largely established, but evolving. Examples include the introduction of the SREP and formalized Pillar 2 approach to determining capital add-ons at the completion of the SREP. BaFin/BBk supervision has typically been principles-based and is being strengthened. A significant part of the supervision approach revolved around qualitative discussions on issues/data from external audit reports and BBk on-site MaRisk inspections. Greater reliance on verification is needed and more time needs to be allocated in the ongoing analysis of supervisory reporting as a way to identify early potential emerging issues to allow the supervisor to be more forward looking and hence active at an earlier stage.</p> <p>To date, the SREP process has been mainly focused at the consolidated level and has not penetrated deep into the organizational structure. While there is a sound understanding of group structures generally, application of the SREP process across the group structure will help identify potential pockets of risk that deserve greater supervisory attention and incorporated into SEPs. For larger and more complex banks this is an important part of the assessment that will help drive a thorough analysis of risk and help identify where further documentation is needed to better inform of the risk assessment process.</p>

	There is scope to increase the frequency of business model analysis for LSIs as part of the ongoing assessment of a bank's risk profile. For example, comparisons of trends against business plans and against peer group data to allow supervisors to systematically compare and contrast financial results against industry benchmarks and competitors.
Principle 9	Supervisory techniques and tools. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
Essential criteria	
EC1	The supervisor employs an appropriate mix of on-site ²⁴ and off-site ²⁵ supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its on-site and off-site functions, and amends its approach, as needed.
Description and findings re EC1	<p>The ECB is empowered: (i) to carry out off-site supervision in accordance with Article 4 of SSMR; (ii) to adopt supervisory measures in accordance with Article 16 of SSM Regulation; (iii) to carry out on-site inspections in accordance with Article 12 of SSM Regulation and Articles 143 to 146 of SSMFR. In application of the CRD and its national implementation, the ECB as the competent authority is required to carry out a SREP and to take decisions for significant institutions. Within a group, this applies at the consolidated, sub-consolidated and single-entity levels unless an entity has been waived from supervision on an individual basis in accordance with Articles 7, 8, 10 of the CRR. In a case of a financial conglomerate, the SREP decisions also needs to take into account the outcome of the supplementary supervision as required by FICOD (see also CP12 for a discussion of how responsibility for consolidated supervision and supervision for individual entities, material entities and sub-consolidations between the wider group are allocated). (see CP 12).</p> <p>The SSM SREP assessment is comprised of nine analytical modules: business model analysis; internal governance and controls; credit and counterparty risk; market risk; operational risk; IRRBB; capital adequacy; liquidity risk; and funding risk (see also CP8). The frequency of the assessment of all the elements of the SREP is dependent upon the categorization of a credit institution. That is, a full review of all nine constituent elements of the SREP will be updated during a full review. According to the framework, a complete review of all elements of the SREP will be performed at least annually for Category 1 institutions; at least every 2 years for Category 2; and at least every 3 years for Category 3 & 4 institutions (see SREP Guideline section 2.4). A summary of the overall SREP assessment should be performed at least annually for all institutions which will allow for a revision to the overall risk assessment process, notwithstanding a review of the constituent elements.</p>

²⁴ On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

²⁵ Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work, etc.

The minimum level of ongoing engagement with senior bank management is a key aspect of the SREP framework and it is expected that supervisors maintain an ongoing dialogue. For Category 1 & 2 institutions engagement with senior management is ongoing and at least annual, whereas for Category 3 & 4 engagement is expected to be continuous and risk-based.

Supervision activities are set out within the SREP guideline based on the following core activities: Monitoring of key indicators; Business model analysis; Assessment of internal governance and institution-wide controls; Assessment of risks to capital; and Assessment of risks to liquidity and funding.

The SREP guideline contains a framework for the regular monitoring of key financial and non-financial indicators to support the SREP process. The off-site monitoring is designed to allow supervisors to monitor the financial condition and risk profile of institutions whereby changes in the indicators will prompt an update to the SREP assessment and lead to potential adjustments in the supervisory stance (e.g., more frequent on-site examinations as provided for in article 99 of the CRD).

The SSM supervisory process starts with the planning of the regular supervisory activities, which is laid down in the Supervisory Examination Program (SEP). The SEP covers the tasks and activities related to off-site ongoing supervision and on-site missions, in line with available resources. Off-site supervision entails a number of activities that are conducted regularly or on an ad hoc basis and that are aimed at checking compliance with prudential regulation, assessing the risk profile and determining potential Supervisory Review and Evaluation Process (SREP) measures. For significant institutions within the SSM, these tasks fall under the responsibility of the JSTs. The assessors saw examples where off-site monitoring took place in line with the SEP which is maintained in IMAS. IMAS provides management with a detailed view of current and planned supervision activities. New activities are readily added to the SEP as a way to follow-up from results of off-site monitoring. Assessors saw several examples of periodic monitoring reports compiled by the JSTs which brought together results of on-site and off-site supervision. The process appeared to work effectively.

In addition to ongoing supervision, the JSTs conduct in-depth reviews on certain topics by having a dedicated on-site mission (inspection or internal model investigation). The on-site inspections are typically carried out by an inspection team, which – while organizationally independent – works in close cooperation with the JST.

From an operational perspective, a risk assessment system (RAS) supports JST's day to day supervisory work. It is used for evaluating banks' risk levels and controls, their business model, their internal governance, their capital adequacy and their liquidity adequacy on an ongoing basis. The assessment of an institution's capital and liquidity needs is based on the outcome of the ongoing RAS, supplemented with a periodic more comprehensive review of the institution's capital and liquid positions, in the light of the latter's own assessments (ICAAP/ILAAP) taking into account normal and stressed conditions.

The various supervisory activities typically result in supervisory measures (e.g., recommendations, requirements, decisions) aimed at the supervised credit institution. Final decisions are taken at the level of the Supervisory Board and the Governing Council. Supervisory activities and decisions are typically followed by a number of routine steps including communication to the credit institution, the hearing of the credit institution, the monitoring of compliance and, if necessary, enforcement and sanctioning.

	<p>In the early stages of the establishment of the SSM and the JSTs, the primary objective of the supervisory process has been to build up knowledge of the institution. The JSTs in conjunction with the specialist divisions (DGIV) have worked hard with the German supervisory authorities to build this base knowledge and apply the SSM framework. A key part in the SEP has been sectoral themes aligned with a centralized priority setting process. The benefit of this approach is to ensure that identified priorities are uniformly and consistently followed up at each SI under the direct supervision of the ECB. Material reviewed by assessors demonstrated that this had been successful at identifying sectoral issues e.g., corporate governance.</p> <p>In relation to LSIs under the direct supervision of BaFin and BBk, the intensity of supervision is flexibly geared to both the supervised institution's specific risk situation and the institutions' systemic importance in the financial market, with supervision being intensified for institutions with a higher risk profile, i.e. the greater the institution's inherent risk and the greater its risk for financial stability, the more attention it receives from supervisors.</p> <p>The supervisory strategy for LSIs is developed jointly by BaFin, BBk and ECB on an annual cycle, taking into account the macro-economic outlook for the near and middle future and the risks identified by the Committee on Ongoing Monitoring (Gremium laufende Aufsicht), as well as overarching supervisory aims and individual institutions' supervisors' recommendations. On the basis of the supervisory strategy, BaFin, BBk and ECB develop a supervisory schedule which mixes on- and off-site supervisory tools (e.g., analysis of audit reports, supervisory interviews and special audits carried out in accordance with section 44 KWG, as well as the setting of audit priorities pursuant to section 30 KWG).</p> <p>The ongoing monitoring of institutions - regularly performed by BBk's Regional Offices (Hauptverwaltungen) - includes evaluating the documents submitted by institutions, auditors' reports pursuant to section 26 KWG and the annual financial statements as well as performing and evaluating audits of banking operations with a view to assessing the adequacy of institutions' capital and risk management procedures, as well as appraising audit findings. It is a mix of financial reporting and risk management information.</p> <p>The day-to-day supervision, BaFin, BBk and ECB is based on the analysis of the auditor's reports, scrutiny of institutions' regular returns and information acquired in other ways. All information sources are condensed in the risk profile of an institution (see also answers to Principle 8). The results of the risk profile, the supervisory strategy and the available supervisory resources form the basis for decisions on on-site inspections, always taking into account the principle of proportionality.</p> <p>BaFin and BBk have implemented a risk-oriented supervisory process for holistically monitoring LSIs' risks. In line with the SREP's principles-oriented approach, a close dialogue between supervisors and institutions, e.g., through meetings with the senior management and prudential supervisory inspections, is of major importance.</p> <p>The mission saw internal MI which demonstrated good coverage of German SIs in terms of on-site supervision activities across a range of risk types e.g., credit, market, IRRBB, market risk, models, corporate governance, business model.</p> <p>By comparison, about 15 percent of all LSIs are inspected (special audits) annually.</p>
EC2	<p>The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that</p>

	there is effective coordination and information sharing between the on-site and off-site functions.
Description and findings re EC2	<p>The relevant articles of the CRD for planning and executing on-site and off-site activities for SIs are 97, 98 & 99 (See also EC1 and CP8). Specifically, Article 99 sets out the expectation for the SSM to adopt a supervisory examination program with a plan on what activities are to be undertaken, the resources required and the institutions subject to enhanced scrutiny (see paragraph 1). The EBA SREP guideline recommends a comprehensive framework for supervisory activities to support the SREP. For each of the nine constituent elements of the SREP, the EBA guideline sets out the topics to be assessed and detailed instructions for what to take into consideration when performing the assessment.</p> <p>For example, when performing an assessment of a credit institution's business model and strategy, the SSM guideline includes general considerations that the supervisor should be aware of such as the ability of the credit institution to generate acceptable returns over a 12-month period (section 4.1). Within the general considerations is a step by step process for conducting a business model assessment which includes: preliminary assessment; identification of the areas of focus; assessment of the business environment; quantitative analysis of the current business model; qualitative analysis of the current business model; analysis of the forward looking strategy and financial plans; assessment of the business model viability; assessment of the sustainability of the strategy; identification of key vulnerabilities; and summarizing of the findings and scoring. The instructions for the business model analysis are illustrative of the depth of detail contained within each of the nine SREP elements. This level of detail helps to strengthen the on-site planning process and execution of on-site supervision activities.</p> <p>EBA's ITS on the joint decisions on institution-specific prudential requirements (as provided for in Article 113 of the CRD) includes instructions on the timetable and step-by-step processes for the joint decision to be undertaken. The framework contributes to the consistency of the planning and the necessary actions needs to arrive at a joint decision.</p> <p>The process for planning and executing on-site and off-site activities is defined internally at the ECB. The JST sets up an individual SEP for the significant institution it supervises. The SEP defines the supervisory activities for off-site on-going supervision, on-site inspections and internal model investigations to be carried at the supervised significant institution over a predetermined time horizon (typically one year for the off-site on-going activities and 6 months for the on-site inspections and internal model investigations).</p> <p>The SEPs must be aligned with the determined Supervisory Priorities and follow the principles of risk-based approach and proportionality. This is accomplished through the establishment of minimum engagement levels (See EC 1) upon which the JSTs build the SEP for its significant institution, adding the necessary activities to address the particularities and specificities of the supervised group or credit institution, taking into account the available resources. Following unforeseen developments, amendments to the individual SEP throughout the year are possible. Assessors saw evidence of the SEP being adjusted throughout the cycle to reflect information gathered and results of off-site analysis.</p> <p>The SEP may be subject to ex post reviews by departments of DG IV (for horizontal consistency), although primarily it is the responsibility of management and staff of operating units to ensure permanent compliance with the internal procedures.</p> <p>Based on the available input and evidence, draft SEPs are formulated in detail by the JSTs for each significant institution. In practice, the overall calendar of the supervisory activities regarding on-going supervision, on-site inspections and internal model investigations is</p>

defined in a horizontal way. The JST also takes into account information provided by non-SSM competent authorities for other entities within the group, in particular in cases where the consolidated supervision of the group in question is the responsibility of an EEA home supervisor. All these activities, except in exceptional cases, are undertaken to comply with the minimum engagement level defined in the strategic planning process by the Planning and Coordination of SEP Division. The activities have to be prioritized to allow for a replacement buffer for possible ad hoc needs. The SEP is discussed in the core JST.

The individual SEP proposal should be associated with a first evaluation of the allocation of tasks and needed resources, including an estimation of the number of resources to be requested for on-site inspection teams and the specialized expertise functions (e.g., specialists on risk analysis or internal models). These additional resources may be supplied by the ECB or from the NCAs horizontal functions.

JSTs need to clear their draft SEPs with their ECB intermediate structures and senior management (i.e. Heads of Division and Directors General) before submitting them to the Planning and Coordination of SEP Division. This process step may include feedback on and revision of individual SEPs. In addition, there is a dialogue between the ECB and NCA senior management which provides input to the establishment of the SEP, especially with regard to diverging views not yet resolved by the core JST.

The individual SEPs are submitted to the Planning and Coordination Division, which will perform a final check for compliance with the minimum engagement levels and consistency across similar significant institutions. This may result in some adjustments to the original individual SEPs to be discussed and agreed with the respective JSTs. The Planning and Coordination Division will then translate the proposals of the individual SEPs into a single consolidated SEP.

At this point, the Centralized on-site inspections and Internal Models Divisions will also perform content quality checks on the requests for on-site inspections and internal model investigations. This may result in some adjustments to the individual SEPs to be discussed and agreed with the respective JSTs. The draft consolidated SEP will be consolidated accordingly.

The ECB horizontal Divisions liaise with their counterparties in the NCAs to plan the on-site inspections and internal model investigations to be performed, taking into account the "prioritized demand" for missions required by the JSTs and the availability of resources and to carry them out in the ECB, NCAs, and if necessary, external providers. This process may require some amendments to the individual SEPs to be discussed and agreed with the respective JSTs. The draft consolidated SEP will be consolidated accordingly. The on-site inspections and internal model investigations resulting from this step (selected missions to be approved by the supervisory board and carried out during the next half year) must be confirmed by the Heads of Division, Senior Management of DGMS I, DGMS II and DGMS IV and the NCAs.

The planning process is concluded with a meeting (or alternative form of contact) of the Head of the Planning and Coordination Division, other HDs/Senior Management involved and the ECB intermediate structures in charge of DGs MS I, II and IV. The purpose of this meeting (or alternative form of contact) is to settle any remaining issues relating to conflicting plans or resource constraints regarding the draft integrated SEP. This may be achieved by reprioritizing, rescheduling or cancelling certain activities or by requesting the allocation of additional resources from NCAs. The Planning and Coordination Division will

	<p>finalize the consolidated SEP with the support of the on-site inspections and internal model Divisions.</p> <p>The consolidated SEP, with separate details for each significant institution, is submitted for information to the Supervisory Board.</p> <p>The list of on-site inspections and internal model investigations included in the consolidated SEP, with separate details for each significant institution, is submitted for approval to the Supervisory Board and the Governing Council will be invited to adopt it under the non-objection procedure. Its approval (including potential changes) is notified to the JST coordinators and NCAs.</p> <p>In order to ensure a pragmatic implementation of the on-site program, the optimal use of available resources and a fast adaptation to new priorities, proposals for adjustments of the approved list may be submitted on a monthly basis to the Supervisory Board. Such adjustments may include changes to previously approved missions as well as new missions to be carried out.</p> <p>The SEPs are implemented by the JSTs, the on-site inspections and the internal model investigation teams, with the support of the Planning and Coordination Division and other Horizontal Divisions involved, according to the defined schedules.</p> <p>A monitoring process is established, encompassing checks on the SEPs' adoption and implementation. The Planning and Coordination Division, in close cooperation with the Centralized On-Site Inspections and Internal Models Divisions, monitors the execution of the program semi-annually. On this basis, the JST coordinators, the Centralized On-site Inspections and Internal Models Divisions cooperate with the Planning and Coordination of SEP Division also on the implementation of the SEPs, providing information on any possible issues that could prevent the fulfillment of the planned tasks (e.g., limited capacity, a change in priorities, sudden events to be taken into account, etc.), so that back-up measures can be devised. The Planning and Coordination Division may take action to ensure that SEPs are implemented, coordinating with the JSTs, the Centralized On-Site Inspections and Internal Models Divisions and the NCAs any necessary adjustments to the SEPs.</p> <p>For LSIs (indirect ECB supervision) an on-site examination schedule is proposed by BBk and finalized in cooperation between BaFin and BBk. In order to ensure that supervision proceeds in a coordinated and risk-based fashion, BBk proposes by October 31 of each year the supervision schedule for the following year built on the supervisory strategy and based on the judgments in the risk profile. BBk will draw up a list of main priorities based on (i) the individual risk profile, (ii) the importance of the institution for the stability of the financial markets, and (iii) the anticipated urgency of the need for individual cases to be dealt with. This schedule is reviewed by BaFin. BaFin also adjusts these proposals due to knowledge of potentially overlapping activities (audits planned by other parts of BaFin, e.g., AML, or by the relevant DGS) or in consideration of the individual audit cycles of institutions dependent on their size and complexity. The on-site examination schedule is jointly finalized by December 15 of each year. The audits are in principle conducted by BBk staff, in special cases by audit firms. BaFin staff joins a mission as the case may be. Assessors saw evidence to demonstrate that the planning process works effectively.</p> <p>The risk-based supervision schedule forms a fundamental result of as well as input for the SREP. The supervision schedule will include, in particular, the analysis of audit reports, supervisory interviews and special audits carried out in accordance with section 44 KWG, as well as, if necessary, the setting of audit priorities pursuant to section 30 KWG.</p>
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	<p>The Supervisory Guideline (Aufsichtsrichtlinie zur Durchführung und Qualitätssicherung der laufenden Überwachung der Kredit- und Finanzdienstleistungsinstitute durch die BBk) describes the coordination between BaFin and BBk with regard to the ongoing monitoring and forward-looking supervision of the institutions.</p> <p>The planning process for on-site activities follows a pre-defined format. Since November 2014, ECB is part of this process. For institutions under direct supervision of ECB (significant institutions), the JSTs (consist of members of BaFin, BBk, ECB and other NCAs) request on a bi-annual basis and in accordance with the supervision schedule missions to be conducted during the next twelve and accordingly six months. The staffing of all missions follows the prioritization of all inspection requests. The final plan is approved by the ECBs Supervisory Board and Governing Council.</p>
EC3	<p>The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable²⁶ and obtains, as necessary, additional information on the banks and their related entities.</p>
Description and findings re EC3	<p>The relevant Articles in the CRD include 73, 97, 98 and 99. In addition, in accordance with Article 10 of the SSM Regulation, the ECB has the power to require institutions and parent undertakings to provide all information that is necessary in order to carry out its supervisory tasks.</p> <p>In performing the SREP assessment for SIs, the JST uses the EBA guideline and instructions for the assessment to include various types of information from many sources. Examples of the types of information include: key macroeconomic variables; indicators of the competitive landscape; overall trends in markets that may impact profitability; stress testing outcomes; external audit reports; and ratings agency reports. The framework suggests the need for qualitative and quantitative types of information to assess risk, and the sources are internally from within the credit institution and publicly available information such as public filings, management disclosures to the market and market analysis. According to the framework, the planning and execution of the SREP should take these inputs into account.</p> <p>The SSM SREP guideline specifies the need for ongoing monitoring of an institutions' risk profile through on-site and off-site activities. Off-site sources of information include prudential returns which are reviewed on at least a quarterly basis as well as other key indicators (both qualitative and quantitative). Quantitative data are of particular importance to foster consistency and comparability. Key sources of quantitative information include:</p> <p>i) risk indicators based on FINREP and COREP data (available on a consolidated level since mid-2014); ii) risk indicators from sources other than FINREP/COREP; iii) indicators on economic and market conditions (GDP, sector NPL, market volatility etc.); iv) other regulatory data, not harmonized (central credit register, etc.); v) a bank's internal estimates (ICAAP, ILAAP, stress tests, internal reports); vi) financial statements, Pillar 3; vii) peer group indicators; viii) supervisory stress test results.</p> <p>Other inputs include: market views (external ratings, investors' quantitative analyses, etc.), supervisory findings (inspection reports, meeting reports, etc.), institutions' internal documents (ICAAPs/ILAAPs, financial statements, board memos, organizational charts, internal audit reports, whistle-blower reports etc.).</p>

²⁶ Please refer to Principle 10.

	<p>The SREP framework includes a minimum engagement model whereby the supervisor should communicate with senior bank management as a way to assess risk and make a risk assessment (see also EC1). The need for ongoing monitoring within the SREP framework provides the basis for supervisors to request and assess a range of information on a regular basis. The receipt of regulatory reporting is a key input into the ongoing monitoring of changes in bank risk profile. Information submitted by banks on a periodic basis – ranging from monthly (liquidity) to quarterly (balance sheet, risk and P&L) through FINREP and COREP provide the basis for supervisors to perform analysis (see also EC10).</p> <p>For LSIs, a range of qualitative and quantitative information is used in the assessment of safety and soundness of banks. The analysis is performed on at least annually and the RAS is updated accordingly. The inputs into the assessment are complemented with frequent contact with LSI senior management. The on-site inspection cycle for LSIs ranges from one year to 12 years. Notwithstanding BaFin’s and BBk’s annual meeting with management, a 12-year on-site inspection cycle for even the lowest risk and smallest LSIs is too long and should be shortened. While it is acknowledged that the external auditor will perform an audit, a shorter cycle is warranted.</p>
EC4	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as:</p> <ul style="list-style-type: none"> a) analysis of financial statements and accounts; b) business model analysis; c) horizontal peer reviews; d) review of the outcome of stress tests undertaken by the bank; and e) analysis of corporate governance, including risk management and internal control systems. <p>The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC4	<p>The SSM SREP is the main tool to regularly review and assess the safety and soundness of SI and the banking system. It is a harmonized methodology applied to all SIs under the supervision of the SSM and developed along the lines of the EBA GL on SREP. It is applied in a proportionate manner to institutions depending on the nature, scale, and complexity of their activities, and, when relevant, on their situation within a group. Within a group, this applies at the consolidated, sub-consolidated and single-entity levels unless an entity has been waived from supervision on an individual basis in accordance with Articles 7, 8, 10 of the CRR. In a case of a financial conglomerate, the SREP decisions also needs to take into account the outcome of the supplementary supervision as required by FICOD.</p> <p>See CP 8. The SSM SREP methodology combines data and expert judgment following a principle of “constrained judgment”, with a view to ensuring that the SREP decision fits best with an institution’s risk profile while also ensuring consistency and accountability across the SSM. The SSM SREP is built on four elements: business model and profitability assessment; internal governance and risk management assessment; A risk-by-risk assessment of risks to capital: A risk-by-risk assessment of risks to liquidity and funding:</p>

	<p>The assessments performed for the four elements result in an overall SREP assessment, which underpins a wide range of possible supervisory actions, including the decisions on the institution's capital or liquidity adequacy or other qualitative or quantitative measures. Assessors saw evidence to demonstrate that the SREP score followed the four elements according to the framework.</p> <p>Addressing the individual aspects of this EC in relation to SIs:</p> <p>(a) The analysis of financial statements and accounts for SIs is conducted as part of the SREP and by the JST on an ongoing basis and assessors confirmed this process works according to the framework. Regulatory reporting is submitted quarterly via through FINREP. For SIs reporting on the basis of German GAAP instead of IFRS a reporting framework has been introduced on a solo basis since March 2014 and on consolidated basis since September 2014. For more detailed information, please see Principle 27.</p> <p>(b) Business model analysis is carried out as part of Element 1 of the SREP, as mentioned above. The assessment of an institution's business model is split into two parts: i) its business model viability (or the institution's ability to generate an acceptable return over the next 12 months); ii) its business model sustainability (i.e. its ability to generate an acceptable return over 3 years and over a full business/economic cycle). Business model analysis may also give rise to targeted horizontal analysis on an ad hoc basis.</p> <p>(c) Horizontal peer review is an essential part of the SSM supervisory approach to SIs and SREP. The JSTs adjust the overall score based on: i) their knowledge of the bank, ii) peer comparisons, iii) the macro environment under which the institution operates, iv) its capital/ liquidity planning and v) the SSM risk tolerance. The consolidated annual accounts of at least the past three years, and the most recent monthly/quarterly management reports for the current year budget (including year-to-date realization) are used. All available information from FINREP and COREP, data and indicators available in IMAS as well as SNL data will form the starting point of the analysis. These data should be used to understand how the following main risk indicators have developed over time and how their current levels and volatility compare to the peer group. The SSM also relies on peer review in the context of targeted horizontal analysis.</p> <p>(d) With regard to stress tests undertaken by SIs, JSTs assess the institution's capacity to cover its capital needs from a forward-looking perspective, assuming stressed economic and financial developments. This is done using a wide range of information sources, including the institution's internal stressed projections, SSM's stressed supervisory proxies, and the outcome of supervisory (bottom-up and/or top-down) stress-tests when available.</p> <p>The analysis and assessments by JSTs are performed and documented in IMAS on an ongoing basis. The results of routine analysis are communicated to SIs on a regular basis during ongoing meetings with all relevant bank management and Board where necessary. Results of on-site examinations are communicated to SIs during a closing meeting immediately after the completion of the field work and at a later stage in writing after having complied with the SSM's decision-making procedures.</p> <p>For LSIs, the basis for the use of the tools to review and assess bank is laid down in the KWG and MaRisk, in particular regarding (b) and (d) of the above list. Addressing the criteria individually:</p> <p>(a) Supervisors review and analyze regulatory reporting and other financial information on an ongoing basis.</p>
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(b) To assess the economic sustainability of a business model BaFin and BBk take into account the objectives defined by the institutions and the related measures as well as internal and external factors and future developments. For example, possible critical developments have to be analyzed, which could result from important sources of earnings divided into products or business lines. Moreover, it is assessed, how the business strategy and the corresponding earnings targets could be realized under tolerable risk conditions.

In coordination with the ECB, the analysis of LSI's business models uses an ECB analytical tool which focuses on: e.g., distribution of assets, non-performing exposures, earnings (and planned earnings) per division and the business environment (e.g., macroeconomic environment, competitive landscape. The quantitative part is an automated rating of profitability based on three indicators: Return on Assets, Cost-Income-Ratio and Recurring Earnings Ratio. The automated rating score is fit in a matrix with thresholds with regard to risk appetite. This score can be adjusted by the supervisor's expert judgment which takes into account other balance sheet indicators, earnings and costs, liquidity profile, and risk appetite, and also qualitative aspects like internal and external key indicators, areas of competitive advantage, risk management capabilities and strategies into account. With regard to significant institutions, the business model analysis is done in 2015's SREP. For LSIs, the work of adapting the SI-methodology, taking into account the principle of proportionality, goes on.

(c) Horizontal peer reviews are used by BaFin and BBk to assess current rectified market developments. For example, the effects of the prevailing low-interest-rate environment are being examined via peer review for all LSIs. Other examples include the analysis of the deposit market is being comparatively reviewed on a quarterly basis for all German banks.

(d) Institutions have to carry out appropriate internal stress tests (see MaRisk AT 4.3.3). According to the regulations these tests shall be done regularly and event driven. These tests are not limited to balance sheet assets but should also cover off-balance-sheet entities and tests are required to be carried out at the firm-wide level of the institution. BaFin and BBk scrutinize the institutions' internal exercises by analyzing the quantitative methods which are used (such as models, methodological assumptions, data and scenarios) as well as the processes (such as whether the management board indeed uses stress testing for monitoring and decision-making processes). As internal stress testing exercises are from a supervisory perspective also seen as vital parts of a qualitative risk management, reverse stress tests are required which identify events that could jeopardize the institution's viability (see MaRisk AT 4.3.3).

(e) Regarding the review and assessment and analysis respectively of corporate governance, including risk management and internal control systems, please refer to the further explanations under principles 14 and 15.

With regards to communication of findings with LSIs, this process is ongoing throughout the supervisory cycle and depends on a bank's risk profile and relevance. As regards individual banks any identified shortcomings are communicated accordingly to the respective bank either in written form or orally during supervisory interviews. In principal, BBk conducts supervisory routine meetings with each bank on a yearly basis as part of its ongoing surveillance process. The aims of these supervisory meetings are twofold: gathering information from the banks' general management and providing feedback of the result of the surveillance process potentially combined with explaining supervisory expectations. Following the well-known risk management cycle each supervisory action normally results in new

	information triggering a supervisory judgment that leads to a feedback (measure) to the relevant bank.
EC5	The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC5	<p>The relevant articles within the CRD include 97-98 100 and 133. The SREP framework sets out the risk factors to be assessed as part of the supervisory review, the topics to be included, and the supervisory measures to be implemented based on the identification of risk. The framework includes risks to the bank as well as risks to the system as required for in Article 97 (see paragraph 1(b) and Article 99 paragraph 2(b)). Article 133 refers to the requirement to maintain a systemic risk buffer for the financial sector in order to prevent and mitigate long term non-cyclical systemic or macro-prudential risks not covered by CRR.</p> <p>In terms of the identification and assessment of emerging risks throughout the EU-area, one of the responsibilities of the EBA is to ensure the orderly functioning and integrity of financial markets and the stability of the financial system in the EU. To this end, the EBA is mandated to monitor and assess market developments as well as to identify trends, potential risks and vulnerabilities stemming from the micro-prudential level.</p> <p>One of the primary supervisory tools to conduct such an analysis is the EU-wide stress test exercise. The EBA Regulation gives the Authority powers to initiate and coordinate the EU-wide stress tests, in cooperation with the European Systemic Risk Board (ESRB). The aim of such tests is to assess the resilience of financial institutions to adverse market developments, as well as to contribute to the overall assessment of systemic risk in the EU financial system.</p> <p>Furthermore, the EBA Guidelines on common procedures and methodologies for SREP contains specifics for the use of stress testing as an input into the supervisory assessment process for individual credit institutions. Article 100 CRD IV requires the NCA to carry out as appropriate at least annually supervisory stress tests on supervised institutions. The article also recommends that common methodologies should be used when conducting annual stress testing exercises. In terms of industry-wide stress testing programs, EBA Regulation Article 32 - Union-wide stress testing – satisfies this EC. The SREP framework also contains instructions for the link between supervisory and macro-prudential measures (see 10.7).</p> <p>Building upon this work, the SSM's specific horizontal risk analysis function is in charge of supporting other ECB SSM operating units (such as other DGs, horizontal divisions and JSTs) by providing up-to-date information on current risks and vulnerabilities affecting the SSM; conducting regular in-depth risk analysis and broader micro-prudential analysis and research on the banking sector; identifying on a timely basis trends, developments and emerging risks affecting multiple banks for further supervisory review and action. Furthermore, the SSM methodologies for SREP contain specifics for the use of stress testing as an input into the supervisory assessment process for individual credit institutions. In particular, in the Element 3 – Assessment of risks to capital –, the JST assesses, among the others, the institution's capacity to cover its capital needs from a forward-looking perspective, assuming stressed economic and financial developments. This is done using a wide range of information sources, including the institution's internal stressed projections, SSM's stressed supervisory</p>

proxies, and the outcome of supervisory (bottom-up and/or top-down) stress-tests when available.

The assessments of these features contribute to the overall SREP assessment, which underpins a wide range of possible supervisory actions, including the decisions on the institution's capital or liquidity adequacy or other qualitative or quantitative measures. There is a direct link between the supervisory assessment, the necessary supervisory measures, and the SEP. Moreover, comprehensive assessments –including assets quality review and stress tests– are performed on new significant institutions or periodically if deemed appropriate.

For LSIs, the relevant articles can be found in the Supervisory Guideline and the KWG. BaFin collaborates with BBk to determine the risk classification of individual banks. The Supervisory Guideline states that BBk will conduct annual prudential discussions with institutions once the annual accounts documents have been analyzed. Assessors reviewed files which demonstrated the annual meeting with the management body incorporated results of off-site and on-site activities, ICAAP and stress testing.

Subject to prior consultation with BaFin, these discussions may also include the remediation of deficiencies found for which formal administrative action does not appear necessary. BaFin will be given the opportunity to take part in these interviews. A memo of the discussion shall be prepared and sent to BaFin. In addition to these routine meetings, both BaFin and BBk may conduct ad-hoc prudential meetings at any time; this will especially be the case for problematic or systemically relevant banks (please refer to articles 4 et seq. Supervisory Guideline). BaFin and BBk will give each other the opportunity to participate. In any event, they will inform each other of the outcome of the prudential meetings. The frequency of the direct contacts for ad-hoc prudential meetings with the representatives of the institutions – usually conducted by BBk – varies greatly. The factors affecting the frequency of ad-hoc prudential meetings include, in particular, the complexity of their business and the possible need to impose supervisory measures.

Routine meetings with the senior management are mainly intended as a tool for regular discussion of business developments and the risk situation as well as the institutions' general business situation on the basis of the evaluated annual financial statements. They can also serve to rectify deficiencies for which further supervisory measures do not appear to be necessary. An element of the routine talks is also to explain the strengths-weaknesses analysis, which banking supervisors establish based on the risk profile.

Ad-hoc meetings focus on issues or topics, which require particular attention from supervisors following major developments at the institution. Supervisors' focus on qualitative aspects means that a much greater role is being given to active dialogue between institutions and supervisors.

In addition, BaFin has the right according to section 44 KWG to send representatives to and address shareholders' meetings, general meetings or partners' meetings, as well as meetings of the supervisory bodies of institutions.

Supervisory stress tests are conducted both at a national level by BaFin and BBk and at a supra-national level together with EBA and ECB. From a micro-prudential perspective, BaFin and BBk conduct various bottom-up and top-down stress tests on various risk categories for large, as well as medium-sized and smaller banks. Furthermore, the largest German banks participate in the EU-wide banking exercise initiated by the EBA and coordinated by BaFin and BBk together with the ECB. The financial stability department of BBk is conducting regularly and on an ad-hoc basis macro-prudential stress tests for the German banking sector, aiming at the identification of potential vulnerabilities and their quantitative

	assessment. The results are shared with other BBk departments and BaFin, respecting confidentiality requirements.
EC6	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
Description and findings re EC6	<p>The SREP framework provides the basis for the JST to evaluate the work of the IA function within the supervisory assessment. Furthermore, the SREP guideline sets out the use of IA reports as an input into the assessment. The SREP framework provides guidance for supervisors to assess the functionality of the IA function to assess whether:</p> <ul style="list-style-type: none"> • The institution conducts internal audits of the credit risk management framework; • Internal audit covers the main themes of credit risk measurement and controls across the institution; and • The internal audit function is effective in determining adherence to the internal policies and relevant regulations and addressing any deviations. <p>According to the SREP framework, IA functionality is to be verified by supervisors and its findings should be used as an input to the assessment of each constituent element of the SREP (e.g., capital, liquidity, credit, etc.). The use of IA findings is emphasized specifically in relation to the business model analysis and assessing internal governance and institution-wide controls. The work of the internal audit function is evaluated within the Element 2 – Internal governance and risk management of the SREP (also see BCP 26). The internal audit reports are key sources of qualitative information to perform SREP assessments. In addition, internal audit function may be subject to on-site inspection to obtain assurance that the Internal Audit Function meets the generally accepted principles on internal audit with respect to governance, status and organization, scope of activity and internal audit life cycle. On the basis of the assessment of the internal audit function carried out during the SREP and on-site inspection, JSTs determine whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk. While a review of the work of the internal auditor the extent of verification of internal audit was not widespread.</p> <p>For LSIs the relevant articles can be found in the KWG and MaRisk. BaFin and BBk place special emphasis on the performance of internal auditing: compliance with the guidelines is part of the (external) audit of the annual financial statement and subject to on-site examination performed by audit teams of BBk. Inter alia, supervisors consider the findings of the abovementioned audits while compiling the overall risk assessment for each institution ("risk profile").</p> <p>The work of the internal audit function is also of great importance for the ongoing supervisory process. Internal Audit reports have to be made available, on request, to the External auditors of the annual accounts, auditors commissioned by BaFin, and to BaFin and Deutsche BBk. Since May 2009, BaFin and BBk expect systemically important banks to submit audit reports on a regular basis. Moreover, the direct dialogue with institutions' internal audit function is of importance for supervisory purposes.</p>
EC7	The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where

	necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.
Description and findings re EC7	<p>For German SIs, the supervisor maintains considerably more contact and directs its main attention to the Management Board as opposed to the Supervisory Board (see also CP14).</p> <p>The assessment of governance is a key element of the SREP and the SREP guidelines recommend a minimum engagement with the bank, including with the banks' management body (Board) and senior management. The frequency of engagement/dialogue with the managing body and senior management will depend upon the Category of bank whereby Cat 1 & 2 banks will have ongoing engagement as prescribed by the framework, whereas Cat 3 banks will have risk-based engagement and Cat 4 will have engagement at last every three years. Material reviewed by the assessors confirmed that the JSTs had made good effort to maintain contact with the Management Board and senior management throughout the supervisory cycle discussing a range of topics relevant to the individual institution (capital, liquidity, credit quality) as well as sectoral themes (earnings capacity, the low interest rate environment).</p> <p>Where the supervisor is conducting an assessment of a material risk element within the SREP, the framework prescribes engagement with the senior management and managing body during this process. The assessment of all SREP elements across the supervisory cycle will facilitate contact with senior management to develop an understanding of all aspects of a bank's strategy, policies and processes, corporate governance, capital, liquidity, funding, Pillar 1 risks etc. The JSTs made use of EBA's guideline on internal governance (GL44) and the SREP framework and supervisory manual.</p> <p>Meetings are held between the senior members of the JST with senior bank management/or risk managers to discuss the bank's condition, its strategic and operational perspectives, governance issues and the business policies (also with reference to specific sectors), with particular regard to risk management, capital and organizational safeguards related to risks, and internal controls. JSTs may challenge the adequacy of the bank's strategies and business model and request further information from the Board and senior management. Where appropriate, JSTs may also participate to Board meetings. Meetings are also held with mid-level management and are technical and operational in nature focusing on areas, such as risk management methodologies, self-assessment of capital adequacy, and the control systems.</p> <p>In relation to LSIs, the BBk – at least annually - holds routine meetings with the management board of the individual banks regarding their risk profile and comprehensively explain opinions and views of various areas (Supervisory Guideline, Article 13 (2)). The aim is to act in a preventive supervisory manner, to suggest areas of improvements and to communicate strengths and weaknesses of the institution. The risk profile aims to align supervisory practices with the identified risks of the supervised banks. At the same time, supervisory practices become more transparent if supervision reflects its views of the banks concerned. In addition, the discussion of the strengths and weaknesses of the banks is required under Basel II. The institutions acknowledge that the supervisory assessment is neither to be published nor to be used for promotional purposes. The process is well established for banks and the nature and scope of the meetings was evidenced to be effective.</p>
EC8	The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as

	<p>appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.</p>
Description and findings re EC8	<p>See also EC7. The JSTs meet with senior management of the bank including CEOs, CROs, CFOs and other senior staff. Periodic meetings will be conducted with the Chair of the Supervisory Board and Chair persons of the Board Risk Committee and Board Audit Committee. The nature of the discussion is typically to share the JSTs risk assessment, to follow up priority issues and to communicate findings from on-site examinations.</p> <p>As mentioned in EC7, a top-level meeting is held with heads of the supervisory and/or management and/or risk managers of the SI to discuss the bank's condition, its strategic and operational perspectives, governance issues and the business policies (also with reference to specific sectors), with particular regard to risk management, capital and organizational safeguards related to risks, and internal controls. JSTs may challenge the adequacy of the bank's strategies and business model and request further information from the Board and senior management. Material reviewed by the assessors showed that the meetings with the Management Board were an effective mechanism at gaining assurance that the Management Board was effective in overseeing the risk management of the institution.</p> <p>Where appropriate, JSTs may also participate to Board meetings but this is less frequent. Meetings are also held with mid-level management and are technical and operational in nature focusing on areas, such as risk management methodologies, self-assessment of capital adequacy, and the control systems.</p> <p>The supervisors of LSIs – according to section 7 KWG notably BBk – at least annually hold routine meetings with the management board of the individual banks regarding their risk profile and comprehensively explain opinions and views of various areas (Supervisory Guideline, Article 13 (2)). The aim is to act in a preventive supervisory manner, to suggest areas of improvements and to communicate strengths and weaknesses of the institution. The risk profile aims to align supervisory practices with the identified risks of the supervised banks (see also EC7).</p>
EC9	<p>The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.</p>
Description and findings re EC9	<p>It is the responsibility of the JSTs to decide how to monitor (including reporting) remediation of findings from on-site examinations for SIs. If an SI does not comply with a supervisory measure, the JSTs have to consider taking additional action against the credit institution. The JSTs have a wide range of possible responses that can be initiated. They range from informal notifications to the credit institutions, or the use of additional supervisory powers, to enforcement measures or even sanctions, depending on the nature of the original supervisory measure and the extent of the non-compliance.</p> <p>The follow up typically involved specific meetings with the SI's management, or follow-up inspections to monitor the implementation activities of the credit institution, however in practice follow up inspections to verify that findings had been remediated had not been performed.</p> <p>If the SI does not start implementing remedial measures, the JST refers the case to the Enforcement and Sanctions Division if it considers that an enforcement measure is needed or that there is reason to suspect that a breach has been committed. No such examples existed.</p>

	<p>BBk assigns four grades for results from LSI on-site examinations - F1 (low priority) to F4 (high priority). The results from the on-site are communicated to the institution through the head of mission (potentially together with BaFin). The final examination report is then submitted to BaFin describing in detail the findings and that remedial action is needed to fill shortcomings (the report does not however recommend how the deficiencies should be remediated). The BaFin will then make a decision in terms of how to communicate the findings to the institution. Typically, a final report of examination findings is communicated to the institution approximately four weeks from receiving the report from the BBk. Evidence from the mission confirmed this process was working effectively.</p> <p>The LSIs required to respond to the examination report including how it will remediate the deficiencies and the timeframe for action. A status report will also be provided to the BaFin until the deficiencies are closed. It was evidenced that F4 findings were taken very seriously by both BaFin and the credit institutions and a review of several files showed that credit institutions implemented prompt and appropriate action to fill gaps in risk management identified through on-site examinations. In cases where an institution did not comply with the legal or implemented requirements the BaFin had exercised its powers using a "ladder of action".</p> <p>The time taken to conduct follow-up on-site examinations to verify that findings graded F1 to F3 had been remediated was approximately three years which assessors viewed as too long. However, the EA long form report does include an evaluation as to whether management had addressed findings from the on-site examination. Nonetheless, greater emphasis should be given to confirming banks management's actions to address on-site findings.</p>
EC10	<p>The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.</p>
Description and findings re EC10	<p>See also BCP 4 to 7 in regards to the notification framework associated with change in ownership, significant holdings, acquisitions and mergers).</p> <p>The relevant legal framework can be found in the KWG and is further specified in the Reports Regulation AnzV and the Holder Control Regulation (InhKontrollIV). Banks send notifications both to BaFin and BBk. They have to notify about every important aspect of their business as soon as it occurs. This section of KWG is understood to include any material development in business conditions as required in the EC. In practice, banks do make the supervisor aware of changes in financial and risk conditions.</p> <p>In addition, banks have to report about essential aspects (e.g., qualified holdings and own funds quota) once a year. The reporting requirements are stipulated especially in section 24 et seq. and 2c of the KWG. These requirements are substantiated in the AnzV and respectively the InhKontrollIV. Additional reporting requirements can be found in part eight of the CRR, for banks in the scope of the regulation. The notifications have to be provided by the bank without undue delay.</p> <p>Banks are not obliged to report their own breaches of legal requirements, as this would be contrary to fundamental rights. However, according to section 29 KWG certified public accountants have to identify abidance of specific laws (especially those of the KWG) in the process of the examination of the annual fiscal statement of the bank.</p>

	<p>While there are established notification rules in relation to a change in ownership/significant interest or a merger/acquisition, there is no such requirement for a credit institution to advise the supervisor of a breach of a prudential requirement. While there is no compulsion for the institution to advise the supervisor, banks typically ensure that supervisors are made aware of their business activities which include changes in strategy, new products, significant events and material adverse developments (especially those that will attract media attention). While there were examples where credit institutions had made efforts to keep the supervisor apprised of developments there were also instances where this was not the case. In the absence of formal notification requirements for breaches, the breach may not be notified to the supervisor until the external audit report.</p>
EC11	<p>The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.</p>
Description and findings re EC11	<p>In relation to SIs, as a general rule the on-site work will be performed by staff from the ECB in coordination with the German supervisory authorities. The ECB, BaFin and BBk conduct an annual planning exercise after the SEPs have been completed for the next twelve months (timing approximately October) with a six monthly status update. The delivery of on-site examinations is tracked by a weekly report that allows management to monitor progress against the plan and adjust resources accordingly. This process allows both the ECB and the German supervisory authorities to plan resources ahead. Nonetheless, where resource pressures exist external parties can and do get tapped to assist in the delivery of on-site examinations.</p> <p>The ECB has concluded a framework agreement with six audit firms for the appointment of external auditors to on-site inspection or internal model investigations missions. External consultants may participate to on-site inspection and internal model investigation missions in case there is a lack of appropriate resources within the inspection team, following the SSM's internal guidelines. To ensure that the responsibility is not outsourced, external consultants can only participate as team members and cannot act as Head of the on-site examination.</p> <p>Prior to the appointment of the external consultants, the head of mission provides a sound rationale, which is adequately approved, for the need of external consultants and a description of the expected tasks and outputs to be produced. To ensure the independence of the external provider, the audit firm must provide the ECB with some background information about its relationship with the inspected entity as well as its self-assessment about the potential existence of a conflict of interest. During the on-site inspection, external consultants perform the same tasks than SSM staff, and apply the SSM methodology under the supervision and as per requirements of the head of mission. Their presence is transparently communicated to the inspected institution. The process was shown to be closely scrutinized so as to ensure the integrity of the process and that the output can be relied upon to delivery equivalent results.</p> <p>To date, the overwhelming majority of on-site examinations are delivered by ECB and representatives from the BBk and BaFin for SIs. In relation to LSIs, a greater reliance on third party experts – mainly the external audit profession – is used to delivery on-site examinations.</p>

EC12	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC12	<p>Directorate General Information Systems provides, maintains and develops the information and communications systems necessary for the SSM to carry out its tasks. This includes the provision of information governance and security. The unit is also responsible for providing support services for end users as well as quality, supplier and license management.</p> <p>DG Statistics ensures the availability of reliable and accurate supervisory data across the SSM for supervision and statistics purposes. The data is made available to end users according to the SSM Information Security Policies and IT system entitlements.</p> <p>DG Statistics checks the completeness and data accuracy of each report received as well as the presentation of the information in order to ensure that different rapporteurs use the same format (allowing for data consistency and making historical or sector-wide analysis easier). In addition, it monitors compliance with the submission deadline for each report. The data check by DG statistics is an automated validation process of built in rules for data checks.</p> <p>On the issues of erroneous data, missing data or reports and failures to meet submission deadlines, DG Statistics liaises closely with the rapporteurs as well as with the NCAs. It keeps track of all its requests to the rapporteurs in order to be sure to have received a satisfactory reply to each of them. In cases where, after a certain predetermined period of time (as set out in the reporting schedules), no response is received, DG Statistics sends a reminder to the rapporteur concerned. Thereafter, it ensures that the database contains always the last and most correct version of the reports; history data is kept in the database but should be clearly marked as such.</p> <p>The Directorate General informs in due course the end users whenever new updates of supervisory data are available. The IMAS system provides an integrated supervisory tool facilitating the analysis of prudential data, the prioritization and monitoring of tasks, as well as the performance of SREP (see also CP8).</p> <p>The BBk provides adequate information systems to interface with all German credit institutions to report prudential information. The system includes automated triggers and manual processes to detect areas of follow up action (see also CP10). The Committee on Ongoing Monitoring is responsible for summarizing, processing, and analyzing prudential information. It identifies the major risks for the banking sector as a whole and summarizes the most recent information in a risk profile. The risk profile also contains the current actions taken to mitigate the risks and thus allows identifying areas with potential need for action. The last change to prudential information systems took place in 2011.</p>
Additional criteria	
AC1	The supervisor has a framework for periodic independent review, for example by an internal audit function or third party assessor, of the adequacy and effectiveness of the range of its available supervisory tools and their use, and makes changes as appropriate.
Description and findings re AC1	SSM supervisory activities are performed under the ECB internal control framework which relies on a three-line-of-defense model. It is the responsibility of the ECB's operational management to establish appropriate systems of internal controls. For instance, a Supervisory Quality Assurance Division (SQA) has been set up in order to provide regular feedbacks to SSM managers on the quality of their supervisory output in terms of consistency and

	<p>effectiveness. The SQA Division operates by means of desk reviews, interviews with stakeholders and factual checks and analysis. Once a year the SQA issue a lessons learnt report discussed by the Supervisory Board who may decide on further actions.</p> <p>In addition to the SQA, the ECB Directorate Internal Audit (D/IA) provides independent and objective assurance and consulting services designed to add value and to improve the ECB's operations. D/IA acts as third, independent line of defense within the ECB governance framework. In doing so, D/IA helps the ECB in accomplishing its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness and efficiency of risk management, control and governance processes. All activities, operations and processes of the ECB may be subject to internal auditing.</p> <p>Moreover, D/IA coordinates and performs audit work under the umbrella of the Internal Auditors Committee (IAC). The scope of the IAC covers the performance of the Eurosystem/ESCB and SSM tasks and activities as defined in the Statute of the ESCB and the ECB and in the SSM Regulation including their enabling processes and risks associated with them, and/or activities decided by the Executive Board, Governing Council or General Council. As regard to third party assessors, the EU Commission as well as the European Court of Auditors are entitled to review SSM operations with a specific focus on operational efficiency.</p> <p>All of BaFin's and BBk's supervisory units are subject to regular quality assurance by a separate quality assurance section within the supervisory unit and audits performed by its internal audit department. The internal audit departments of BaFin and BBk and the IAC in SSM composition provide independent, objective assurance and consulting services designed to add value and to improve the performance of supervisory tasks and activities, respectively. In doing so, they assist in accomplishing the respective objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.</p> <p>Prior to the implementation of the SSM, the internal audit departments of BaFin and BBk performed regular audits covering all areas of banking supervision. Since November 4, 2014, the IAC in SSM composition has become responsible for SSM-related audit work. The first IAC audit is planned for late 2015. Additional audit service is provided by the German Federal Court of Auditors - Bundesrechnungshof (BRH). The BRH examines as an independent body of government, the financial management of all federal authorities. The BRH audits BaFin's and BBk's accounts annually regarding banking supervision and all other national tasks BaFin and BBk are entrusted with.</p>
Assessment of Principle 9	Largely compliant
Comments	<p>Overall supervisors of German banks take an active approach to using supervisory tools. The supervisory manual and associated frameworks provide a sound basis for supervisors to perform comprehensive risk assessments using a mix of on-site and off-site supervision activities. Annual risk assessments and the SREP process allow for the results of off-site and on-site supervision to be integrated and combined for form a single overall view of all material risks and the necessary measures. Supervision manuals are detailed and help guide the risk assessment process in a systematic way. On-site examinations were demonstrated to be an effective tool to focus on deficiencies in risk management. There are, however, gaps in the approach for off-site that need to be attended to. For LSI off-site supervision, there is an undue reliance on the work of the external auditor and while the annual EA report contains a</p>

	<p>significant amount of detail, a greater use of other inputs to off-site supervision is needed in the risk assessment process.</p> <p>In the early phase of the new supervision framework for SIs, activities have been heavily influenced by thematic priorities reflecting cross-cutting issues set by a centralized division. This process ensures consistency in SEPs, which should help drive a consistent approach to strategic priorities across all German SIs. However, this comes at the expense of activities identified from a bottom up analysis of an institutions' risk profile. A more balanced approach to between thematic and bottom up supervision priorities is warranted.</p> <p>The results of on-site examinations for SIs are not ranked in degree of severity. While there is a clear process for the communication of findings at the conclusion of the examination process, the ultimate communication to the bank does not prioritize findings from high priority to low. As a result, it is not always clear for banks the prioritization of actions to address on-site findings. A ladder of severity will help ensure management and supervisory boards are able to prioritize remedial action according to severity of on-site findings.</p> <p>Greater attention needs to be paid to confirming that banks have appropriately addressed findings from on-site examinations. There is a solid process in place to ensure banks report periodically remedial measures to address deficiencies identified as part of the on-site examination and assessors reviewed many examples where this process was working. Nonetheless, more emphasis should be placed on verifying that remedial actions address shortcomings identified during the on-site. This is especially needed given that for LSIs the specific action to remediate findings from the on-site is not prescribed by BaFin/BBk but instead is left to the institution to determine. Currently the results of the bank's remediation of on-site findings will typically not be evaluated in detail until the next follow up examination which has a frequency of 3-12 years.</p> <p>For German credit institutions, the supervisor maintains considerably more contact and directs its main attention to the Management Board as opposed to the Supervisory Board (see also CP14). As a result, there was limited evidence to demonstrate that the supervisor effectively challenged the bank's Supervisory Board on the assumptions made in setting strategies and business models. The role in setting the strategy and business model in the German banking system rests with the Management Board and the Supervisory Board is not expected to be involved in this directly.</p> <p>Banks are not obliged to report their own breaches of legal requirements. Swifter notification of breaches may help alert the supervisor at an earlier stage and enable action earlier (EC10).</p>
Principle 10	Supervisory reporting. The supervisor collects, reviews and analyses prudential reports and statistical returns ²⁷ from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power ²⁸ to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations

²⁷ In the context of this Principle, "prudential reports and statistical returns" are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

²⁸ Please refer to Principle 2.

	(including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	<p>All German banks are obliged to prepare and submit information on their financial position and risk level. The major reports are financial reports (FINREP) and capital adequacy reports (COREP) under the ITS on supervisory reporting and CRR. Those reports provide information on such matters as capital adequacy, liquidity, Pillar 1 risks, balance sheet and P&L, off-balance sheet items, large exposures, asset quality, related party transactions, etc. The data are reported on both a solo and/or consolidated basis as required in the EU Implementing Technical Standard (ITS) on reporting. (For reference see also http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0680&from=EN).</p> <p>Reporting is obtained both on a consolidated (prudential) and solo level. The perimeter of the entities included in the prudential scope of consolidation is defined in the CRR (Chapter 2, "Prudential consolidation") and is applied to all institutions supervised by SSM. The ITS on supervisory reporting together with the Regulation (EU) 2015/534 provide harmonized reporting requirements for all SSM institutions. The EU harmonized supervisory reporting for SIs covers the following areas:</p> <ul style="list-style-type: none"> - Solvency/COREP (quarterly) - Financial information/FINREP (quarterly with some templates semi-annually or annually) - Large exposures (quarterly) - Losses from immovable property (semi-annually) - Leverage ratio (quarterly) - Liquidity (monthly) - Asset encumbrance (quarterly) - Supervisory benchmarking (annually) <p>As part of the ITS on Reporting, institutions also need to report the 10 largest exposures to institutions and the 10 largest exposures to unregulated financial entities, with identification of counterparty and maturity buckets. These reports are filed quarterly beginning March 31st, 2014.</p> <p>The frequency of collection and analysis of information from banks can be adjusted depending upon the risk profile and systemic importance of the bank as per the CRD (Article 104 paragraph 1(j)) and as suggested within the EBA SREP guideline when performing the supervisory review (see Table 1).</p> <p>Data needs of the SSM not addressed by the EBA ITS on Supervisory Reporting might be covered via additional data collections or Short Term Exercises (STEs). The JSTs demonstrated frequent use of STE data to augment routine reporting submitted by SIs. For example, requests in 2015 include interest rate in the banking book, sovereign risk and liquidity among others. The ECB may also request, on an ad hoc or continuous basis, information from the national competent authorities for the performance of its tasks (see Art 10 and 6(5) of the SSMR).</p> <p>Reporting frequency of STEs varies depending on the type of data: monthly (liquidity); quarterly and semi-annual or annual for some individual templates. While routine reporting of the complete suite of regulatory returns is required on a quarterly basis, the frequency can be more often where deemed necessary. No such examples of SIs on enhanced reporting at this juncture. Also as part of the ITS on Reporting, institutions need to report the items integrating the LCR (liquidity coverage ratio) and the NSFR (net stable funding ratio).</p>

JSTs use the routine regulatory reporting in the ongoing supervision processes. ITS data is used to generate key risk indicators as inputs into Phase 1 of the SREP risk assessment process. The data is also transposed into a summary of key financial and risk information (so called ID cards) which are used to provide senior management with a snap-shot of bank key risk indicators.

In respect of LSIs under the immediate supervision from German supervisory authorities, all institutions subject to Article 4 of Regulation (EC) No 1606/2002 have to report financial information. Germany has defined different reporting requirements which are anchored in the KWG. All institutions at solo level as well as institutions using the German GAAP - HGB at consolidated level must submit financial information to Bundesbank after the end of each calendar quarter, which is forwarded to BaFin including an assessment by BBk if required (section 25 (1) KWG).

The financial information comprises in particular the profit/loss data since the last annual accounts statement (including planning data for profit/loss) and has to be submitted to German supervisors by all required institutions on a quarterly basis (Section 3 (1) of the FinaRisikoAV). For CRR institutions the report of the balance sheet information submitted by institutions to Bundesbank according to the "Monthly balance sheet statistics" meet this requirement (section 4 (2) FinaRisikoAV) so there is no additional reporting requirement for CRR institutions concerning balance sheet positions. The Monthly balance sheet statistics serve as an information basis originally for monetary purposes and are conform to the supervisory information needs in this respect. This financial reporting does not contain information on the institution's ICAAP ("risk bearing capacity concepts"). This reporting requirement is addressed in chapter 3 of the FinaRisikoAV (sections 8 to 12 FinaRisikoAV).

According to section 4 FinaRisikoV the reporting on financial information contains mainly the current and the planned profit and loss statement and further risk sensitive measures such as data on loan quality. In addition, section 25 (2) KWG requires the consolidated enterprise of groups within the meaning of section 10a KWG to submit aggregated financial information accordingly. Monthly returns in respect of the adequacy of liquidity for payment purposes are submitted in accordance with section 11 KWG in conjunction with section 11 (Liquidity Ordinance Liquiditätsverordnung (LiqV).

Additionally, the reporting connected to the national German liquidity standard (LiqV, i.e. Liquiditätsverordnung) remains in place until the full introduction of the LCR (binding minimum standard at 100 percent in 2018). This reporting is also required at a monthly basis. More complex institutions do also report their net liquidity position over several time buckets up to one year on a monthly basis. This report includes information on sources and prices of funding as well as available central bank eligible and ineligible collateral.

Since January 2014 the details of this obligation are laid down in the new Financial Information Regulation (Finanzinformationenverordnung - FinaV; since January 2015 amended as Finanz- und Risikotragfähigkeitsinformationenverordnung – FinaRisikoV) which replaced the Monthly Returns Regulation (MonAwV) and the Aggregated Monthly Returns Regulation (Zusammengefasste Monatsausweisverordnung - ZuMonAwV).

Furthermore, according to section 25 (1) KWG, institutions must submit once a year information about the internal capital adequacy (risk bearing capacity) to Bundesbank, which is forwarded to BaFin including an assessment by Bundesbank. The details of this obligation are laid down in the FinaRisikoV. The aim of this report is to obtain regularly and uniformly structured information about the internal methods and processes the institution uses to manage their capital adequacy. Pursuant to section 2 FinaRisikoV the report provides

	<p>statements concerning the profit and loss account from the end of the last financial year and the statement of assets and liabilities of the last reporting period.</p> <p>According to section 44 KWG BaFin and Bundesbank can require an institution to provide information on all business related affairs. This includes the possibility to request ad-hoc reports on specific risks as warranted. In addition, according to section 24 (3b) KWG BaFin and Bundesbank can implement additional notification and reporting requirements, in particular with regard to gaining a better insight into the economic situation of the institution.</p> <p>This means, all institutions using IFRS have to report FINREP data. In case, an institution uses national GAAP, the NCA can decide if these institutions additionally have to report FINREP data (Article 99 section 6 CRR). In Germany, all institutions using national GAAP (HGB) have to report their financial information according to the FinaRisikoV. The scope and periodicity is the same for all institutions.</p> <p>All banks report solo in German GAAP and for those that are consolidated using IFRS.</p>
EC2	<p>The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.</p>
Description and findings re EC2	<p>According to the CRR (Article 99(2)), FINREP reporting templates for supervisory purposes are required to be based on the IFRS at the consolidated level (see EC1) in case the supervised group institution is subject to IFRS reporting pursuant to Regulation (EC) 1606/2002 or applies IFRS for supervisory reporting pursuant to Article 24(2) of Regulation (EU) No 575/2013. At the solo level, reporting can be based on local GAAP and national discretion can be exercised to require IFRS for solo reporting of FINREP. Reporting instructions are included in Commission Implementing Regulation (EU) No 680/2014 and contains detailed instructions for the submission of supervisory reporting. Specifically, in relation to SIs, FINREP reporting is based on IFRS and adapted also for German GAAP.</p> <p>ECB Regulation 2015/13 extends the harmonized regular reporting of financial information to the consolidated reports of banks under national accounting frameworks, as well as to solo reports, e.g., for supervised entities that are no groups. The Regulation does not affect the accounting standards applied by supervised groups and entities in their consolidated or annual accounts, nor does it change the accounting standards applied to supervisory reporting.</p> <p>The Regulation uses templates designed by the EBA and forming part for the Implementing Regulation (EU) 680/2014. In particular, there are dedicated national GAAP reporting templates that harmonize the reporting of entities under these accounting standards while respecting their differences vis-à-vis IFRS. In addition, the ECB is collaborating with the NCAs to provide national GAAP banks' further guidance to facilitate their reporting.</p> <p>Reporting instructions for LSIs are not laid down by the German banking supervisors. Rather, the HGB contains comprehensive recognition criteria and valuation principles for use in the preparation of annual accounts for corporations, as well as supplementary regulations for credit institutions and financial services institutions (sections 340 et seq. HGB). Furthermore, the HGB contains precise details on how the balance sheet and profit and loss account should be presented. The Regulation Governing the Financial Statements of Credit Institutions and Financial Services Institutions (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute – RechKredV), which was drafted by BaFin and approved by the Federal Ministry of Justice and Consumer Protection, specifies the</p>

	<p>annual financial reporting requirements of financial institutions and contains further provisions, which comply with the EU Bank Accounts Directive (EC 86/635) as well as with the fourth and seventh EC Accounts Directives (EC 78/660 and EC 83/349); updating of HGB according to the new EU Accounting Directive (RL 2013/34/EU) has been done in July 2015.</p> <p>Pursuant to regulation (EC) No 1606/2002 or section 315a (2) HGB, a parent institution may be required to draw up its consolidated annual accounts in accordance with the IFRS. Where a parent institution is not required to apply the IFRS to the consolidated accounts, it has the option to do so (section 315a (3) HGB). If the consolidated accounts are set up in accordance with the IFRS, the regulations of the HGB concerning the annual accounts of corporations are only applied within the scope of section 315 (1) HGB.</p> <p>The German Accounting Standards laid down in HGB has prudence among its guiding principle and therefore anchored on conservatism (see also EC27). Examples include the strict limitation to the fair valuation of financial instruments and the use of hidden reserves. Supervisory instructions are the ITS on reporting and national instructions e.g., the regulation FinaRisikoV (see also EC1) which clearly describe the accounting standards to be used. Supervisory reporting requirements are based on the valuations of the respective accounting standards.</p>
EC3	<p>The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and is consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.</p>
Description and findings re EC3	<p>In relation to SIs, Article 24 of the CRR specifies that the valuation of assets and off-balance sheet items shall be effected in accordance with the applicable accounting framework. Article 76 of the CRD requires that the management body will devote sufficient time to the consideration of risk issues as well as the valuation of assets, the use of external credit ratings and internal models relating to those risks (see paragraph 2). The CRD provides the legal basis for governance arrangements and control processes for valuation of assets. The measurement of fair values and valuation rules are also determined on the grounds of IFRS requirements (IAS 39, IFRS 13). Specifically, in relation to internal approaches, Article 78 of the CRD requires that, at least annually, supervisors of SIs to assess the consistency and comparability in risk-weighted assets (RWA) produced by internal modeling approaches (except for operational risk).</p> <p>The governance arrangements for the submission of regulatory reporting will depend upon the size and complexity of the credit institution, but typically the sign off will be head of department within the bank's finance division. At least annually, regulatory reporting is tabled to the board. While this occurs in practice, it is not required as part of MaRisk.</p> <p>EBA Technical Standards (EBA/RTS/2015/01) provide supervisors with a benchmarking tool to enable the JST to compare the outputs of banks' models. The ITS specify the benchmarking portfolios as well as the templates, definitions and IT solutions that should be applied in the benchmarking exercise for market and credit risk. The RTS for prudential valuation (EBA/RTS/2014/06/rev1) establishes approaches for prudential valuation adjustments as required by the CRR for traded instruments (simplified and core approaches)</p>

The valuation framework and control procedures are subject to adequate independent validation and verification, mainly through the SIs internal audit function and external auditors. JSTs routinely receive reports from IA as well as meetings with IA regarding ongoing audit work. Furthermore, the external auditor is required to conduct an assessment of the data systems that input into the regulatory reporting. The JST will become aware of deficiencies in control procedures via these two channels.

EU-wide legislation fails to cover the capacity for the supervisor to require a bank to make adjustments to its reporting for capital adequacy or regulatory reporting if valuations are deemed not sufficiently prudent. However, article 16.2.a) of SSMR allows the ECB to require institutions to hold own funds in excess of the capital requirements laid down in the acts referred to in the first subparagraph of Article 4.3 related to elements of risks and risks not covered by the relevant Union acts. To date, on-site examinations have not been conducted that test the veracity of data systems used to report regulatory data. Furthermore, supervisors do not routinely assess whether the valuation used for regulatory purposes is reliable and prudent.

In regards to LSIs, (and for certain SIs as well), the annual accounts are based on nGAAP which mainly follow a cost accounting approach. The data is prepared in accordance with the Principles of Proper Accounting (Grundsätze ordnungsgemäßer Buchführung – GoB) according to section 243 (1) HGB. Additionally, the annual account of corporations must, in compliance with the GoB, present a true and fair view of the net worth, financial position and results of the company. If the annual accounts do not show a true and fair view due to special circumstances, additional disclosures are required in the notes (section 264 (2) sentence 2 HGB). This requirement also applies to all banks, regardless of the legal form under which they operate (section 340a HGB). The basic GoB are codified in the HGB, among those are the “historical cost principle”, the “item-by-item valuation principle”, the “realization principle,” the “impairity principle” and the “prudence principle” (sections 252 et seq. HGB).

As a general rule, the recognition of unrealized profits is prohibited. However, for financial years starting 2010, institutions have to show financial instruments held for trading at fair value, after taking into account an adequate deduction for risk (section 340e (3) HGB). The deduction for risk must reflect the probability that some of the gains may not be realizable. In addition, every financial year an amount of at least 10 percent of the net trading profits has to be booked into the “fund for general banking risks” (section 340g HGB) and to be shown separately. These amounts may only be reversed in order to account for net trading losses or in case they exceed 50 percent of the average net trading profits of the previous five years (section 340e (4) HGB). The notes must include information about assumptions with regard to the calculation of the fair values and categories and volume of the financial instruments concerned including conditions that may have impact on cash flows.

Together, these rules intend for only distributable profits can be disclosed (after expenses – including provisioning – have been deducted). According to Section 252 HGB validation shall be done annually for individual institutions. Furthermore, trading book positions subject to market risk shall be valued daily (MaRisk BTR 2.2.2). Banking book positions subject to market risk shall be valued at least once a quarter (MaRisk BTR 2.3.1).

When auditing the annual accounts or interim accounts, the auditor examines the institution's financial situation and determines in particular whether the institution has fulfilled the regulatory requirements (section 29 KWG). In addition to that, according to MaRisk BT 2.3.1, the scope of internal audits also covers the risk management and risk control processes, including the valuation framework of the institution and its practical use. BaFin and Bundesbank conduct routine on-site examinations of LSI's to test the veracity of

	information systems and control procedures associated with supervisory reporting (see section 44 KWG). The examinations will select a sample of supervisory reports and check whether the data reconciles with the accounts.
EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	<p>See also EC1.</p> <p>The frequency of collection and analysis of information from SIs can be adjusted depending upon the risk profile and systemic importance of the bank as per the CRD (Article 104 paragraph 1(j)) and as suggested within the EBA SREP guideline when performing the supervisory review (see Table 1). ITS data and data collected through short term exercises (STEs) feed into ongoing supervision and importantly the SREP process which occurs throughout the supervisory cycle. The data is a key input into the first two phases of the assessment of the four elements of the SREP decision. The data is also automatically populated into a two-page high level summary of the SI's financial and risk position that is used for reporting to senior management.</p> <p>The regular reporting requirements for LSIs contain standard reporting days or standard reporting periods. These are commensurate with the nature, significance and availability (i.e. annual accounts) of such data. Generally, these provisions apply to all institutions. In special cases (e.g., high risks, significant institutions, etc.) supervisors may request further information. CRR institutions (other than significant institutions) have to submit the information required under to the EU harmonized supervisory reporting framework according to the frequencies as described above. National supervisory reporting is conducted on a quarterly frequency; while a more comprehensive analysis such as through the ICAAP process is annual. Throughout the supervisory cycle the Bundesbank will conduct regular in-depth analysis of specific risk areas of LSIs including NPLs, LEs and IRRBB.</p> <p>CRR institutions have to submit information on their balance sheet positions on a monthly basis (according to "Monthly balance sheet statistics"). Other institutions than CRR institutions have to submit that information on a quarterly basis (according to FinaRisikoAV). Information on institution-internal ICAAP (risk bearing capacity information) has to be submitted in general on yearly basis (according FinaRisikoAV, section 8 to 12). Institutions which are subject to direct supervision of ECB (SSM institutions) or other institutions with the potential to pose a systemic risk have to submit this information twice a year.</p>
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	<p>The EBA publishes a set of papers for benchmarking the internal approaches that EU institutions use to calculate own-funds requirements for credit and market risk exposures (see also EBA assessment comparing capital requirements for IRB banks in EU). JSTs readily use cohort benchmarks as a way to identify outliers and peer group averages to inform and enrich analysis of supervisory reporting. The population of SIs supervised by the ECB allows for cross-border comparisons.</p> <p>In order to ensure comparability between banks with different year-ends, SIs adjust their financial information based on their accounting year-end which deviates from the calendar</p>

	<p>year so that reporting of financial information is done every three, six or twelve months from their accounting year-end, (according to art 2 of Commission Implementing Regulation (EU) No 680/2014).</p> <p>To strengthen the analysis of credit risk for German banks, the Bundesbank maintains a central credit register (CCR). According to section 14 KWG lenders (credit institutions including foreign subsidiaries and branches, financial services and insurance companies) have to report loans to an individual counterparty or a group of connected counterparties of EUR 1 million or more (large loans) to the CCR quarterly. This report includes information about the client (i.e. identifiers, geographical and sectoral, group of connected counterparties) and credit data (on-/off-balance, provisions, collaterals, probability of default, code of default etc.).</p> <p>The CCR collates all reporting and performs quality checks for the total indebtedness of an individual counterparty or a group of connected counterparties. The information derived from the reports on large loans are regularly analyzed by the Bundesbank especially for banking supervision and financial stability reasons (for example to analyze the exposure of a credit institution or to give an indication how a sovereign debt crisis effects lenders or groups of lenders). In addition, there is a feedback loop, which returns the total indebtedness of an individual counterparty or a group of connected counterparties to all involved lenders. Apart from this, an institution has to report to the Bundesbank all large exposures (as a part of the European common reporting) to an individual counterparty or group of connected clients exceeding the threshold of 10 percent of its eligible capital. The CCR has to deliver these reports to the ECB. This enables the supervisors to review this specific type of concentration risk within a bank's portfolio on a harmonized level (see also CP17).</p>
EC6	<p>The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.</p>
Description and findings re EC6	<p>See also EC1.</p> <p>In relation to SIs, banking groups are requested to provide supervisory reports on the basis of their consolidated situation following Article 11(1) CRR. Regarding consolidated reports of financial holding companies or mixed financial holding companies the credit institution controlled by the financial holding company is requested to report at the highest level of consolidation for the whole group following Art 11(3) CRR. In this way the financial position of the consolidated group— including unregulated subsidiaries —is reported and made available for analysis. Information for the wider banking group is included in the risk assessment for the purpose of due transparency of these institutions' group structure, as well as within the scope of group solvency information on affiliates being subject to the EBA ITS on Reporting.</p> <p>In relation to LSIs, according to section 44 (1) sentence 1 and section 44 (2) sentence 1 KWG, German banking supervisors can request that an institution submit all relevant documentation regarding the credit institution. In principle, German banking supervisors can make use of the formal request for information provided for under section 44 KWG at any time in order to obtain up-to-date information. However, often the request is triggered by auditor's report findings, reports filed in accordance with section 29 (3) or section 24 (1) no. 4 KWG, newspaper reports, etc. The formal request for information may be intended to elicit one-off comments.</p>

	<p>According to section 24 (3b) KWG BaFin and Bundesbank may also impose additional notifications and reporting requirements on institutions or certain types or categories of institutions, in particular in order to obtain more deep insight into developments in the institutions' final situation, into their principles or proper management or into the abilities of members of the institution's governing bodies where it is necessary to fulfill the tasks of BaFin and the Bundesbank. These provisions include information regarding the wider banking group and the German supervisory authorities demonstrated evidence where such information had been requested and submitted by LSIs for analysis.</p> <p>Regarding the support of resolution planning by the respective institution or group, section 42 and 46 of the SAG defines the cooperation and contribution requirements for the banks. This also includes the provision of any information and analyses needed by the resolution authority for the preparation and implementation of the resolution plan. BaFin and Bundesbank together with FMSA are required to review whether some or all of the information which is to be forwarded is already available. If such information is available, the BaFin and the Bundesbank will provide it to FMSA.</p>
EC7	<p>The supervisor has the power to access²⁹ all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.</p>
Description and findings re EC7	<p>See also EC6.</p> <p>Article 11 of the SSMR allows the ECB to examine the books and records and take copies or extracts from such books and records; and "obtain written or oral explanations from any person referred to in Article 10(1) or their representatives or staff". The (legal and natural) persons referred to in Article 10(1) are the following: (a) credit institutions established in the participating Member States; (b) financial holding companies established in the participating Member States; (c) mixed financial holding companies established in the participating Member States; (d) mixed-activity holding companies established in the participating Member States; (e) persons belonging to the entities referred to in points (a) to (d); (f) third parties to whom the entities referred to in points (a) to (d) have outsourced functions or activities.</p> <p>The corresponding legal powers of BaFin and Bundesbank are derived from sections 44 et seq. KWG. They apply in connection with individual institutions, institutions which form part of a group, and holders of qualified participating interests. According to section 44 (1) 3 KWG BaFin's staff, the staff of the Bundesbank as well as any other person BaFin uses in performing the inspections are allowed to enter and inspect the business premises of the institution, the external service providers and the subordinated undertakings during ordinary office and business hours.</p> <p>Institutions and acting persons in institutions must show all documents and have to provide BaFin and Bundesbank with all information they need to conduct their supervision. BaFin can also send representatives to the general meetings and to the meetings of the supervisory board. In addition, section 24c KWG gives BaFin automated access to the customer account information of individuals and institutions to perform its prudential functions under the KWG or the Money Laundering Act, in particular with respect to unauthorized banking business and financial services.</p>
EC8	<p>The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines the</p>

²⁹ Please refer to Principle 1, Essential Criterion 5.

	<p>appropriate level of the bank's senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.</p>
<p>Description and findings re EC8</p>	<p>The relevant legal basis for enforcement of supervisory reporting standards for SIs is found in the CRD. Article 76 of the CRD assigns responsibility to bank senior management for the accuracy of supervisory reporting (see also EC3). Article 67 paragraphs (e) to (m) establish the capacity for the competent authority to enforce compliance with the requirement that information submitted for regulatory purposes is accurately and timely. Regarding timeliness, the remittance dates to the ECB are specified, with different deadlines according to the nature of the reporting entity. SIs directly supervised by ECB have an earlier remittance date than LSIs.</p> <p>Regarding accuracy of data, NCAs monitor and ensure the quality and reliability of the data made available to the ECB, by applying the validation rules specified in Annex XV of Implementing Regulation (EU) No 680/2014 applying data quality checks defined by the ECB in cooperation with the German supervisory authorities. The coordination between the agencies was demonstrated to work well where timely submission of data existed. Delayed reporting was promptly followed up with the credit institution and quality checks were flagged with the ECB in relation to SIs.</p> <p>Directly applicable EU law (cfr. CRR Articles 99(1), 101, 349(1), 415(1) and (2), 430 (1)) imposes reporting obligations on the institutions within its scope. The ECB is entitled to impose both pecuniary sanctions and enforcement measures on SIs for breaches of those obligations. Pursuant to Article 18(1) SSMR, the ECB has the exclusive competence to open infringement proceedings against and impose administrative pecuniary penalties on SIs as concerns breaches of directly applicable EU law.</p> <p>The ECB may also, pursuant to Article 18(5) SSMR, request NCAs to open proceedings in order to impose (i) non-pecuniary penalties on SIs and (ii) sanctions against natural persons belonging to these entities. For enforcement and sanctions available to the ECB, see CP 1 and CP 11. To date, no examples can be provided of cases where the penalties have been applied to supervised entities for not providing reporting in time or with insufficient data quality.</p> <p>The legal basis for enforcement of reporting obligations for LSIs is set out in KWG. According to section 25a KWG an institution shall have in place a proper business organization which ensures compliance with the legal provisions to be observed by the institution. If institutions are in breach of reporting requirements BaFin can impose pecuniary sanctions against the institution itself or against the acting natural person. Section 56 (6) KWG sets out the respective maximum amounts for the penalties that can be imposed for the sanctions listed in Section 56 (1) to (5) KWG. See CP 1 and CP 11.</p> <p>Recently a fine of in total Euro 3,000 had been imposed against an institution for acting twice negligently contrary to Article 396 CRR in connection with section 56 (5) No. 19 KWG. Regarding the amount of the fine, within the legal framework BaFin has discretion in determining the penalty. This discretion is guided in particular by section 17 of the Administrative Offences Act (Ordnungswidrigkeitengesetz – OWiG) which stipulates that the penalty should be based on the relevance of the offence and the case against the offender. Another aspect is whether the offence has been committed premeditatedly or negligently. In addition, the economic situation of the offender has to be taken into account. If the institution acts persistently against the provisions of the KWG, as e. g. the notification requirements, or other binding regulations or issued orders BaFin can also hold responsible</p>

	the senior management for these breaches and may demand the removal of the responsible senior managers (see section 36 (1) KWG)."
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts. ³⁰
Description and findings re EC9	<p>The ITS reporting framework developed by the EBA includes binding validation rules and the Data Point Model ensures consistent application of the requirements. According to article 140(4) of the SSMFR, "the ECB shall organize the processes relating to collection and quality review of data reported by supervised entities subject to, and in compliance with, relevant Union law and EBA implementing technical standards."</p> <p>The Supervisory Statistics Division within the ECB checks the completeness and data accuracy of each report received as well as the presentation of the information in order to ensure a common format among the different rapporteurs (allowing data consistency and easing historical or sector-wide analysis). Automated processes are in place to ensure a sound and efficient follow-up of the reports and the function maintains close cooperation with the German supervisory authorities which are the first receivers of prudential reporting by credit institutions and which perform the first data quality check. Once the data is received by the ECB the Supervisory Statistics Division uploads all the data into a dedicated database. The function is responsible for keeping and updating the database on a continuous basis.</p> <p>On the issues of erroneous data, missing data or reports and breaches of submission deadlines, the Supervisory Statistics Division closely liaises with the rapporteurs as well as with the German authorities. It keeps track of all its requests to the rapporteurs in order to be sure to have received a satisfactory reply for each of them. In case where, after a certain pre-determined period of time (as set in the reporting schedules), no response is received, the Supervisory Statistics Division sends a reminder to the concerned rapporteur. Thereafter, the Supervisory Statistics Division ensures that the database contains always the last and most correct version of the reports; history data is kept in the database but should be clearly indicated. The Supervisory Statistics Division informs in due course the end users whenever new updates of supervisory data are available. In cases where the function receives an amendment to a report that has already been released, it informs the end users and provides them with an updated version of the report as soon as possible.</p> <p>The Supervisory Statistics Division maintains SSM Reporting Instructions and provides the end users with technical support and on requesting data and statistics – for example to instruct others on how use the database and how to look for specific information. Members of this function also maintain good knowledge of the different types of reports and the information contained therein so as to be able to advise the end users which reports and/or what kind of data is useful to perform the tasks/analyses they have been asked for. The Supervisory Statistics Division creates regular supervisory statistics for the end users.</p> <p>Supervisory reporting for LSIs is based on electronic processing of the data submitted by banks. The verification and validation of banks supervisory reports are laid down in CRR is granted on a harmonized basis following the provisions of the ITS on Reporting. The residual national supervisory reports not applicable under ITS on Reporting also undergo automated internal processes to confirm completeness and accuracy.</p>

³⁰ Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	<p>Validity and integrity of supervisory reports is in general checked by external auditors in course of the audit of the annual accounts in accordance to the Auditors' Report Regulation, Prüfberichterordnung (PrüfbV). The requirements of the PrüfV in conjunction with section 29 KWG ensure that all items deemed to be relevant by German banking supervisors are audited as part of the audit of the annual accounts. In accordance with section 19 PrüfV, this includes checking that the reports issued by the institutions are complete, accurate and timely. Any infringements ascertained must be noted in the auditor's report.</p> <p>Furthermore, additional material checks are done on a manually basis by off-site supervision. Assessors saw evidence that the manual checks were undertaken on a sample of banks as part of the off-site analysis of supervisory reporting.</p>
EC10	<p>The supervisor clearly defines and documents the roles and responsibilities of external experts,³¹ including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.</p>
Description and findings re EC10	<p>In the cases where external experts are required to support the ECB in carrying out its prudential supervisory tasks, including the direct supervision of SIs, the rules followed are those that apply generally within the ECB. The ECB initiates the tender process by means of a contract notice published in the Official Journal of the European Union with highly-qualified external providers. The aim is to have the appropriate expertise and resources available when required, including at short notice, to assist the ECB's head of supervisory assignments. The selection process is conducted in compliance with ECB Decisions (for example Decision ECB/2007/5 for the 2015 process), laying down the Rules on Procurement. The publication is followed by a selection and an award phase.</p> <p>The roles and responsibilities of external experts contracted to undertake part of the supervisory tasks are covered clearly in KWG (section 29). Furthermore, the Auditor's Regulation includes such stipulations as to the individuals' probity and fitness to undertake such functions on behalf of the supervisor.</p>
EC11	<p>The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.</p>
Description and findings re EC11	<p>Section 29 (3) KWG contains the auditor's reporting and explanation duties in the course of the audit. According to the provisions of this section, the auditor must inform the German banking supervisors immediately of facts which might warrant the qualification or withholding of the certificate of audit, jeopardize the existence of the institution or seriously impair its development which constitute a major infringement of the provisions relating to the institution's approval criteria or the pursuit of business under the KWG, or which indicate that the senior managers have severely infringed the law, the articles of association or the partnership agreement.</p> <p>BaFin and Bundesbank also have the right to request that the auditor explains the auditor's report to them, and communicate any other facts which have come to his or her attention in the course of the audit and which suggest that the business of the institution has not been</p>

³¹ Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

	<p>conducted properly. In addition to the auditor's duties set out in section 29 (3) KWG, and in particular the duty to inform BaFin and Bundesbank immediately of any significant findings, German banking supervisors can contact auditors at any time in order to exchange information.</p>
EC12	<p>The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.</p>
Description and findings re EC12	<p>SSM is represented in the relevant bodies responsible for the establishment of reporting requirements. SSM is continuously assessing data needs of supervisors and adjusting data requirements accordingly. ECB Regulation 2015/534 on reporting of supervisory financial information and additional ad hoc data collection exercises that aim to fulfill data needs for supervisory tasks (e.g., for the SREP) are the relevant examples for this activity. The German supervisory authorities monitor on a continuous basis the quality of supervisory data and other information against a bank's business model and risk profile. If this information is not adequate, there is the possibility to require ad hoc information needs by specific requests pursuant to section 44 para 1 KWG. The German supervisory authorities most recently enhanced the suite of reporting analytics in 2011 and have in place processes to periodically review the data sets.</p> <p>With reference to EBA ITS data the periodical review is done by the German NCA based on reporting requirements as set at EBA level for reporting institutions. With regard to national reporting the German supervisor developed FinaRisikoV as a result of a periodical review taking into account the supervisory need for adjusted reporting including the assessment if data are still relevant. It will also continue to periodically review national reporting in the future via the national meetings ("fora") including supervisors and in several cases banks' associations.</p>
Assessment re Principle 10	<p>Materially Non-Compliant</p>
Comments	<p>The requirements associated with supervisory reporting are now predominantly governed by a harmonized EU regime. However, the application of regulatory data requirements (FINREP/CoRep) is not uniform, resulting in circumstances where some banks do not report a comprehensive suite of data for off-site analysis based on common definitions. Assessors identified several instances where the lack of granular data inhibited the effectiveness of off-site supervision, which was a finding from the previous FSAP and has not been sufficiently remedied.</p> <p>Credit institutions report using both nGAAP and IFRS where the differences, in some instances, can be material. The main differences between accounting treatments are generally known and understood by the supervisor and work-arounds are implemented to deal with this situation. Nonetheless, the existence of different accounting treatments makes comparisons between banks and risk positions difficult and the identification of outliers more complex. Mapping of financial reporting from German GAAP to IFRS goes some way to addressing this issue.</p> <p>ECB Regulation 2015/13 extends the harmonized regular reporting of financial information to the consolidated reports of banks under national accounting frameworks, as well as to solo reports, e.g., for supervised entities that are no groups. The Regulation does not affect the accounting standards applied by supervised groups and entities in their consolidated or annual accounts, nor does it change the accounting standards applied to supervisory reporting.</p>

The Regulation uses templates designed by the EBA and forming part for the Implementing Regulation (EU) 680/2014. In particular, there are dedicated national GAAP reporting templates that harmonize the reporting of entities under these accounting standards while respecting their differences vis-à-vis IFRS. In addition, the ECB is collaborating with the NCAs to provide national GAAP banks' further guidance to facilitate their reporting.

Analysis of regulatory data is hampered by a lack of granular data. While FinRep and CoRep are harmonized standards more detailed risk information is needed to support the off-site supervision process and make in-depth analysis. Examples include related party exposures, credit risk, operational risk loss data, market risk and liquidity. Gaps in regulatory data are often supplemented by short term data exercises/surveys which the supervisors making use of these options. For example, supervisors are making increased use of requests for management information from the banks they supervise to obtain the data they need to perform their analysis. Assessors confirmed this process was working. However, this work-around does not facilitate a structured approach to peer group analysis, development of time series data and standardized analytical processes based on similar data sets. The clearest example of lack of granular data is in regard to credit risk i.e. authorities do not get loan loss data for portfolios, segmentation of past due loans by portfolio and time bucket, restructured loans, and forborne loans.

Greater segmentation of the data such as multiple time buckets and by portfolio would allow more detailed analysis of portfolio quality and help to identify early trends and deterioration. For operational risk, only the operational risk capital figure is routinely reported. A more systematic and structured approach to the development and use of industry and peer group benchmarks is needed as a way to strengthen off-site supervision. The breadth and depth of supervisory data to support effective off-site supervision needs to be expanded. There is a need to perform more system-wide monitoring of trends through the development of more systematic peer group benchmarks that will help sectoral analysis and identification of systemic risks.

The extent of verification of the accuracy of supervisory data needs attention. Currently the accuracy checks are performed in the case of ITS measures mainly through the design and application of automatic triggers which validates data at the time of submission e.g., reconciliation of related data points, pre-defined triggers and sensitivities. Apart from data quality assurance work routinely performed at NCA and ECB level (through the Supervisory Statistics Division) supervisors are also responsible to report data quality issues they encounter in their work. For this purpose, the "Supervisory Data Issues Tracker" (a ticketing software) has been set up which allows all data users to register data quality issues. Those tickets are then automatically routed to the Supervisory Statistics Division at the ECB which will investigate the issues and follow-up with NCAs, who in turn will request banks to resubmit data in case of reporting errors. One concrete example where this process is applied is the quarterly ID-Cards update, where individual bank factsheets are updated and finalized by JSTs and then provided to Supervisory Board members for information. Greater emphasis on manual analysis of supervisory data to test and assess accuracy as an input into the overall supervisory process is needed.

Supervisory practices to assess whether valuations are prudent were not demonstrated as a routine task of the supervisor based on ITS reporting procedures. Supervisors have so far accordingly tended not to focus on the prudence of valuations in their assessment of banks and as a result valuation adjustments by the supervisor could not be evidenced.

Principle 11	Corrective and sanctioning powers of supervisors. The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings re EC1	<p>See CP 1 EC 3. The ECB is empowered to require banks, financial holding companies or mixed financial holding companies to take necessary measures. Currently the main tool in use by the ECB is the annual SREP, from which derive most supervisory measures. ECB supervisory decisions, as defined in Article 2(26) SSMFR, must be adopted following the provisions set forth in Article 22 SSMR and Articles 25 et seqq. SSMFR. The ECB notifies as a rule supervisory decisions in writing. According to Article 35 SSMFR, the ECB's supervisory decisions can be notified to the persons authorized to represent the SI. Before making use of supervisory powers, the ECB may consider if the problems can be addressed in another way, in particular in the form non-binding routine or ad hoc requests, letters, statements, meetings with the management of the credit institution or a letter of intervention. If a SI does not comply with the ECB's recommendations or the relevance of the problem identified or deficiency so requires, the process will involve a formal supervisory measure, which implies a decision by the Supervisory Board and the Governing Council. The follow-up of the decisions may be based either on periodical/ad hoc reports only, or through a closer interaction with the SI, which may include follow-up inspections. The ECB may also impose an enforcement measure to compel the SI to quickly restore compliance, or a sanction, to punish the infringement. The decisions on enforcement measures and sanctions are taken by the Supervisory Board and the Governing Council. For LSIs, any material supervisory procedures or draft supervisory decisions should be notified to the ECB.</p> <p>If BaFin has indications of upcoming difficulties or negative developments, it has various possibilities of supervisory actions, which will depend on the nature and gravity of the problem, e.g., the breach of regulatory minimum requirements or non-compliance with organizational requirements. Administrative orders are as a rule issued in written form, and are addressed to the management board - the supervisory board of the bank is informed by copy. Due to section 44 (1) KWG BaFin has the power to request information from the institutions or order on-site inspections to check that the institution complies with the legal requirements. In cases of corrective actions BaFin combines supervisory measures regularly with the duty to submit regular progress reports as well as with deadlines by which the institution has to restore compliance with the supervisory requirements. Where appropriate, the institution's success can also be verified by way of an on-site inspection.</p>
EC2	The supervisor has available ³² an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions,

³² Please refer to Principle 1.

	<p>is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.</p>
Description and findings re EC2	<p>See EC 1. The powers of the ECB are laid down in Chapter III of SSMR (Articles 9 to 18). Apart from the supervisory powers listed in Article 16(2) SSMR the ECB can directly exercise powers conferred on the national authorities by national law transposing Union law directives – the KWG, in the case of Germany. It can also require BaFin, to the extent necessary, and by way of instructions, to make use of their powers, under and in accordance with the conditions of national law, where the SSMR does not confer such powers on the ECB. The assessors had access to files when this was the case.</p> <p>The ECB can act in two different ways to address shortcomings: a) Informal dialogue with the credit institution (or operational acts), which do not require a Supervisory Board and Governing Council decision and is not legally binding.; and b) formal supervisory measures, which require decisions by the Supervisory Board and the Governing Council. These powers include, amongst others, the power to draw up an action program and a timetable for its implementation, to replace one or more managers, to request the management to convene a shareholders' meeting and to appoint a special manager (EC4).</p> <p>For BaFin, most supervisory powers set out in the KWG contain specific conditions for their application or aim at specific actions, and have the objective of rectifying shortcomings and restoring compliance with regulatory requirements or at averting dangers by restricting the institution's business and/or tightening regulatory requirements. BaFin uses its discretion when deciding when and how to act taking into account the particular circumstances of each individual breach. In order to facilitate this process for the staff of BaFin an internal guideline regarding the application of supervisory measures has been compiled ("ladder of actions") which also guides the user through several escalation levels to the <i>ultima ratio</i> of revoking the license or issuing a transfer order (BaFin has retained the power to withdraw authorizations of non-CRR institutions, while revocation of banking licenses of both SIs and LSIs is now under the competence of the ECB). The powers are executed as administrative acts.</p> <p>More specifically, if an institution does not have a sound business organization according to section 25a KWG, BaFin must request the institution to comply with higher capital requirements (section 10 (3) sentence 2 no. 10 KWG). In cases of organizational weaknesses BaFin may also request the institution to take risk reducing measures or not to engage in certain types of business (section 25a (2) sentence 2-4, 45b (1) KWG). If an institution is in breach of its individual combined capital buffer ratio or would be in breach if it conducted the intended distributions or dividend payments BaFin can require the institution to increase its own funds, decide on authorization of the institution's capital conservation plan or limit on distributions and payments (section 10(6)-(8) KWG).</p> <p>The general provision in section 6 (3) KWG entitles BaFin to issue orders to institutions and their managers to avoid an unsound administration of business that is not complying with laws, regulations or supervisory decisions and to counteract undesirable developments that may endanger the safety of the assets entrusted to the bank, or that could impair the proper conduct of banking business or financial services. If institutions or natural persons act contrary to any of section 56 KWG provisions a fine can also be applicable.</p> <p>Violations of the provisions in sections 54-55b KWG may also qualify as criminal offences.</p> <p>Furthermore, any intentional or (gross) negligent breaches of the provisions listed in section 56 KWG can be sanctioned with fines.</p>

	Administrative acts may be contested by an objection or an appeal, but these have no postponing effect.
EC3	The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.
Description and findings re EC3	<p>See CP 1 EC 3 on the powers granted to ECB by Article 16 SSMR. These powers are available not only when the institution is breaching requirements but also when the ECB has evidence that the bank is likely to breach the requirements within the next 12 months; or when, based on the SREP, the ECB considers that the arrangements, strategies, processes and mechanisms implemented by the credit institution and the own funds and liquidity held by it do not ensure a sound management and coverage of its risks.</p> <p>When the institution is in breach of the minimum own funds or liquidity requirements BaFin can take one of the following measures set out in section 45 (2) KWG:</p> <ul style="list-style-type: none"> • Prohibit or limit withdrawals by shareholders or distribution of profits • Prohibit or restrict accounting measures that aim at balancing an existing annual deficit or show a profit • Prohibit or limit payments on profit-related own funds instruments • Prohibit or limit the granting of loans within the meaning of section 19 (1) KWG (which includes derivatives, guarantees and other off-balance sheet items) • Order measures to reduce risks arising from certain types of activities and products or through the use of certain systems • Order the limitation or cancellation of the planned annual total amount for variable remuneration • Cancel or limit payment of variable remuneration • Order to set up a restructuring plan and regularly report on the progress of its implementation • Order the implementation of one or more options set out in a recovery plan pursuant to section 13 SAG <p>In cases when institutions are likely to breach minimum own funds and/or liquidity requirements in the foreseeable future BaFin may require the institution to improve the level of own funds and/or liquidity as set out in section 45 (1) KWG (see EC 4). BaFin has also the power to increase the regulatory requirements as set out in section 10 (3) KWG by requiring additional own funds above the minimum requirements set out in the CRR to address any risk or risk element that is not yet covered by Article 1 CRR.</p> <p>To ensure an institution's lasting liquidity BaFin can increase the liquidity requirements as set out in section 11 (2)-(4) KWG.</p> <p>To address the overall situation BaFin may also appoint a special representative and entrust him/her with the performance of activities at an institution and assign him/her the requisite powers as set out in section 45c KWG.</p>

	In cases of danger to the safety of the assets entrusted to an institution BaFin may take the temporary measures set out in section 46 KWG to avert this danger (see EC 4).																										
EC4	The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.																										
Description and findings re EC4	<p>See CP 1 EC 3 on the powers granted to ECB by Article 16 SSM for SIs. Under Article 14 (5) SSMR the ECB also has the powers to withdraw the authorization. The ECB can also impose sanctions. The allocation of sanctioning tasks between the ECB and the NCAs vis-à-vis SIs depends on three main elements: (i) type of regulation allegedly infringed (i.e. directly applicable Union law, national law implementing Directives, ECB decisions or regulations, national law relating to tasks not conferred on the ECB); (ii) entity to be penalized (i.e., supervised entity or natural person); (iii) sanction to be imposed (i.e., pecuniary or non-pecuniary). In general, the ECB can only apply non-pecuniary sanctions and sanction natural persons through an NCA. For Germany, in practice there are few powers directly available to ECB as the powers available to BaFin are not determined as enforcement under CRDIV but as administrative measures under the VwVfG. The table below summarizes the allocation of sanctioning powers between the NCA and ECB based on the nature of the infringement:</p> <table border="1"> <thead> <tr> <th colspan="4">ECB / NCA SANCTIONING POWERS</th> </tr> <tr> <th colspan="2" rowspan="2">Infringement / Sanction</th> <th colspan="2">Significant Supervised Entities (SSE)</th> </tr> <tr> <th>Entities</th> <th>Natural persons</th> </tr> </thead> <tbody> <tr> <td rowspan="2">Directly applicable EU law</td> <td>Pecuniary</td> <td>ECB (Art. 18.1 SSMR)</td> <td></td> </tr> <tr> <td>Non-pecuniary</td> <td colspan="2"></td> </tr> <tr> <td rowspan="2">National law implementing EU Directives</td> <td>Pecuniary</td> <td colspan="2" rowspan="2">NCA (only at ECB request) (Art. 18.5 SSMR)</td> </tr> <tr> <td>Non-pecuniary</td> </tr> <tr> <td>ECB regulations and decisions</td> <td>Pecuniary</td> <td>ECB (Art. 18.7 SSMR)</td> <td></td> </tr> </tbody> </table>	ECB / NCA SANCTIONING POWERS				Infringement / Sanction		Significant Supervised Entities (SSE)		Entities	Natural persons	Directly applicable EU law	Pecuniary	ECB (Art. 18.1 SSMR)		Non-pecuniary			National law implementing EU Directives	Pecuniary	NCA (only at ECB request) (Art. 18.5 SSMR)		Non-pecuniary	ECB regulations and decisions	Pecuniary	ECB (Art. 18.7 SSMR)	
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	Non-pecuniary	NCA (only at ECB request) (Art. 18.5 and 18.7 SSMR)*
National law: non-ECB tasks	Pecuniary	NCA
	Non-pecuniary	
<p>Where SIs intentionally or negligently breach a requirement under relevant directly applicable Union law in relation to which administrative penalties are available to competent authorities the ECB may under Article 18 (1) SSMR impose administrative pecuniary penalties of twice the amount of the profits gained or losses avoided because of the breach where those can be determined or up to 10 percent of the total annual turnover in the proceeding business year. In case of breach of ECB regulations or decisions, the ECB may under Article 18 (7) SSMR impose fines against supervised entities of the same maximum amount. The ECB has the power to impose periodic penalty payments of up to 5 percent of the average daily turnover per day of infringement in order to enforce ECB decisions or regulations.</p> <p>The ECB can require BaFin to open proceedings if penalties for breaches of national law transposing EU Directives, penalties against natural persons or non-pecuniary penalties are to be imposed, Article 18 (5) SSMR, Article 134 SSMFR.</p> <p>The legal framework for early intervention in Germany has been subject to a substantial overhaul in order to incorporate the requirements of BRRD. Section 45 to Section 46 KWG and Section 36 to Section 38 SAG provide BaFin with a range of options. Early intervention powers that have already been at BaFin's disposal in the past have been complemented by specific recovery and resolution tools, and a resolution authority has been established. The regulatory framework encompasses recovery planning, i.e. a requirement for banks to be prepared for restoring their financial position on their own initiative prior to supervisory intervention, early intervention tools that include detecting and fighting crisis through supervisory measures, and resolutions powers should measures taken in the recovery or early intervention stages prove not to be sufficient.</p> <p>See EC 3. Section 45 KWG can be applied if an institution is in breach of the minimum capital or liquidity requirements or an order setting higher capital or liquidity requirements e.g., according to Section 10 (3) or (4) KWG or if there is an assumption that the institution will not be able to sustainably fulfill these requirements. The KWG provides more precise thresholds to justify such assumption:</p> <ol style="list-style-type: none"> 1. the total capital ratio for the ratio of own funds to the sum, multiplied by 12.5, of the total capital charge for credit risk, the capital charge for operational risk and the sum of the capital charges for market risk exposures including options trades pursuant to Articles 92 to 386 CRR as last amended (or the regulation detailing the requirements), has decreased from one reporting date to the next by at least 10 percent, or the liquidity ratio to be calculated in accordance with the statutory order pursuant to section 11 (1) KWG has decreased from one reporting date to the next by at least 25 percent and it can be expected on the basis of this development that the minimum requirements will be undershot within the next 12 months, or 2. the total capital ratio for the ratio of own funds to the sum, multiplied by 12.5, of the total capital charge for credit risk, the capital charge for operational risk and the sum of the capital charges for market risk exposures including options trades pursuant to Articles 92 to 386 CRR as last amended (or the regulation detailing the requirements), has decreased on at 		

	<p>least three successive reporting dates by more than 3 percent in each case, or the liquidity ratio to be calculated in accordance with the statutory order pursuant to section 11 (1) KWG has decreased on at least three successive reporting dates by more than 10 percent in each case and it can be expected on the basis of this development that the minimum requirements will be undershot within the next 18 months and no facts are apparent which justify the assumption that it is highly likely that the minimum requirements will not be undershot.</p> <p>Section 36 SAG grants early intervention powers where an institution infringes the requirements of CRR or of the institution specific capital or liquidity decision, or where it is likely in the near future to do so due, inter alia, to a rapidly deteriorating financial condition, including a deteriorating liquidity situation, an increasing level of leverage, non-performing loans, or a concentration of exposures, as assessed on the basis of a set of triggers, which may include the institution's own funds requirement plus 1.5 percentage points.</p> <p>Recovery plans should include possible measures which could be taken by the management of the institution where the conditions for early intervention are met (Section 12 SAG). Section 14 SAG stipulates detailed requirements for a group recovery plan and empowers BaFin to also request recovery plans on a solo level where appropriate. Institutions are required to submit their plans to the competent authorities (ECB of BaFin) for a complete assessment.</p> <p>Section 46 KWG is triggered by a danger to the discharge of an institution's obligations to its creditors, especially to the safety of the assets entrusted to it. BaFin may take temporary measures such as issue instructions on the institution's management, forbid the acceptance of deposits, funds or securities of customers and the granting of loans, prohibit proprietors and senior managers from carrying out their activities, or limit the performance of these activities, temporarily impose a ban on sales and payments by the institution, order that the institution be closed for business with customers, and prohibit the acceptance of payments not intended for the payment of debt vis-à-vis the institution, unless the competent compensation scheme or other guarantee scheme warrants that the obligees will be satisfied in full.</p> <p>Due to the severity of such measure, Section 46b KWG grants BaFin the power to initiate insolvency proceedings only under more stringent requirements: when an institution becomes insolvent or over-indebted. The petition for the initiation of insolvency proceedings may only be filed by BaFin. In the event of imminent insolvency, however, BaFin may file the petition only with the consent of the institution, pursuant to Section 46b KWG.</p> <p>Finally, according to section 35 KWG, the competent authority (BaFin for non CRR institutions or ECB for credit institutions) is empowered to revoke the banking license.</p>
EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC5	See EC 4. Pursuant to recital 53 and Article 18 (1) SSM-R, the ECB may impose sanctions only on legal entities (SIs), but has not the power to directly impose sanctions on natural persons. The ECB may require BaFin to open proceedings. In that case, BaFin may impose sanctions to natural persons belonging to SIs only at ECB request (Article 134 SSMFR). BaFin may also ask the ECB to request them to open proceedings to impose a sanction on natural persons belonging to a SI.

	<p>In addition, the ECB has the competence pursuant to Article 16 (2) (m) SSMR remove by way of supervisory measure at any time members from the management body of SIs who do not fulfill the fit-and-proper requirement.</p> <p>Based on section 36 KWG, BaFin can by way of supervisory measure demand the dismissal of executive board managers and of members of the supervisory board or prohibit them from further acting in their positions. According to section 45c KWG BaFin may by way of supervisory measure also appoint a special representative in order to replace members of the management or supervisory board. Section 56 KWG provides for the option of imposing fines on the institution itself or any natural person responsible for intentional or reckless breaches of the provisions of the KWG listed, or of orders issued by BaFin.³</p>
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	See EC 4. The ECB as the competent authority for significant institutions can also make use of the existing national structural powers (indirectly exercised by way of instructions pursuant to Article 9(1)3 SSMR). In the case of Germany, if there is a danger that the institution is no longer able to discharge its obligations to its creditors or if there are grounds for suspecting that an effective supervision of the institution is not possible Section 46 KWG empowers BaFin to take any measure appropriate to avert the risks. In particular, it may issue the measures set out in the (non-exhaustive) list of section 46 (1) sentence 2 KWG such as issuing instructions for the management, prohibiting or restricting the acceptance of deposits, funds or securities of customers and the granting of loans, prohibiting proprietors and managing directors from carrying out their activities, or limiting the performance of these activities. According to section 46 (1) sentence 3 and 4 KWG, BaFin may also ban or restrict disadvantageous payments to affiliated undertakings or setting of conditions for such payments if these payments adversely affect the financial situation of the institution. In urgent cases BaFin may also issue a ban on sales and payments, close the institution for the business with customers and prohibit the acceptance of payments which are not intended to settle debts owed to the institution, except in cases where the full settlement of claims is warranted by the competent compensations or deposit guarantee scheme. Assessors saw evidence of ring-fencing action.
EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	<p>The legal framework for crisis management and bank resolution for SIs was very recently established under BRRD and SRMR. The framework defines in detail the cooperation arrangements between the ECB and the SRB/NRAs during the resolution process. If the ECB/SSM determines that the institution is failing or likely to fail, or if the ECB/SSM receives such a determination from an institution itself, the ECB/SSM must notify, inter alia, the relevant resolution authorities: the resolution authority for the institution, the resolution authority of any branch of the entity. Likewise, before it makes a determination that an institution is failing or likely to fail, the SRB must first inform the ECB/SSM that it intends to make this determination, and allow the ECB 3 calendar days to make an assessment. The ECB and SRB have signed a Memorandum of Understanding, which should ensure early and effective coordination and information sharing.</p> <p>At the resolution stage, the BRRD envisages certain tasks to be performed by the supervisor. The ECB will perform these tasks in accordance with the national transposition of the BRRD –</p>

	<p>in the case of Germany, the SAG. For example, in case a bridge institution is set up by the resolution authority, it may submit a request for a temporary exemption of the conditions for authorization. In these cases, the ECB/SSM would grant authorization and it could become the competent authority for the bridge bank.</p> <p>With regard to LSIs, if an institution or group runs into severe problems which cannot be solved via early interventions measures or if such measures cannot mitigate the problems the competent authority, i.e. BaFin together with Bundesbank, makes the assessment that the institution is failing or likely to fail and informs the resolution authority about the decision. FMSA may also make an assessment that an institution is failing or likely to fail as the competent resolution authority for LSIs that do not fall in the remit of the SRB after January 1, 2016. In sum, the determination that an institution is failing or likely, can be either done by FMSA after hearing the supervisory authority or by the supervisory authority after hearing the FMSA.</p>
Additional criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	In Germany, there are neither banking supervisory nor general administrative law regulations applying to incriminating administrative acts, which expressly state that BaFin must take certain measures within a certain period.
AC2	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of non-bank related financial entities of its actions and, where appropriate, coordinates its actions with them.
Description and findings re AC2	There is no provision for the ECB to communicate with BaFin when taking formal corrective action against a bank which has non-bank related financial entities supervised by BaFin. However, as BaFin is an integrated supervisory authority for all regulated financial sector entities and sits at the Supervisory Board at the ECB, who approves all supervisory measures, it will be informed. In addition, BaFin has members in the JSTs, who are responsible for the liaison and communication of material issues. The ECB is encouraged, however, to develop protocols for communication with supervisor of non-bank entities in order to coordinate actions, since not all NCAs are integrated supervisors.
Assessment re principle 11	Largely compliant
Comments	German law and SSMR provide a broad range of actions that can be taken by supervisors in their respective responsibilities. Direct enforcement powers and sanctions of ECB are limited; however, the ECB can make use of the enforcement and sanction powers available to BaFin. Assessors had access to evidence of such indirect actions, where ECB instructed BaFin to apply local enforcement and sanctioning powers according the national legislation. Assessors note the complex legal framework may make it operationally difficult and time consuming for ECB to impose enforcement actions and sanctions in some countries, where some powers may not be available, and assessments in other SSM member countries may reach diverse conclusions regarding enforcement and sanctions. At the time of this mission, considering the recent establishment of the SSM, the ECB had not directly applied any sanction or enforcement action; therefore, assessors were not able to verify effectiveness in practice. In Germany, actions by BaFin (on its own initiative or at the initiative of the ECB) can be appealed but such appeals do not have a suspension effect. While BaFin seems to have

	<p>adequate set of supervisory tools at its disposal, the assessors note that the actual use of these formal powers in practice is not intensive, suggesting a light touch in the enforcement area. BaFin has traditionally, and by requirement of German Constitution, always used first the mildest of all comparable measures, so it often does not reach the stage where formal actions are taken, and few banks reach thresholds where mandatory action is warranted. In response to recommendations in the last FSAP, in order to provide clarity and consistency in the progressive application of supervisory actions, BaFin has detailed “ladders” of action that assist in the decision which measure to take in which situation and at what stage.</p> <p>There are no laws or regulations that guard against BaFin or ECB unduly delaying appropriate corrective actions.</p>
Principle 12	Consolidated supervision. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide. ³³
Essential criteria	
EC1	<p>The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.</p>
Description and findings re EC1	<div data-bbox="431 1041 1382 1457" data-label="Diagram"> </div> <p>The ECB is the competent authority required to carry out a SREP and to take decisions for significant institutions. Within a group, this supervision is applied at the consolidated, sub-consolidated and single-entity levels unless an entity has been waived from supervision on an individual basis in accordance with Articles 7, 8, 10 of the CRR. In the case of a financial conglomerate, the SREP decisions also need to take into account the outcome of the supplementary supervision as required by FICOD. (SM Ch. 7 para 2.) This means that the supervisor must understand both the group-wide view as well as gain an understanding of all material activities conducted by the various entities within the group.</p>

³³ Please refer to footnote 19 under Principle 1.

In order to achieve this and in case supervision has not been waived, the ECB carries out a SREP. When it concerns the consolidated supervision, in general:

Supervision at the consolidated level is carried out by the JST with a high degree of involvement of ECB staff.

Solo/sub-consolidated supervision of SSM parent companies, banking subsidiaries and significant branches follows the same supervisory model as consolidated supervision, but with a greater involvement of the local JST members.

For solo/sub-consolidated supervision of subsidiaries and branches established in non-participating Member States, the model based on supervisory colleges set out in CRD applies.

For solo/sub-consolidated supervision of subsidiaries and branches established in third countries (outside the EU), the model is based on MoUs, and if possible on colleges as set out in CRD.

If the parent entity is established in a non-euro Member State or third country, the JSTs conduct sub-consolidated/solo supervision on the entities established in the SSM participating Member-States.

For all significant institutions within the SSM, the JSTs conduct the SREP in accordance with the SSM methodology, and ensure compliance with the requirements of CRD IV and the CRR.

The interaction between consolidated and sub-consolidated/single entity supervision is mainly relevant for large cross-border credit institutions. The model adopted by the SSM is designed for those credit institutions but, in principle, can also apply to smaller cross-border groups. For unconsolidated and consolidated supervision, a matrix model applies under which NCA staff remain employed in their own institutions, although for the fulfillment of the JST tasks, a reporting line exists with the JST coordinator, who is consequently in a position to give instructions to all JST members for the purpose of internal coordination. In addition, sub-coordinators can be used to efficiently manage the JST and to facilitate cooperation with the NCAs.

Consolidated supervision is at the center of the SSM supervision. The JST coordinator refers to ECB delegated experts and NCA experts directly. He or she can, on his or her own initiative, also mandate the sub-coordinator of the parent company with the management of specific tasks.

The core JST also plays a role in consolidated supervision and refers to information exchange and organization of work. It reviews the consolidated assessment, taking into account the results of the analysis at national level, and acts as a first level of mediation in case of conflict between NCAs or between NCAs and the ECB.

The respective sub-coordinator, as the competent organizational manager for the parent-company NCA staff in the JST, is involved in discussions on strategic issues related to the supervisory program. The JST coordinator liaises with him or her on important supervisory decisions, such as SREP decisions.

The experts working on consolidated supervision are ECB supervisors, supervisors from the previously responsible authority for the parent company, and supervisors responsible for material subsidiaries. In order to successfully avoid competing teams and potential overlap between ECB and NCA supervisors, they are organized as one cross-border team.

Regarding solo and sub-consolidated supervision – notwithstanding the JST coordinators' right to have direct contact with the employees working in sub-consolidated or single entity supervision at national level – the role of the sub-coordinators is more prominent. Together

with their team, they play the main role in the preparation of the necessary supervisory activities. In the case of the parent entity and material subsidiaries, the teams can be supported by ECB staff also working at national level.

In addition, risks arising from participation in entities included in the consolidation but not supervised as credit institutions by the SSM (i.e. supervised by other authorities such as insurance supervisors or not supervised at all) are to be considered as well.

In the case of a financial conglomerate, established on the basis of the FiCOD criteria, the SREP should include the potential impact of non-banking activities on the banking part of the group, its risk profile of the group, its profitability, and its capital and liquidity position, and assess the situation at the conglomerate level.

During the assessment, JSTs would need to understand the risks from non-banking activities (e.g., Underwriting risk and the mitigation of this risk are specific to insurance entities), and the mechanisms through which these activities could affect the institution part of the conglomerate. This assessment, and the issuance of any requirements arising from it, takes place at the end of the process. The conglomerate approach takes into account the different sector regulations.

In cases where a mixed financial holding company is subject to equivalent provisions under CRD IV and under FICOD there is the option to apply only the provisions of FICOD to the mixed financial holding company. Decisions will have to be taken on a case-by-case basis.

As a consequence of having separate regulatory requirements for each sector, groups may have separate risk databases for banking, insurance and other activities. Some consolidation of risks is, however, performed at group level and is presented in groups' internal risk dashboards.

In order to carry out its role of coordinator, the ECB may receive the conglomerate's data from the supervised banking entity. If banking, non-banking and other risks are managed in a fully integrated manner by the supervised institution, the information provided may be used in the assessment.

The ECB may also receive information from the competent insurance supervisors. FICOD provides indeed that the competent authorities responsible for the supervision of regulated entities in a financial conglomerate and the competent authority appointed as the coordinator should provide one another with any information which is essential or relevant for the exercise of the other authorities' supervisory tasks under the sectoral rules and FICOD.

The proper allocation of supervisory work between the "central" parent/group and the "local" subsidiary/sub-consolidated level requires, as a precondition, a thorough awareness of the group's structure, business model(s) and operational features. Mapping the group's perimeter includes, as a minimum, the following:

- a) Degree of relevance of the subsidiary/sub-consolidated group: "Relevance" indicates the importance that a given subsidiary/sub-consolidated group has within the significant group it belongs to. There are different quantitative indicators deemed suitable to measure "relevance", such as percentage of total assets, income contribution, contribution to the consolidated capital requirements, risks, etc. Qualitative information may be considered as well, as in the case where a local subsidiary manages an important production process or business area within the group (e.g., subsidiaries managing the credit card business or the custodian bank function) or develops complex activities.
- b) Degree of significance of the subsidiary/sub-consolidated group: "Significance" indicates the importance that a given subsidiary/sub-consolidated group holds in the local market,

	<p>for example in terms of market share of loans, deposits, etc. As is the case for the relevance criterion, significance may also be assessed on the basis of qualitative information; for example, a subsidiary may be considered locally significant if it manages a "core" infrastructure in the local payment system.</p> <p>c) Degree of centralization/decentralization of strategy, business, operations, risk governance and controls Institutions' organization structures exhibit different degrees of centralization or decentralization. Situations may exist where the parent company plays a considerable role in setting strategies, providing binding business guidelines, managing and controlling risks, and providing operational and support services (e.g., IT, accounting, back-up and central processing services, etc.). On the other hand, there are cases where the local subsidiaries/sub-consolidated entities enjoy greater autonomy when following the guidelines and principles issued by the parent company. Therefore, knowing the degree of centralization opted for is of key importance in defining the supervisory model to be adopted on a solo basis.</p> <p>d) Level of perceived risk The level of risk of the subsidiary/sub-consolidated group being assessed has to be taken into account in defining the intensity of supervision, based on the principle that entities deemed to be particularly risky within cross-border groups can have potentially destabilizing effects – at least on a reputational level – on the group as a whole.</p> <p>The mapping allows for the identification of two subsets of subsidiaries/sub-consolidated groups: (i) Those which are significant and/or relevant and/or more autonomous and/or riskier (material subsidiaries). This subset of entities warrants a level of supervisory intensity comparable to that applied at the consolidated level; (ii) The remaining entities (non-material subsidiaries), for which the supervisory intensity may be lower.</p> <p>The mapping, to be performed along the aforementioned dimensions, is the JST's responsibility supported by DG MS IV and NCAs where needed. An annual review of the mapping is carried out by the JST coordinator, who requests updates from the NCAs.</p> <p>With regard to the assessment of business model viability indicators on consolidated level:</p> <p>The objective of this part of the supervisory process is to assess the viability of the current business model by means of a quantitative analysis of several risk indicators at the consolidated level, and a comparison to peers. Taken together, these and other indicators should give the analyst a full picture of the real and concrete strategy pursued from the bank and the key metrics regarding profitability at the consolidated level.</p> <p>The consolidated annual accounts of at least the past three years, and the most recent monthly/quarterly management reports for the current year budget (including year-to-date realization) should be used. All available information from FINREP and COREP, data and indicators available in IMAS as well as SNL data will form the starting point of the analysis.</p> <p>At the consolidated level, the analyst should focus on how the following points develop over time and how this compares to the relevant peer group.</p> <p>A bank should be able to provide detailed bottom-up forecasts of performance for the short-to-medium term (one to three years) and, at least, top-down forecasts for the longer term (two to five years). The assumptions used by the bank to generate forecasts for key drivers should be identified and understood. These are usually found in the bank's strategic assessment and planning documents and Board papers/documents regarding strategic and financial planning. It is necessary to distinguish between assumptions applied at the consolidated level and assumptions applied to business lines.</p>
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With regard to the supervision of financial conglomerates:

Additional objectives have been established with regard to cross-sector supervision, which requires specific institutional arrangements (including at the national level when there is distinct sector supervision). Within the EU, cooperation among sector supervisors is governed by the FICOD.

This supplementary supervision is understood as supervision that does not substitute the sectorial supervision but builds on it and addresses those risks that stem from the activities of a group in the other financial sectors. Supplementary supervision addresses the "Five Cs":

- i. Capital adequacy at group level (i.e. avoidance of "double gearing" across the sectors);
- ii. Contagion (i.e. supervising intra-group transactions);
- iii. Concentration (i.e. supervising risk concentration across business lines);
- iv. Conflict of interest (i.e. the issues with respect to corporate governance);
- v. Complexity.

The KWG contains a number of reporting requirements designed to enable BaFin, Bundesbank and ECB to judge the structure of institutions at group level. The documentation submitted has to contain detailed information about significant holdings.

According to section 2c KWG, persons wishing to acquire or to increase a significant ownership in an institution have to notify BaFin and Bundesbank. According to Art. 4 (1) (1) CRR BaFin may oppose an acquisition due to supervisory concerns.

Furthermore, BaFin, and Bundesbank are kept informed on a continual basis of any developments or changes in the structure of the group by a number of notification requirements:

In accordance with section 26 (3) KWG, institutions that produce consolidated annual accounts or a group management report must submit these documents to BaFin and Bundesbank without delay. This also applies to auditor's reports prepared by an auditor of the group.

In accordance with section 24 KWG, German banking supervisors must be informed without delay of the following:

1. Ad-hoc notifications of changes in the structure of an institution's participating interests:
 - the acquisition or termination of a significant ownership in its own institution as well as the reaching, overshooting or undershooting of the thresholds for significant ownerships of 20 percent, 30 percent and 50 percent of voting rights or capital – passive participating interests (section 24 (1) no. 10 KWG);
 - the fact that the institution becomes or ceases to be the subsidiary of another enterprise (section 24 (1) no. 10 KWG);
 - the existence of, change in or termination of a close link to a natural person or an enterprise (section 24 (1) no. 12 KWG);
 - the acquisition and termination of significant ownerships in other enterprises, and changes in the amount of the significant ownerships (section 24 (1) no. 13 KWG);
 - the intention to merge with another institution (section 24 (2) KWG).

	<ul style="list-style-type: none"> • the establishment, relocation and closure of a branch in a non-EEA state and the commencement and termination of the provision of cross-border services without establishing a branch (section 24 (1) no. 6 KWG); <p>2. Annual notifications according to section 24 (1a) KWG:</p> <ul style="list-style-type: none"> • the institution's close link to a natural person or an enterprise; • the institution's significant ownerships in other enterprises; • the name and address of any holder of a significant ownership in the reporting institution and in the enterprises subordinated to it as described in section 10a KWG that are domiciled abroad, as well as the amounts of these significant ownerships; • the number of its domestic branches; • the modified balance sheet capital ratio based on the approved annual accounts; • the classification as a significant institution pursuant to section 17 of the Remuneration Ordinance for Institutions (Institutsvergütungsverordnung) of 16 December 2013 (Federal Law Gazette I page 4270) as well as a change in this classification; • if the institution is a CRR institution, the information that is required by the European Banking Authority to compare remuneration trends and practices within the meaning of Article 75 (1) CRD IV in conjunction with Article 450 (1) letters (g) and (h) CRR as last amended, and; • if the institution is a CRR institution, the information pertaining to senior managers and members of staff that earn total annual remuneration of at least €1 million within the meaning of Article 75 (1) CRD IV in conjunction with Article 450 (1) letter (i) CRR as last amended that the European Banking Authority requires for publishing aggregate information. <p>In addition, in accordance with section 24 (3) sentence 1 no. 2 KWG, the managers of an institution shall report to BaFin and Bundesbank without delay the acquisition and termination of a direct participating interest in an enterprise, as well as any changes in the amount of such a participating interest.</p> <p>In accordance with section 24 (3a) sentence 2 KWG, financial holding companies must annually submit to BaFin and Bundesbank an aggregated report of subsidiaries, financial enterprises and ancillary services undertakings. In accordance with section 24 (3a) sentence 3 KWG, BaFin shall transmit a list of these to the competent authorities in other EEA states and to the European Commission. The establishment of, changes to or discontinuation of such participating interests or corporate relationships must be reported to BaFin and Bundesbank without delay in accordance with section 24 (3a) sentence 4 KWG.</p> <p>Additionally, institutions face regulation and reporting requirements on a consolidated basis. This includes solvency regulation, large exposure regulation, adequacy of risk management systems on a consolidated level and outsourcing requirements. Additionally, for systemic relevant institutions, further reporting on a consolidated level (e.g., earnings situation, solvency) is required.</p>
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	<p>BaFin requirements concerning group-wide risks, section 25c (4b) no. 1 KWG states that the management board of a parent undertaking shall ensure that the group has in place a group-wide business strategy geared to the group's sustainable development and a group-wide risk strategy that is consistent therewith. As a minimum, the management board shall ensure that the strategic orientation of the undertakings belonging to the group is aligned with the group-wide business and risk strategies. Section 25a (1) KWG requires an appropriate risk management of institutions both on a solo and group level, which are further specified in the MaRisk. Section 4.5 MaRisk exclusively deals with group management aspects; other sections also touch the group dimension. The basic principle is that a parent undertaking has to manage all its material risks regardless of where they arise or if the entity is a financial operation.</p> <p>Finally, BaFin benefits from being an integrated supervisor providing the possibility to have in-house dialogues about the different facets of a banking group or a conglomerate. Such a dialogue is institutionalized in an annual conference of all relevant supervisors for a banking group/conglomerate (banking, insurance securities market, anti-money laundering, consumer protection) held at BaFin where prudential findings and plans are exchanged to learn from each other and complement single views to a common picture.</p> <p>The mission reviewed documentation on the planning and supervisory process for a financial conglomerate with a significant insurance subsidiary, asset manager and building society. The process determines the capital adequacy for the conglomerate. An estimate of risk bearing capacity (RBC) and capital adequacy requirements (CAR) is calculated for each sector. An overall RBC and CAR is estimated for the conglomerate. The supervisory assessment assigns risk ratings to each risk category for the consolidated entity and solo subsidiaries. Deficiencies in the group included market risk processing, internal controls and monitoring. There was no model in the conglomerate to evaluate individual risk, only on an aggregate level. Results are discussed at the college of supervisors and supervisory scope agreed-to.</p>
EC2	<p>The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, and exposures to related parties, lending limits and group structure.</p>
Description and findings re EC2	<p>Prudential standards established by the CRR/CRD are imposed at consolidated, sub-consolidated and individual basis. In particular:</p> <ul style="list-style-type: none"> a) 'consolidated situation' means the situation that results from applying the requirements of this Regulation in accordance with Part One, Title II, Chapter 2 to an institution as if that institution formed, together with one or more other entities, a single institution b) 'sub-consolidated basis' means on the basis of the consolidated situation of a parent institution, financial holding company or mixed financial holding company, excluding a sub-group of entities, or on the basis of the consolidated situation of a parent institution, financial holding company or mixed financial holding company that is not the ultimate parent institution, financial holding company or mixed financial holding company <p>CRR articles 11, 13, 14 state that parts 2 (Own Funds), 3 (Capital requirements), 4 (Large Exposures), 5 (Exposures to Transferred Risk), 6 (Liquidity), 7 (Leverage) and 8 (Disclosure) are to be complied with on consolidated basis.</p>

As regards large exposures, Article 11 (1) CRR stipulates that parent institutions in a member state of the EU shall comply, to the extent and in the manner prescribed in Article 18 CRR, with the large exposures obligations laid down in Part Four of the CRR on the basis of their consolidated situation. According to Article 11 (1) CRR, the parent undertakings and their subsidiaries set up a proper organizational structure and appropriate internal control mechanisms in order to ensure that the data required for consolidation are duly processed and forwarded. In particular, they ensure that subsidiaries which are not subject to the CRR implement arrangements, processes and mechanisms to ensure a proper consolidation.

With respect to parent financial holding companies, Article 11 (2) CRR stipulates that institutions controlled by a parent financial holding company or a parent mixed financial holding company in a member state of the EU shall comply, to the extent and in the manner prescribed in Article 18 CRR, with the large exposure obligations laid down in Part Four of the CRR on the basis of the consolidated situation of that financial holding company or mixed financial holding company.

CRR article 6 states that parts 2 (Own Funds), 3 (Capital requirements), 4 (Large Exposures), 5 (Exposures to Transferred Risk), 6 (Liquidity), 7 (Leverage) and 8 (Disclosure) are to be complied with on individual basis, unless waivers under Article 7, 8 or 10 apply.

CRR provisions on reporting in Articles 99-100 (reporting on own funds on consolidated basis based on accounting standards), 394 (large exposures), 415-416 (liquidity), 430 (leverage) as specified by the EBA's ITS on reporting (Commission Implementing Regulation (EU) No 680/2014) impose that information shall be reported on both solo and consolidated basis, unless a waiver from reporting on solo basis under articles 7, 8 or 10 applies.

ECB Regulation (EU) 2015/534 of 17 March 2015 on reporting of supervisory financial information. The regulation lays down the requirements regarding reporting on supervisory financial information to be submitted to national competent authorities (NCAs) and the ECB by supervised banks. This reporting includes information on balance sheet items such as financial assets, non-performing exposures and financial liabilities as well as on income and expenses such as impairment due to credit losses.

The supervisor collects and analyses information on a consolidated basis for the banking group covering various business areas. When assessing this information for the banking group, the Supervisor 'maps' several components. This model used is complemented by a detailed centrally coordinated planning process which defines the supervisory priorities and the level of involvement of the JSTs, the ECB staff and the level of assistance provided by the NCA within the JSTs for all major supervisory tasks to be carried out. Please refer to EC1 for further details.

Part 1 Title II Chapter 2 section 3 CRR in conjunction with section 10a KWG sets out the scope of supervisory consolidation under BaFin supervision. Depending on the legal structure of the parent, this provision differentiates between groups of institutions, financial holding groups and mixed financial holding groups. A group of institutions consists of an institution domiciled in Germany with subsidiaries that are themselves institutions, financial institutions and ancillary services undertakings if at least one subsidiary is an institution or financial institution. A (mixed) financial holding group consists of a (mixed) financial holding company domiciled in Germany with subsidiaries that are institutions, financial institutions and ancillary services undertakings, if at least one of these is a credit institution (see Article 4 (1) 1 CRR) or investment firm (See Article 4 (1) 2 CRR) domiciled in Germany and subordinated to the financial holding company as a subsidiary. A (mixed) financial holding group does not exist if

	<p>the (mixed) financial holding company itself is subordinated to an institution of that kind domiciled in Germany or to a (mixed) financial holding company domiciled in Germany.</p> <p>The parent of the group is responsible for ascertaining the information necessary at group level and ensuring that the requirements of the KWG are observed at group level. The KWG sanctions the failure of the super-ordinated enterprise to meet its obligations by requiring the deduction of the book value of the entity concerned from the own funds of the parent.</p> <p>In addition to the documents to be submitted by institutions in line with the general reporting requirements set out in section 24 KWG, in accordance with section 25 (2) sentence 1 KWG, a parent company shall submit an aggregated quarterly return (aggregated financial information) to Bundesbank.</p> <p>Through the colleges of supervisors significant information is shared on organizational structures, financial conditions and supervisory concerns. The process was demonstrated to the mission.</p>
EC3	<p>The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.</p>
Description and findings re EC3	<p>As detailed in the previous ECs the ECB has implemented a group-wide supervisory approach when assessing the legal entities. The supervisor gathers all information necessary such as information concerning the risk management and internal governance on a group-wide level, while risk category specific areas are covered by the related methodological documents on the individual risk categories. As part of supervisory process, the BaFin provides supervisory reports to ECB on a regular basis on the operations of SIs, including bank-specific analysis. The results from those assessments feed into the reliability assessment conducted for capital and liquidity determination.</p> <p>BaFin takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations. (Please refer to EC 4).</p> <p>As part of the SREP and the conduct of consolidated supervision and supervisory colleges, the SSM achieves an overall view of how a group's cross-border activities are managed and whether risk management deficiencies are present.</p> <p>BaFin/Bundesbank regularly review the appropriateness of the institution's and the group's risk management either off-site or via on-site inspections (regularly carried out by the BBk). The latter is usually carried out pursuant to section 44 KWG, and includes cross-border inspections. The BBk regularly visits London, New York. In case of inadequate risk management, BaFin has several supervisory tools according to section 45b KWG including measures to reduce risks or orders to reduce the aggregate large exposure limit of a group or to limit the business activities of an institution's branch in a non-EEA state.</p>
EC4	<p>The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or</p>

	require additional reporting, and has the power and resources to take those steps as and when appropriate.
Description and findings re EC4	<p>The legal basis for on-site inspections conducted by the ECB is in Article 12 SSM Regulation which is flanked by the provisions of the Title 5 of the SSM Framework Regulation. It empowers the ECB in para. 1, based on a respective ECB decision, to conduct all necessary on-site inspections at the business premises of the legal persons referred to in Article 10(1) SSM Regulation and any other undertaking included in supervision on a consolidated basis where the ECB is the consolidating supervisor in accordance with point (g) of Article 4(1) SSM Regulation.</p> <p>Colleges of supervisors are vehicles for cooperation and coordination among the authorities responsible for and involved in the supervision of the different components of cross-border banking groups. This provides a framework for the supervisors and competent authorities to carry out the tasks referred to in CRD IV.</p> <p>The roles that the ECB may have in supervisory colleges for significant banking groups are:</p> <p>Home supervisor for colleges where the ECB is the consolidating supervisor and which include supervisors from non-participating Member States (European colleges) or from countries outside the EU (international colleges); Host supervisor for colleges where the consolidating supervisor is from a non-participating Member State (or a country outside the EU).</p> <p>Where the ECB is the consolidating home supervisor, the JST coordinator acts as chair of the college, both in European and international colleges. The EBA Technical standards and Guidelines on supervisory colleges provide the basic framework for the functioning of the college, once adopted by the Commission. In this respect, the JST has to establish a cooperation and coordination agreement for the functioning of supervisory colleges that reflects its role as the competent authority within the SSM. If necessary, support from the Supervisory Policies Division, Crisis Management Division and DG L/SLA can be provided.</p> <p>In cases where the consolidating supervisor is not in a participating Member State, the rules on participation to colleges are those laid down in article 10 of the SSM Framework Regulation:</p> <ol style="list-style-type: none"> if the supervised entities in participating Member States are all SIs, the ECB shall participate in the college of supervisors as a member, while the NCAs shall be entitled to participate in the same college as observers; If the supervised entities in participating Member States are all less LSIs, the NCAs shall participate in the college of supervisors as members; If the supervised entities in participating Member States are both LSI and SI, the ECB and the NCAs shall participate in the college of supervisors as members. The NCAs of the participating Member States where the SIs are established shall be entitled to participate in the college of supervisors as observers. However, the ultimate decision on the participation of an NCA lies with the competent authority chairing the college. The overall SREP assessment and decision are shared with the host supervisors in the colleges. <p>Another form of supervision of cross-border banking groups is achieved through bilateral cooperation between either the ECB or NCA and a supervisory authority outside the SSM. Such a cooperation requires specific arrangements specifically regarding LSIs; these can be bank-specific; cover a wider range of supervised authorities; they can include issues such as the exchange of information, the possibility of carrying out on-site inspections, internal model approval, etc. Some of them can be issue-specific, like the exchange of information on</p>

	<p>Global Systemically Important Financial Institutions (G-SIFIs) under the Senior Supervisors Group (SSG). The need for bilateral cooperation can extend to the area of tasks not conferred upon the ECB by the SSM Regulation. As envisaged in Recital 29 of the SSM Regulation, the ECB should cooperate, as appropriate, fully with the national authorities which are competent to ensure a high level of consumer protection and the fight against money laundering.</p> <p>According to section 8 (3) KWG, BaFin cooperates with the other competent authorities within the EEA. The cooperation includes the exchange of information which is necessary for supervisory purposes. The identification of the group structure of all major credit institutions in a group is considered essential information which can materially influence the assessment of the financial soundness of the institution and shall, therefore, be communicated on the supervisor's own initiative. According to section 8e KWG, BaFin or the ECB in case of significant institutions establishes colleges of supervisors.</p> <p>As part of the ongoing supervision German banking supervisors conduct inspections on cross-border establishments which are included in the consolidation. These inspections according to section 44 (3) KWG in particular focus on risk management aspects as well as the accuracy of the data supplied for the consolidation pursuant to section 10a (4) to (7), section 25 (2) and (3) and Articles 11 to 17 CRR as last amended, insofar as this is both necessary to enable BaFin to perform its functions and permissible under the laws of the other state. This shall also apply to subsidiaries domiciled outside Germany which are not included in the consolidation.</p> <p>The BBk regularly visits New York, London and Singapore and have scheduled visits for New York and London in 2016. Other jurisdictions are visited as warranted by risks analyzed during colleges.</p>
EC5	<p>The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and takes appropriate supervisory action.</p>
Description and findings re EC5	<p>SSM framework requires supervisors to review activities of companies affiliated with parent companies which may have an impact on the safety and soundness of the group only in the case these are classified as "institutions," i.e. have investment firm or credit institution license. Otherwise, such assessment may be done based on national law.</p> <p>As described in ECs 1, 3 and 4, the ECB has the authority and responsibility to understand and assess the risks of cross-border and subsidiaries. For further information on the supervision of non-banking activities within a financial conglomerate see EC2. For cooperation and more on the supervision on parent companies see CP8 EC5 and EC8.</p> <p>As part of the ongoing supervision German banking supervisors may require information or conduct audits in accordance with section 44 (1) KWG. In addition to the direct rights of German banking supervisors to receive information and conduct audits in accordance with section 44 (1) and (1a) KWG, section 44 (2) and (3) KWG also grants them the right to request information from and perform audits on subsidiary enterprises within the meaning of Part 1 Title II Chapter 2 section 3 CRR in conjunction with section 10a KWG, both domestic and cross-border, as well as financial holding companies at the head of a financial holding group and mixed financial holding companies at the head of a mixed financial holding group and members of a governing body of such enterprises. These regulations also apply to subsidiaries not included in consolidation. In particular, this is to ascertain whether consolidation may be required.</p>

	Ring-fencing may be applied to the members of a mixed financial company and banking groups on an accounting consolidation sphere. Outward transactions may be limited also. KWG, section 46.
EC6	<p>The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that:</p> <ul style="list-style-type: none"> a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed; b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or c) the exercise of effective supervision on a consolidated basis is hindered.
Description and findings re EC6	<p>See CP 1 and CP 11 on supervisory powers. The ECB can restrict or limit the business, operations or network of institutions or request the divestment of activities that pose excessive risks to the soundness of an institution and require the reduction of the risk inherent in the activities, products and systems of institutions.</p> <p>In addition, the ECB has the power to grant authorization to take up the business as credit institution (licensing); if the applicable national law allows, when issuing the decision the ECB can limit the range of activities that are conducted and the locations in which they can be conducted within the consolidated group and of individual institutions.</p> <p>The aim of such assessment is to ensure that applying entities meet the relevant requirements, in particular on governance, conduct of business, prudential requirements and the business model, and fulfill the applicable national requirements. It consists of a detailed review and evaluation of the information in the application and other documentation requested by the NCA.</p> <p>Another power of authorization the ECB has regards the use as a remedial measure. An authorization may be withdrawn by the ECB on its own initiative (or on basis of a proposal from the NCA of the participating Member State where the credit institution is established) (SM Ch. 5 para 92).</p> <p>The range of activities groups of institutions or financial holding groups conduct depends on the type of license the individual group entities hold. As long as they do not violate these bounds and adhere to the respective supervisory and prudential rules, BaFin has no explicit supervisory powers to limit the group's activities or the locations in which they can be conducted.</p> <p>BaFin/ECB will, be informed if a German institution intends to take up business abroad and will object if this could encumber the supervision on a consolidated level. The same applies if a foreign investor intends to acquire a significant ownership in a German institution.</p> <p>Section 25a (2) sentence 2 KWG gives BaFin the right to issue instructions to institutions which are suited and necessary to set up / restore a proper business organization. Such instructions could, theoretically, also refer to the termination of activities or business lines which are not properly managed. If the supervision of representative offices and legally dependent branches by the institution itself is not adequate to the risks the respective office presents, BaFin/ECB may issue orders according to section 25a (2) sentence 2 KWG requiring the institution to implement adequate arrangements for managing, monitoring and controlling these risks or if this appears not possible to close the office.</p>

Apart from that, section 45b KWG allows BaFin to decree that the institution has to take risk reducing measures which could also include terminating or in-sourcing certain activities. Section 45b KWG also allows implementing a prior supervisory approval requirement for the establishment of further branches or prohibiting or limiting the conduct of certain activities.

Similar competences are contained in other provisions dealing with breaches of structural prudential rules or the treatment of institutions in economic difficulties. All rules also apply at group level.

However, German credit institutions are generally free to establish operations anywhere, i.e. they are permitted to operate representative offices, legally dependent branches or legally independent subsidiaries in any other country. In terms of legally independent subsidiaries, BaFin/ECB is authorized by section 12a (2) KWG to prohibit the continuation of the participating interest or of the corporate ties if the super-ordinated enterprise does not receive the information required to fulfill the obligations stipulated by sections 10a, 13 (3), 25 (1) KWG or legislative decrees according to sections 10 (1) sentence 1 KWG or 13 (1) sentence 1 KWG as well as obligations stipulated by articles 11 - 17 of CRR.

Furthermore, where a branch domiciled in a third country does not have a proper business organization, is not able to provide the information required to assess its business organization or its integration in the organization of the institution, is not properly supervised in the third country or the competent authority of the third country is not willing to cooperate with BaFin/ECB, BaFin/ECB is empowered to limit the business activities of the branch or to decree its closure and resolution, see Section 45b (2) sentence 2 KWG.

If a credit institution or an investment firm domiciled in another EEA member state, which has established a branch in Germany or is exercising its freedom to provide financial services, is not observing its obligations set out in section 53b (3) KWG, and neither the institution nor its competent home authority remedy the shortcoming or if the measures are not sufficient, BaFin/ECB may take the necessary measures, which can include prohibiting new business within Germany.

Where German institutions are subsidiaries of an institution in a third country without provisions for the consolidated supervision equivalent to the rules applying in the EEA / set out in the KWG, BaFin/ECB can determine the German subsidiary as the parent institution for the purposes of consolidated supervision (section 53d (1) KWG).

As long as an institution does not violate the license conditions, and the respective supervisory and prudential rules, BaFin has no explicit supervisory powers to limit the group's activities or the locations in which they can be conducted. BaFin/ECB will opine if a German institution intends to take up business abroad and will object if this could encumber the supervision on a consolidated level. The same applies if a foreign investor intends to acquire a significant ownership in a German institution.

Section 25a (2) sentence 2 KWG gives BaFin the right to issue instructions to institutions to set up / restore a proper business organization. Such instructions could, also refer to the termination of activities or business lines which are not properly managed. If the supervision of representative offices and legally dependent branches by the institution itself is not adequate to the risks the respective office presents, BaFin/ECB may issue orders according to section 25a (2) sentence 2 KWG requiring the institution to implement adequate arrangements for managing, monitoring and controlling these risks or if this appears not possible to close the office.

	<p>Apart from that, section 45b KWG allows BaFin to decree that the institution has to take risk reducing measures which could also include terminating or in-sourcing certain activities. Section 45b KWG also allows implementing a prior supervisory approval requirement for the establishment of further branches or prohibiting or limiting the conduct of certain activities. Similar competences are contained in other provisions dealing with breaches of structural prudential rules or the treatment of institutions in economic difficulties. All rules also apply at group level.</p> <p>However, German credit institutions are generally free to establish operations anywhere, i.e. they are permitted to operate representative offices, legally dependent branches or legally independent subsidiaries in any other country. In terms of legally independent subsidiaries, BaFin/ECB is authorized by section 12a (2) KWG to prohibit the continuation of the participating interest or of the corporate ties if the parent enterprise does not receive the information required to fulfill the obligations stipulated by sections 10a, 13 (3), 25 (1) KWG or legislative decrees according to sections 10 (1) sentence 1 KWG or 13 (1) sentence 1 KWG as well as obligations stipulated by articles 11 - 17 of CRR.</p> <p>Furthermore, where a branch domiciled in a third country does not have a proper business organization, is not able to provide the information required to assess its business organization or its integration in the organization of the institution, is not properly supervised in the third country or the competent authority of the third country is not willing to cooperate with BaFin/ECB, BaFin/ECB is empowered to limit the business activities of the branch or to decree its closure and resolution, see section 45b (2) sentence 2 KWG.</p> <p>If a credit institution or an investment firm domiciled in another EEA member state, which has established a branch in Germany or is exercising its freedom to provide financial services, is not observing its obligations set out in section 53b (3) KWG, and neither the institution nor its competent home authority remedy the shortcoming or if the measures are not sufficient, BaFin/ECB may take the necessary measures, which can include prohibiting new business within Germany.</p> <p>Where German institutions are subsidiaries of an institution in a third country without provisions for the consolidated supervision equivalent to the rules applying in the EEA / set out in the KWG, BaFin/ECB can determine the German subsidiary as the parent institution for the purposes of consolidated supervision (section 53d (1) KWG).</p> <p>Supervisors can ring-fence all consolidated entities.</p>
EC7	<p>In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group.³⁴</p>
Description and findings re EC7	<p>See CPs 8 and 9. In addition to supervising on a consolidated basis, the supervision also takes place on individual level in the group in order to gain a better understanding the group dimension. Within the SREP, the various assessments are performed at different frequencies, defined as a result of the SREP in the SEP (minimum engagement levels) are scoped by the SEP for each individual institution. Supervision takes place on a bank-by-bank SEP basis.</p> <p>Based on the available input and macro evidence, draft SEPs are formulated in detail by the JSTs for each significant institution. In practice, the macro-calendar of the supervisory activities regarding on-going supervision, on-site inspections and internal model investigations is defined. The JST also takes into account information provided by competent</p>

³⁴ Please refer to Principle 16, Additional Criterion 2.

	<p>authorities for other entities within the group, in particular in cases where the consolidated supervision of the group in question is the responsibility of an EEA home supervisor. All these activities, except in exceptional cases, are undertaken to comply with the minimum engagement level defined in the strategic planning process by the Planning and Coordination of SEP Division. The activities have to be prioritized to allow for a replacement buffer for possible ad hoc needs. The SEP is discussed in the core JST.</p> <p>According to the general principles stated in Part 1 Title II Chapter 1 of CRR institutions shall comply with the obligations laid down in Parts Two to Five and Eight of the CRR on an individual basis. The legal basis for the changes of the supervisory measures and sanctions is Art. 64 et seq. CRD IV. CRD IV was transposed into German law by the CRD IV Transposition Act (CRD IV-Umsetzungsgesetz) which entered into force on January 1, 2014.</p> <p>As part of the ongoing supervision section 44 (1) sentence 1 KWG grants German banking supervisors the right to request information and conduct audits on solo level. Additionally, section 44 (1) sentence 2 to 4 KWG grants them the right to conduct on-site inspections on solo level. The information and inspection rights according to section 44 (1) KWG also apply on group level.</p> <p>However, the powers are limited to monitoring the accuracy of the information or data transmitted that is necessary for supervision on a consolidated basis, or that is to be transmitted in the quarterly returns (please refer to the answer to Essential Criterion 5).</p>
Additional criteria	
AC1	For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit-and-proper standards for owners and senior management of parent companies.
Description and findings re AC1	<p>Significant ownership in banks by non-banks and corporates are permitted under the conditions set out by section 2c KWG. According to section 44b KWG, the holder of a significant ownership is subject to the same obligation to provide information and documents to the supervisor as the institution itself.</p> <p>Moreover, the KWG contains a number of indirect requirements for the owner of the institution or the holder of a significant ownership. If these persons or their statutory representatives fail to meet these requirements, BaFin/ECB can either deny the institution's license in the first place, revoke it at a later stage or prohibit a later acquisition of a significant ownership.</p>
Assessment of Principle 12	Compliant
Comments	Supervisors have the authority to conduct consolidated supervision and this was displayed to the assessors during reviews and presentations of the supervisory process. All relevant issues are considered and information is available to draw conclusions on a consolidated basis and the legal framework permits collection of needed information. Examples of cases where ring-fencing was applied were demonstrated.
Principle 13	Home-host relationships. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.

Essential criteria	
EC1	<p>The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.</p>
Description and findings re EC1	<p>See CP 12.</p> <p>Within the SSM, the ECB is exclusively competent for carrying out the supervisory tasks of Article 4 Regulation 2013/1024/EU for SIs. Rather than establishing colleges of supervisors, the joint supervision of SIs is being exercised in JSTs. According to Article 3 SSM Framework Regulation, each JST is comprised of staff members from the ECB and from the NCAs including National Central Banks (NCBs) where the NCA is not a central bank but cooperates with the NCB in the supervision based on national law.</p> <p>With regard to subsidiaries of SI's located outside the SSM, the ECB establishes colleges of supervisors in order to facilitate the exchange of information, to coordinate the supervisory activities and to ensure a consistent application of the prudential requirements. The ECB chairs the college of supervisors as consolidating supervisor. In this case, BaFin and Bundesbank participate in the colleges as observers (Article 9(1) SSM Framework Regulation). The supervisory college tasks are performed at least on an annual basis.</p> <p>The decision on the college membership or observer status of authorities is based on a mapping exercise, which is performed on the basis of Article 3 of EBA/RTS/2014/16. The mapping exercise identifies the entities (subsidiaries, branches, other financial sector entities) of a cross-border banking group and it determines and notes the significance of these entities for the local markets and the group. EBA is invited as college member by default. On the basis of Article 4 of EBA/RTS/2014/16, the competent authorities responsible for the supervision of subsidiaries of an EU parent institution or of an EU parent financial holding company or of an EU parent mixed financial holding company and the competent authorities of host Member States where significant branches as referred to in Article 51 of Directive 2013/36/EU are established as well as ESCB central banks of Member States that are involved in accordance with their national law in the prudential supervision of the legal entities, but which are not competent authorities can participate in the colleges as members. Competent authorities of host EU Member States where non-significant branches are established, so-called third country supervisory authorities (from countries which are not EU Member States) and other relevant authorities may be invited to participate in the colleges as observers.</p> <p>After identification of possible college members and observers, the ECB invites the potential members and observers. College members discuss and agree on the scope and level of involvement of observers, if any, in the college. The framework of observers' participation in college is recorded in the written coordination and cooperation arrangements. Colleges are structured depending on the size of the banking group and its activities. All college members and observers are attending a General College, which is the basic form of college. If needed, other possible college structures besides the General College are the Core College (no third-country supervisors, supervisors of the most important group entities attending), the Crisis Management Group and Cross Border Stability Groups (see BCP 13 EC05), Resolution Colleges (not yet in place) as well as subgroups depending on the specific needs (for instance, Liquidity Subgroup).</p>

	<p>The establishment and the functioning of supervisory colleges are elaborated in written cooperation and coordination arrangements (WCCA), which, among other issues, specify arrangements for information exchange and cover observers' participation in the college.</p> <p>The ECB establishes regular cooperation with college members that can take the form of meetings (at least annually) or other activities. Where the ECB acts as host supervisor, it participates in the college as a member. Depending on the ultimate decision of the home supervisor, the JST's NCAs participate as observers.</p> <p>BaFin as NCA in cooperation with Bundesbank remains responsible for college-activities that concern LSIs. According to Article 8 (3) KWG, BaFin and Bundesbank shall cooperate with the relevant EEA authorities as well as the EBA and ESMA when supervising cross-border institutions. In cases where the BaFin is home supervisor of an EEA institution or host supervisor of an EEA institution, it transfers the relevant data to the responsible authorities. They exchange with them all relevant and fundamental information which may affect the assessment of an institution's financial situation in the EEA state in question. Information to be exchanged comprises inter alia information on liquidity difficulties or trustworthiness and professional qualifications of persons entrusted with the management of an institution or holders of significant holdings.</p> <p>According to section 8e KWG, colleges of supervisors have been established. As described in Article 8e (1) and (2) KWG, information exchange between college members (home and host supervisors) is one task of the colleges. College members have to guarantee the confidentiality level of Title VII Chapter I Section II. Section 9 (1) sentence 4 no. 9 KWG provides that information can be exchanged with competent authorities in EEA member states and third countries when working together in colleges of supervisors established according to the new section 8e KWG. BaFin and Bundesbank cooperate closely under this section.</p> <p>Regarding third countries, the relevant provisions are Article 53 c and d KWG, which establishes the principle of host supervision and gives BaFin the respective competencies.</p>
EC2	<p>Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group³⁵ and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.</p>
Description and findings re EC2	<p>See CP 3 and EC 1.</p> <p>Commission Delegated Regulation (EU) 2016/98 or Commission Implementing Regulation (EU) 2016/99 on information exchange between home and host competent authorities specify the kind of information that supervisory authorities are required to share, including:</p> <ul style="list-style-type: none"> • information on capital requirements for credit, market, operational and settlement risks and on additional own fund requirements (i.e. Pillar 2 add-ons) for all other risks and elements of risk; • information on institutions' violations of requirements on internal control mechanism, including risk management, risk control and internal audit.

³⁵ See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

	<p>Commission Delegated Regulation (EU) 2016/98 sets the information exchange for performing group risk assessments and reaching joint decisions, including on the assessment of inherent individual risks and risk management and controls (art. 10). It also requires that the information exchanged be adequate, accurate and timely.</p> <p>EBA Guidelines on common procedures and methodologies for SREP require competent authorities to discuss and coordinate - within the framework of supervisory colleges – the outcomes of their assessments, including SREP scores assigned to various elements, and the overall SREP assessment and overall SREP score at consolidated and entity level, focusing on the risks that are identified as material for the respective entities.</p> <p>Article 48 of CRD IV entitles the European Commission to draft proposal (to be then submitted to the European Council) for the negotiation of agreements with one or more third (i.e. non-EU) countries regarding the means of exercising supervision on a consolidated basis, in particular to ensure adequate exchange of information.</p>
EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	<p>See CP 3 and EC 1.</p> <p>Commission Delegated Regulation (EU) 2016/98 and Commission Implementing Regulation (EU) 2019/99 contain provisions on information exchange and coordination between the consolidating supervisor and college members for a number of tasks: for performing group risk assessments and reaching joint decisions; with regard to the ongoing review of the permission to use internal approaches and non-material extensions or changes in internal models; on early warning signs, potential risks and vulnerabilities; with regard to non-compliance and sanctions; for the assessment of the group recovery plan; for the assessment of the group recovery plan; and with regard to group financial support agreements.</p>
EC4	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings re EC4	<p>See CP 3.</p> <p>Commission Implementing Regulation (EU) 2016/99 establishes a number of requirements in terms of communication between the college members and with the supervised entities; in particular, they require that:</p> <ul style="list-style-type: none"> • written coordination and cooperation arrangements include a description of the communication policy of the consolidating supervisor and the members of the college with the EU parent undertaking and with the group entities; • the communication with the institution and its branches shall be organized according to the supervisory responsibilities of the consolidating competent authority and the members of the college (art. 28); in general, the consolidating supervisor shall be responsible for communicating, including requesting information, to the EU parent undertaking, while the members of the college shall be responsible for communicating, including requesting information, with the EU institutions and EU branches under their supervisory remit;

	<ul style="list-style-type: none"> the members of supervisory colleges ensure that any external communication is done in a coordinated way and covers elements which are agreed ex ante. <p>Commission Delegated Regulation (EU) 2016/98 also regulates the coordination of external communication in an emergency situation (art. 22, 37).</p> <p>Article 48 of CRD IV entitles the European Commission to submit proposals to the European Council for the negotiation of agreements with one or more third (i.e. non-EU) countries regarding the means of exercising supervision on a consolidated basis, in particular to ensure adequate exchange of information.</p> <p>BaFin and Bundesbank have agreed with many other foreign supervising authorities on information sharing and exchange in bilateral and multilateral memoranda of understanding according to the Core Principles of Effective Banking Supervision of the Basel Committee.</p>
EC5	<p>Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.</p>
Description and findings re EC5	<p>KWG) and SAG provide a comprehensive framework for cross-border crisis cooperation and coordination, as required by the relevant European directives, CRD IV and the Bank Recovery and Resolution Directive (Directive 2014/59/EU, BRRD).</p> <p>Pursuant to sections 6, 7 and 9 KWG and 138 SAG, BaFin is both empowered and required to share information on crisis preparation and to effectively cooperate with other relevant authorities including the European Banking Authority (EBA). According to section 138 (2) SAG BaFin has to inform the resolution authority in case of imposing crisis preparation or early intervention measures immediately. If the supervisory authority or resolution authority concludes that an institution or an entity of a group is failing or likely to fail, they have to inform BaFin, Bundesbank and FMSA, the relevant deposit guarantee scheme, the group-level supervisory authority (including the consolidating supervisor), the group-level resolution authorities (including the resolution authority of Member States where the consolidating supervisory authority is located), the Financial Stability Committee and the European Systemic Risk Board immediately. As in case of other aspects of home host relationships, supervisory colleges and/or resolution colleges play a key role in this regard. The SAG provides for colleges, in which the home and host supervisors of cross-border banking groups share information of crisis preparation, especially effective handling of crisis situations. For this the SAG envisages the establishment of resolution colleges (section 156 SAG).</p> <p>The specific procedures for the planning and coordination of supervisory activities in preparation for and during emergency situations, including the minimum set of information to be exchanged during an emergency situation, are laid out in written coordination and cooperation arrangements (WCCA) for each supervisory college. Please note that these WCCA are currently being negotiated with the college members of SI for which the ECB is either a host or a home supervisor. These WCCA also include provisions regarding the framework for providing coordinated input to the resolution college. Such a framework addresses, inter alia, the group resolution plans, the assessment of the group resolvability, powers to address or remove impediments to the group resolvability, as set out in Directive 2014/59/EU.</p>

EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	<p>The KWG and SAG provide a comprehensive framework for cross-border crisis cooperation and coordination, as required by the relevant European directives, CRD IV and the BRRD.</p> <p>Pursuant to sections 6, 7 and 9 KWG and 138 SAG, BaFin is both empowered and required to share information on crisis preparation and to effectively cooperate with other relevant authorities including the EBA. According to section 138 (2) SAG BaFin has to inform the resolution authority in case of imposing crisis preparation or early intervention measures immediately. If the supervisory authority concludes that an institution or an entity of a group is failing or likely to fail, they have to inform BaFin, Bundesbank and FMSA, the relevant deposit guarantee scheme, the group-level supervisory authority (including the consolidating supervisor), the group-level resolution authorities (including the resolution authority of Member States where the consolidating supervisory authority is located), the FSC and the European Systemic Risk Board immediately. In all cases confidentiality must be ensured. As in case of other aspects of home host relationships, supervisory colleges and/or resolution colleges play a key role in this regard. The SAG provides for colleges, in which the home and host supervisors of cross-border banking groups share information of crisis preparation, especially effective handling of crisis situations. For this the SAG envisages the establishment of supervisory colleges (section 8e KWG combined with section 2 paragraph 3 No. 8 SAG) and of resolution colleges (section 156 SAG).</p> <p>In this context, the members shall endeavor to reach a joint decision on e.g., the review and assessment of the group recovery plan, the application of measures referred to in section 16 SAG (Section 17 and 18 SAG) or coordinate early intervention measures and the appointment of a temporary administrator in relation to groups (section 39 SAG).</p> <p>Group-level resolution authorities shall establish resolution colleges, and optionally, to ensure cooperation and coordination with third-country resolution authorities, carry out the following tasks: exchanging information relevant for the development of group resolution plans, for the application to groups preparatory and preventive powers and for group resolution; developing group resolution plans pursuant to section 46 and 47 SAG; assessing the resolvability of groups pursuant to section 58 SAG; exercising powers to address or remove impediments to the resolvability of groups pursuant to section 60 SAG, deciding on the need to establish a group resolution scheme as referred to in section 161 to 165 or 166 SAG; reaching the agreement on a group resolution scheme proposed in accordance with section 161 to 165 or 166 SAG; coordinating public communication of group resolution strategies and schemes; coordinating the use of financing arrangements; setting the minimum requirements for groups at consolidated level under section 49 to 54 SAG. In addition, the resolution colleges may be used as a forum to discuss any issues relating to cross-border group resolution.</p> <p>Members of the resolution college shall be, according to section 157 SAG, the resolution authority, the group-level resolution authority, the resolution authorities of each Member State in which a subsidiary covered by consolidated supervision is established, the resolution authorities of Member States where a parent undertaking of one or more institutions of the group is established, the resolution authorities of Member States in which significant</p>

	<p>branches are located, the Bundesbank, the ECB (if it is the competent consolidating supervisor), the competent authority, the competent authorities of the Member States where the resolution authority is a member of the resolution college (where the competent authority of a Member State is not the Member State's central bank, the competent authority may decide to be accompanied by a representative from the Member State's central bank), the MoF, the competent ministries (where the resolution authorities which are members of the resolution college are not the competent ministries), the authority that is responsible for the deposit guarantee scheme and the authority that is responsible for the deposit guarantee scheme of a Member State, where the resolution authority of that Member State is a member of a resolution college.</p> <p>The transposition of the EU Bank Recovery and Resolution Directive (BRRD) into German law has significantly strengthened the existing resolution regime in Germany.</p> <p>Institutional arrangements have undergone fundamental change with the implementation of the SSM and Single Resolution Mechanism (SRM). The SRB has assumed responsibility to ensure effective resolution of ECB-supervised banks along with several other German banks with cross-border operations in other EU jurisdictions effective January 1, 2016. The SRB is supported in this task by Internal Resolution Teams in which FMSA, the national resolution authority will play an important role. While the SSM is establishing a track record, the SRM is still in a start-up phase.</p> <p>The German authorities are making significant progress in recovery and resolution planning. Having adopted a requirement for large domestic banks to have recovery plans in 2013, this is now also being implemented in additional banks, including potentially systemic institutions (PSI) supervised by the domestic authorities, and to small banks by 2017. Similarly, resolution planning and resolvability assessments are being implemented in all PSIs.</p> <p>The resolution framework constrains the participation of third country authorities in Resolution Colleges, as well as their access to confidential information. However, in practice, the German authorities have developed a good track record of coordination with countries outside of the EU. The authorities should continue efforts to foster cooperation with non-EU countries, despite gaps in the European framework.</p> <p>The resolution framework currently requires the resolution authority to take into account the effects of a resolution decision in other EU Member States, but not the effects in third countries. It is understood that the aforementioned cooperation in Resolution Colleges and Crisis Management Groups (CMGs) will also address these effects.</p>
EC7	<p>The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.</p>

Description and findings re EC7	<p>Licensing and supervision of branches is accomplished by the SSM if the branch is significant. Applications to establish branches are filed with BaFin.</p> <p>In accordance with section 53b KWG (implementing article 40 (1) of CRD IV, the principle of home state supervision applies to branches in Germany of institutions based in member states of the EEA. But even in their role as host competent authorities, BaFin and Bundesbank still have several competencies in compliance with CRD IV, for example regarding liquidity provisions, reporting requirements, rights of access to data, suitable arrangements for managing, monitoring and controlling risks.</p>
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	The special regulation stipulated in section 53 (1) sentence 1 KWG determines that branches of foreign credit institutions with domicile in states outside the EEA are subject to the supervision of the host country (Germany).
EC8	The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	Home supervisory authorities are regularly granted access to inspect branches and subsidiaries of foreign institutions in Germany on the basis of KWG Section 44a (2) to the extent that the requesting jurisdiction grants reciprocal inspection possibilities and the inspection is discussed with the BaFin/ the ECB SSM in advance. Section 53b (6) KWG expressly grants foreign supervisory authorities in the EEA states an audit opportunity after prior notification of BaFin/ the ECB SSM. Additionally, section 44a (2) KWG allows BaFin/ the ECB SSM to permit banking supervisory authorities from other EEA-states – and if reciprocity is granted also non-EEA states – to check the accuracy of data transmitted by a German enterprise to certain enterprises abroad, if the transmission of data is necessary to comply with the prudential provisions on the enterprise domiciled abroad, as provided in the Banking Directive.
EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	Art. 13 of CRD IV requires that competent authorities grant a banking license only where at least two persons effectively direct the business of the applicant; and every bank has its head office in the same Member State as its registered office or in the Member State where it is licensed and it actually carries out its business. Branches of third countries are supervised by BaFin and are required to maintain capital. There are no shell banks or booking offices in Germany.
EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	To the extent possible, BaFin notifies the respective competent authorities of any measures it intends to take against breaches of an institution based on information provided by the competent authorities (section 8 (8) KWG). Examples were provided of action taken based on information from the home country supervisor.
Assessment of Principle 13	Compliant
Comments	Member states are fully incorporated in the supervisory process. Third countries are provided the same arrangements through the MOU process if they meet the equivalency test for EU protection of confidential information.
B. Prudential Regulations and Requirements	
Principle 14	Corporate governance. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the

	banks' Boards and senior management, ³⁶ and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
EC1	Laws, regulations or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings re EC1	<p>In Germany there is a two-tier structure for the Board, where the Supervisory Board exercises the oversight function and the Management Board the Executive function. For purposes of the assessment therefore, "Board" will mean the oversight function, i.e., the Supervisory Board, and "senior management" will mean the executive function, i.e., the Management Board. In a one tier Board of Directors, both senior managers and directors representing shareholders and independent directors are present. Therefore, duties and responsibilities assigned by laws and regulations to the Board of Directors cover both tiers of the German board structure. In a two tier structure the laws and regulations and the duties and responsibilities that apply to the "Board" would need to address and be applied proportionally to the supervisory board and the management board.</p> <p>In Germany, the structure of banking enterprises and credit institutions is essentially governed by the HGB, and the Stock Corporation Act.</p> <p>The corporate governance structure for banks can be summarized in the following terms:</p> <ul style="list-style-type: none"> • Incorporated enterprises, have a dual board structure with a management board and a supervisory board (two tier system): • The management board is the executive organ, which runs and, to that extent, is also responsible for day-to-day business (known at a public limited company as the board of management and at a private limited company as the board of managing directors). • The supervisory board is responsible for supervising the management board (known at a public limited company as the supervisory board, this body is not mandatory at a private limited company and its creation is in principle optional). The supervisory board is appointed by a decision-making body representing the shareholders which is responsible for major decisions (the general meeting at a public limited company and the shareholders' meeting at a private limited company). <p>According to KWG, an institution shall have in place a proper business organization which ensures compliance with the legal provisions to be observed by the institution as well as business requirements. The management board is responsible for ensuring the institution's proper business organization; it shall take the necessary measures to formulate the applicable internal guidelines except where such decisions are taken by the supervisory board. A proper business organization shall comprise, in particular, appropriate and effective risk management, on the basis of which an institution shall continuously safeguard its internal capital adequacy; risk management shall comprise, in particular,</p> <ol style="list-style-type: none"> 1. the definition of strategies, in particular the definition of a business strategy geared to the institution's sustainable development and a risk strategy that is consistent

³⁶ Please refer to footnote 27 under Principle 5.

	<p>therewith, as well as the establishment of processes for planning, implementing, assessing and adjusting the strategies;</p> <ol style="list-style-type: none"> 2. processes for determining and safeguarding internal capital adequacy, which shall be based on a conservative determination of risks and of the available financial resources to cover them; 3. the establishment of internal control mechanisms consisting of an internal control system and an internal audit function, whereby the internal control system shall comprise, in particular, <ol style="list-style-type: none"> (a) rules on the organizational and operational structure that include a clear delineation of competencies, (b) processes for identifying, assessing, managing as well as monitoring and reporting risks in accordance with the criteria laid down in Title VII, Chapter 2 Section II Sub-Section 2 of CRD IV, and (c) a risk control function and a compliance function; <p>The MaRisk, issued by BaFin, provides guidance on supervisory expectations for sound corporate governance. The MaRisk is a proportionate framework, which sets detailed qualitative requirements to expand on section 25a KWG. Responsibilities arising from the statutory obligations laid down in section 25a KWG lie with the management board (AT 3 MaRisk). Section 25c, and further elaborated in AT 1 MaRisk, risk management creates a basis for the proper performance of the supervisory board's monitoring function and thus shall also include the adequate involvement of the supervisory board. Section 25c establishes the management board responsibility for the business strategy, internal control system, governance and the business strategy on a solo and group-wide basis. The management board is required to inform the supervisory board of the risk situation at least quarterly.</p> <p>Further to 25c, the internal audit function reports to the management board and the supervisory board at appropriate intervals and at least once per quarter. As implemented, in MaRisk AT 4.4.3: the internal audit function is an instrument of the management board being directly subordinated and reporting to it or to a single member of the management board. In cases observed, the internal audit reports to the CEO.</p> <p>According to section 25d (6) KWG, the supervisory board shall oversee the management board, also with regard to its adherence to the applicable prudential supervisory requirements. This applies in consequence also for the requirements laid down in section 25a and section 25c KWG.</p> <p>The BCP standards place increased emphasis on the role of the supervisory board's oversight of management and the institution. Historically, post-mortem of bank failures and crises revealed that passive and un-informed supervisory boards played a significant role in risk management failures. As a result, there is an increased focus on the role and level of engagement that the supervisory board must demonstrate in developing, promoting and monitoring risk management and a culture of corporate governance.</p> <p>While Germany has well-developed corporate governance requirements, as implemented, the oversight role of the supervisory board is passive and its operational oversight role is limited. The fit-and-proper process is streamlined for supervisory board members as are technical knowledge requirements. Operationally, discussions with Bundesbank and BaFin staff</p>
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	confirmed that their ongoing supervision focuses on the management board and there is less frequent substantive interaction with the supervisory board.
EC2	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.
Description and findings re EC2	<p>For SIs, governance is assessed on a continuous basis as part of SREP. Corporate Governance and risk management is one of the four modules that make-up the SSM SREP and includes 1) internal governance, 2) risk framework and risk culture, and 3) risk infrastructure, data and reporting. In addition, governance is one of the four priorities of the SSM strategy and is being reviewed as a thematic review of all the SIs. The primary focus includes; boards' functioning and effectiveness, and 2) the risk appetite framework. As part of its off-site analysis JSTs have been building a database of corporate governance practices by completing a survey of the banks' governance practices and structures.</p> <p>On LSIs, BaFin and Bundesbank, on a regular basis monitor compliance with Ma Risk which contains the governance guidance issued by BaFin. Bundesbank conducts off-site monitoring through institution-specific information requested by the analysts. In addition, on-site inspections are conducted by Bundesbank that include reviewing compliance with MaRisk corporate governance requirements. BaFin may send representatives to supervisory board meetings (Section 44 (4), (5) KWG). However, attendance is more on an observer status rather than to discuss the bank's condition.</p> <p>BaFin may request all relevant information and conduct local inspections according to section 44 (1) KWG. With these tools, BaFin assesses whether the institution meets the respective requirements of section 25a KWG and of the MaRisk. In addition, based on section 29 (1) sentence 2 No. 2.a) KWG, in its annual report, the banks' external auditor has to determine whether the institution has fulfilled the requirements of section 25a KWG and of the MaRisk.</p> <p>A review of supervisory documentation disclosed communications with banks requiring corrective action and the use of capital add-ons as appropriate based on SREP reviews.</p>
EC3	The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members.
Description and findings re EC3	<p>Section 25d (11) KWG specifies in detail the tasks which shall be performed by the nomination committee of an institution's supervisory board (or the supervisory board as a whole if no nomination committee has been established), including the support of the supervisory board in identifying candidates to fill management board vacancies and preparing proposals for the selection of members of the supervisory board; in so doing, the nomination committee shall take into account the balance and diversity of the knowledge, skills and experience of all members of the board in question, prepare a job description with a candidate profile, and state the time commitment associated with the task (Section 25d (11) sentence 2 No. 1 KWG).</p> <p>Pursuant to Section 25d (7) sentence 1 KWG significant CRR-institutions shall, depending on their size, internal organization and the nature, scope, complexity and riskiness of their activities establish committees, which advise and support the supervisory board in its functions. Proportional to the complexity of the bank, the committees should include: risk,</p>

	<p>audit, remuneration and nomination. The supervisory board does not contain senior management of the bank.</p> <p>The SSM internal procedures include the sub-section "Organizational structure" within the Internal Governance and Risk Management Assessment. In this context, the analysis of the processes for nominating and appointing the Board members includes also the criteria applied for selecting these members and the existence of a succession plan. The assessment is also focused on the composition and functionality of the Board and the management body as well as in the evaluation of the different Board Committees, particularly the Audit, Risk and Remuneration Committees. Also other committees have to be assessed, if they are established (e.g., Nomination/human resources/governance/Ethics/Compliance committees. Furthermore, the analysis aims at understanding how each Committee operates, develops its charter to perform its mandate and reports to the Board. This is contained in the scope of the thematic review of 2015.</p> <p>BaFin/Bundesbank conduct on-site reviews as appropriate. External auditors must review compliance with the MaRisk requirements on corporate governance and the results may lead to further follow-up by the regulators.</p>
EC4	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty." ³⁷
Description and findings re EC 4	<p>The ECB carries out the assessment of the suitability ('fit-and-proper') of members of management bodies of significant credit institutions, having regard to Articles 4(1)(e) and 16(2)(m) of the SSM Regulation and Article 93 of the SSM Framework Regulation. In the SSM internal procedures, this topic is addressed every time there is an appointment of a new board member and in the assessment of Internal Governance in the SREP, and more specifically in the part of Organizational structure and governance. Key function holders should be identified and their qualifications and experience ascertained in the context of their competence in their position. Managers should be of good repute have appropriate professional expertise and experience in a diversity of relevant areas so as to ensure that collectively they can make sound, objective and independent decisions and judgments.</p> <p>The concept of suitability is defined in Section 25c KWG for members of the management board of a credit institution and Section 25d KWG for members of the supervisory board. In addition to requirements relating to professional qualification it also covers reliability and the availability of sufficient time to perform the respective functions as well as limitations of mandates.</p> <p>Members of the supervisory board (cf. Section 25d (1) KWG) have to possess an adequate degree of expertise to exercise their control function and to assess and monitor the transactions entered into by their undertakings. The required expertise depends on the scope and complexity of the undertakings` business activities.</p>

³⁷ The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables", 2003, www.oecd.org/dataoecd/19/26/23742340.pdf.) defines "duty of care" as "The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a 'prudent man' would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."

	<p>In discussing the determination of fit-and -proper with Bundesbank and BaFin staff, it was revealed that the process for determining suitability for supervisory board members is streamlined as compared with management board members. For example, the expertise standard may be met by attending a banking seminar. The role of the supervisory board is not viewed as one responsible for the safety and soundness of the bank and the responsibility is placed on the management board as evidenced by interactions with the bank in the supervisory process, and KWG and MaRisk. A proposed revision to MaRisk will include a requirement for institutions to have in-place a code of conduct.</p> <p>With the establishment of the SSM the assessment procedure of fitness and propriety of Supervisory Board members of SIs has been harmonized.</p>
EC5	<p>The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite³⁸ and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.</p>
Description and findings re EC5	<p>In Germany, most of the responsibilities referred to in this EC are assigned to the management board and not to the supervisory board. According to section 25c (3) no. 1 KWG the management board, as part of their overall responsibility, is inter alia, responsible for the bank's strategic direction, risk appetite and strategy, and related policies to ensure a proper business organization. A proper business organization is defined in section 25a KWG and are specified in the MaRisk. According to section 25c (4a) KWG, the management board of an institution shall inter alia ensure that the institution has a business strategy in place geared to the institution's sustainable development and a risk strategy that is consistent therewith, as well as processes for planning, implementing, assessing and adjusting the strategies pursuant to section 25a (1) sentence 3 number 1 KWG. The role of the supervisory board is more generally described as oversight of the management board. External auditors are required by BaFin to review and certify bank compliance with MaRisk and the law. Additionally, Bundesbank in its on-site inspections and off-site reviews compliance also.</p> <p>Thematic reviews of Risk Governance and Risk Appetite were conducted by the SSM. The SSM internal procedures include areas to be addressed: risk appetite should be addressed when discussing strategic decisions; detailed policies on conflicts of interest; internal process for communicating conflict of interest policies to staff; supervisors should discuss with board the relationship between the risk appetite statement and the business strategy; review how often the board reviews the risk appetite compliance; determine whether board and senior management have clear views on which business lines pose the greater risk; and whether board/management determine employee morale. The reviews highlighted deficiencies in corporate governance concerning qualifications and involvement of the supervisory board in oversight of management and made recommendations in strengthening internal audit reporting to supervisory board.</p> <p>In on-site inspections BBk places significant emphasis on risk management and governance concerning the management board.</p>
EC6	<p>The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit-and-proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's</p>

³⁸ "Risk appetite" reflects the level of aggregate risk that the bank's Board is willing to assume and manage in the pursuit of the bank's business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms "risk appetite" and "risk tolerance" are treated synonymously.

	execution of Board strategies, including monitoring senior management's performance against standards established for them.
Description and findings re EC6	<p>Section 25d (11) KWG specifies in detail the tasks which shall be performed by the nomination committee of an institution's supervisory board (or the supervisory board as a whole if no nomination committee has been established), including the support of the supervisory board in identifying candidates to fill management board vacancies and preparing proposals for the selection of members of the supervisory board; in so doing, the nomination committee shall take into account the balance and diversity of the knowledge, skills and experience of all members of the board in question, prepare a job description with a candidate profile, and state the time commitment associated with the task (Section 25d (11) sentence 2 No. 1 KWG). In general, credit institutions are required to have in place a sound business organization, including suitable staffing levels (cf. Section 25a (1), sentences 1 and 3 No. 4 KWG, Section 25c (4a) No. 4 KWG). With regard to a suitable staffing level, MaRisk states more precisely: "Staff members and their deputies shall possess the expertise and experience needed for their tasks, competencies and responsibilities. Appropriate measures shall be taken to ensure that staff is suitably qualified." (cf. MaRisk AT 7.1, (2)).</p> <p>Pursuant to Section 25d (7) sentence 1 KWG significant CRR-institutions shall, depending on their size, internal organization and the nature, scope, complexity and riskiness of their activities establish committees, which advise and support the supervisory board in its functions. The members of the committees shall have the necessary knowledge, skills and experience to perform the respective committee functions (Section 25d (7) sentence 3 KWG). CRR institutions within the meaning of the KWG are credit institutions and investment firms within the meaning of Article 4 (1) number 1, respectively Article 4 (1) number 2 CRR (cf. Section 1 (3d) KWG). The committees which shall be established by such institutions shall include a risk committee (Section 25d (8) KWG) and an audit committee (Section 25d (9) KWG), which may be combined if this is appropriate in consideration of the size, internal organization and the nature, scope, complexity and riskiness of the activities of the undertaking (Section 25d (1)0 KWG), i.e., when they are not considered significant based on the aforementioned criteria. Furthermore, a nomination committee (Section 25d (11) KWG) and a remuneration committee (Section 25d (12) KWG) shall be established when the institution is considered significant based on the aforementioned criteria. If the institution is not considered CRDIV significant, this function should be fulfilled by the supervisory board as a whole.</p> <p>BaFin also issued the Guidance Notice for Assessing the Professional Qualifications and Reliability of Managers in Accordance with the Banking Supervision Act. The supervisors determine compliance, and assessors were provided evidence of performance of the external audit reviews and Bundesbank/SSM reviews.</p>
EC7	The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.
Description and findings re EC7	The ECB seeks to determine that the bank's Board actively oversees the design and operation of the remuneration system. The compensation system and incentive structure should promote good performance, convey acceptable risk-taking behavior and reinforce the bank's operating and risk culture. The board is responsible for the overall oversight of the compensation system for the entire bank, and must regularly monitor and review (at least

	<p>annually) outcomes to ensure that the bank-wide compensation system is operating as intended.</p> <p>Furthermore, banks that are considered to be significant for these purposes should have a supervisory board level remuneration committee to oversee the compensation system's design and operation on behalf of the board of directors. The remuneration committee should be constituted in a way that enables it to exercise competent and independent judgment on compensation policies and practices and the incentives created for managing risk, capital and liquidity.</p> <p>In addition, according to section 25a (5) KWG, institutions shall set appropriate ratios between the variable and fixed annual remuneration components for (all) employees and management board members. The variable remuneration component shall not exceed 100 percent of the fixed remuneration component for each individual employee or management board member. The shareholders, proprietors or members of the institution may decide whether to approve a higher variable remuneration component; this higher remuneration component shall not exceed 200 percent of the fixed remuneration component for each individual employee or management board member.</p> <p>In case of a violation of the capital requirements, BaFin can, according to section 45 (1) sentence 1 no. 5a KWG order an institution to limit the total annual amount designated for the variable remuneration of an institution to a certain proportion of the profit for the year or to completely cancel it; this does not apply to variable components of remuneration established in a collective wage agreement or within its scope of application through an agreement of the contracting parties on the application of the provisions of the collective wage agreement or on the basis of a collective wage agreement in a plant-level or service agreement.</p>
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	SSM and Bundesbank/BaFin ensure that banks maintain detailed records on the organizational structure and these are discussed with the management board. The information was shared with the assessors, including disclosing the data systems and the ability to massage the data and drill down on to determine affiliates.
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	<p>If facts are found from which it can be inferred that members of the management board or of the supervisory board no longer meet the applicable suitability requirements, BaFin can demand their dismissal and prohibit them from further carrying out their positions (Section 36 (1) in conjunction with section 35 (2) No. 3 and section 33 (1) No. 2, 4 et seqq. KWG, section 36 (3) No. 1-3 and 6-10 KWG, section 2d (2) No. 1 KWG).</p> <p>BaFin may also demand the dismissal of members of the management board or prohibit them from further carrying out their positions if they have intentionally or recklessly contravened provisions of the relevant supervisory law or orders issued by BaFin and persist in such behavior despite having been duly warned by BaFin (section 36 (2) KWG, section 2d (2) No. 2 KWG). With regard to members of the supervisory board, BaFin may demand a dismissal or prohibit them from further carrying out their positions , if they were unaware of</p>

	<p>serious violations of the principles of proper management by their institution due to careless exercise of their oversight and control function and such behavior persists despite due warning by BaFin (Section 36 (3) No. 4 KWG) or if they did not do everything needed to counter detected infringements and continue to refrain from doing so despite due warning by BaFin (Section 36 (3) No. 4 KWG). However, BaFin will in most cases send an informal letter of disapproval to the credit institution in advance of formal measures and thus work toward adequate corrective measures by the institution itself. Assessors were provided with an example where BaFin required supervisory board changes.</p> <p>The ECB has the power to remove members of the management boards of SIs who do not fulfill the requirements set out in relevant legislation.</p>
Additional criteria	
AC1	Laws, regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management.
Description and findings re AC1	Management board or supervisory board have to report information that may affect the fitness and propriety of members of the bank's management bodies, such as information on (qualifying) participating interests (section 24 (1) No. 10, 13, (1a) No. 2, 3, (3) sentence 1 No. 2 KWG), close links with natural persons or other undertakings (section 24 (1) No. 12, (1a) No. 1KWG), loans to shareholders (who might at the same time be members of the management board or supervisory board) who own more than 25 percent of the capital or voting rights if these have not been granted on market terms or are not adequately secured in line with banking practice (section 24 (1) No. 17a, (1b) No. 1KWG) and activities of members or the management board (section 24 (3) sentence 1 No. 1 KWG) and members of the supervisory board (section 24 (2a) KWG) as members of the management board or supervisory board of another undertaking.
Assessment of Principle 14	Largely Compliant
Comments	<p>In Germany there is a two-tier structure for the Board, where the Supervisory Board exercises the oversight function and the Management Board the Executive function. For purposes of the assessment therefore, "Board" will mean the oversight function, i.e., the Supervisory Board, and "senior management" will mean the executive function, i.e., the Management Board. In a one tier Board of Directors, both senior managers and directors, representing shareholders and independent directors, are present.</p> <p>The KWG, Commercial Code and Stock Corporation Act establish a proper framework for corporate governance; a supervisory board with an oversight of the management board. A lesson-learned from the crisis that started in 2007 was that management oversight by the supervisory board (Board) had been passive and too reliant on management recommendations. As a result, the core principles were revised and emphasis increased on corporate governance.</p> <p>Currently, in Germany, the role of supervisory boards is in general weak and passive with most policy, and risk management duties and responsibilities placed on the management board. In the past few years there has been some evolution on supervisors focus on the supervisory board and a thematic review on corporate governance has been conducted with recommendations made on making the supervisory board involvement more robust. Additionally, MaRisk is being amended and will include code of conduct requirements.</p>

	<p>Most supervisory interactions are with the management board. Internal audit is not required to report directly to the supervisory board. Operationally, the internal audit function reports to the management board. The supervisors copy the supervisory board on important communications but the letters and discussions are largely with the management board. Discussions with bank supervision staff confirmed that communication and interaction with the supervisory board on issues are limited. Fit-and-proper and technical knowledge requirements for the supervisory board are also light. It is recognized that the legal framework provides opportunity for an assertive board to expand its role and based on discussions with banks, it may take place, to a limited extent, in the larger banks.</p> <p>Findings of the BCP assessment indicate the following actions are needed to strengthen the role of the supervisory board:</p> <ul style="list-style-type: none"> • Supervisory guidance should clearly state that ultimate responsibility for establishing the risk culture, developing business plans and risk appetite statement rests with the supervisory board. • Supervisory enforcement and sanctioning programs should explicitly address supervisory board member liability. • The knowledge/experience requirements for supervisory board members should be commensurate with the complexity of the bank. • Reporting to the board should be frequent and with sufficient detail to enable the board members to challenge management. • Banking supervisors should continue to increase dialogue and discussions with the supervisory board on results of supervisory activities and concerns.
Principle 15	<p>Risk management process. The supervisor determines that banks³⁹ have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate⁴⁰ all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank.⁴¹</p>
Essential criteria	
EC1	<p>The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define</p>

³⁹ For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

⁴⁰ To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

⁴¹ It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.

	<p>the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that:</p> <ul style="list-style-type: none"> (a) a sound risk management culture is established throughout the bank; (b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) uncertainties attached to risk measurement are recognized; (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Description and findings re EC1	<p>According to section 25a (1) sentence 3 of the KWG, banks have to establish an appropriate and effective risk management on the basis of which an institution shall continuously safeguard its internal capital adequacy. Risk management shall comprise in particular:</p> <ul style="list-style-type: none"> • the definition of strategies, in particular the definition of a business strategy geared towards the institution's sustainable development and a risk strategy that is consistent therewith, as well as the establishment of processes for planning, implementing, assessing and adjusting the strategies; • processes for determining and safeguarding internal capital adequacy, which shall be based on a conservative determination of risks and of the available financial resources to cover them; • the establishment of internal control mechanisms consisting of an internal control system (comprising rules on the organizational and operational structure that include a clear delineation of competencies; processes for identifying, assessing, managing as well as monitoring and reporting risks in accordance with the criteria laid down in Title VII, Chapter 2 section II Sub-section 2 of CRD IV; a risk control function and a compliance function) and an internal audit function; • adequate staffing and technical and organizational resources; • the definition of an adequate contingency plan, especially for IT systems; • suitable and transparent remuneration systems for both management board members and employees geared towards the institution's sustainable development. <p>These requirements are specified in the MaRisk (the current version is dated 2012; a revision to MaRisk was out for comment). Due to its holistic approach, MaRisk is aimed at the management of all material risks of an institution. The circular has a modular structure: a general part (AT module) provides basic principles for risk management (e.g., strategies, internal procedures to ensure the risk-bearing capacity, general requirements for the internal control system, including stress testing and risk reporting, requirements for new product processes and outsourcing). Specific requirements with regard to the organization of the lending and trading business are set forth in special parts (BTO modules). Taking due account of risk concentrations, the MaRisk also list requirements for the identification, assessment, management, monitoring and communication (which is synonymously used for reporting) and management of credit risk, counterparty risk, market price risk (including interest rate risk), liquidity risk and operational risk (BTR modules). Another BT module (BT 2) also provides a framework for the internal audit function of institutions.</p>

The philosophy of proportionality is important in regards to risk management standards for German banks as specified in KWG. The risk management processes and mechanisms are to be proportionate to the nature, scale, and complexity of risks inherent in the business model and the institution's activities.

Articles 97 & 98 of the CRD provide the basis for the supervisory review and examination of a bank's risk management processes. The EBA guidelines contain detailed instructions for the supervisory review and assessment of all aspects of an institution's corporate governance and risk management, upon which the SSM has developed its internal procedures. Title 5 of the SREP guideline contains detailed instructions for the supervisory review and assessment of internal governance and institution-wide controls. Relevant sections of the SREP guideline include: Overall internal governance framework; Corporate risk culture; Risk management framework; Risk appetite and strategy; Internal control framework; Information systems and business continuity; Recovery planning

Importantly, the SREP guideline emphasizes the need for involvement of the managing body (Board) and senior management. Equally, the SREP guideline details a framework for the supervisor to engage and review the role of the Board and senior management proportionate with its size, scale, complexity and risk profile. However, the SREP as applied to German banks directs responsibility to the Management Board as opposed to the Supervisory Board, and in this way the oversight function is expected to be conducted by the Management Board (see also CP14).

The SREP methodology serves as an overall review of the institution's operational and organizational structure, overall risk control and risk management framework and the technical architecture supporting the risk management framework and practice. The assessment covers three main aspects: i) The institution's internal governance framework (including key control functions such as risk management, internal auditing, and compliance); ii) Its risk management framework and risk culture; iii) Its risk infrastructure, internal data and reporting.

According to the framework, the assessment of risk management includes the following categories: board, risk management function, organizational structure and operation of the risk management function. When assessing the institutions on their risk management framework as a whole (and not per risk), the JSTs assess whether the overall risk management framework is appropriate to both the scale and complexity of this institution. The JST should also look at whether the risk management function ensures that it is adequately staffed and sufficiently independent both in terms of quality and quantity of human resource that is allocated to the function and if it maintains links with operational lines.

As discussed above, the CRO is also assessed; the criteria are amongst others whether the CRO has the necessary experience and skill, bears the responsibility for risk management and is able to give the risk perspective significant weight within the institution with regard to significant business decisions. The JSTs have established regular quarterly meetings with a number of representatives from SIs, including the CRO. The meetings are often targeted at particular risk issues and serve as an effective means for the JST to monitor risk management on an ongoing basis. By contrast LSIs are visited far less regularly but at least annually a meeting with the Management Board will take place. Supervisory engagement with the CRO for LSIs will depend and reflect the risk profile with an ability to increase where necessary. More frequent meetings with the LSI CRO are exceptional and event based rather than ongoing.

Assessors saw examples that the supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Management Boards and

	<p>that the Management Board sets a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. While the Supervisory Board is able to obtain reporting regarding the implementation of the risk management framework, compliance with limits etc. the accepted practice in the system is for the management Board to take primary responsibility for this function as opposed to the Supervisory Board or sub-committees of the Supervisory Board. In this case, the Supervisory Board plays a more passive role which is contrary to the spirit of this EC.</p>
EC2	<p>The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:</p> <ul style="list-style-type: none"> (a) to provide a comprehensive “bank-wide” view of risk across all material risk types; (b) for the risk profile and systemic importance of the bank; and (c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank’s risk management process.
Description and findings re EC2	<p>See also EC1. MaRisk adopts a holistic approach for the management of all material risks a bank is exposed to. According to AT 2.2 no. 1 MaRisk the management board shall, regularly and on an ad hoc basis, gain an overview of the risks faced by the institution in the context of a risk inventory (overall risk profile) in order to assess whether or not a single risk is material. According to MaRisk, the following risks shall at least be deemed as material by every institution: counterparty and credit risk (including country risk), market risk (including interest rate risk), operational risk, liquidity risk.</p> <p>Risk concentrations associated with material risks shall likewise be taken into account (as a single risk category or as risks associated with other risks). In this meaning – and besides risk exposures to single counterparties which constitute a risk concentration on account of their size alone - risk concentrations can arise both from a co-movement of risk positions within a risk type (“intra-risk concentrations”) and from a co-movement of risk positions across different risk types (due to common risk factors or interactions between various risk factors of different risk types – “inter-risk concentrations”) (annotations to AT 2.2 no. 1 MaRisk).</p> <p>SIs are required to have a comprehensive risk management framework for all material risks. In their assessment of risk management, JSTs have to evaluate Internal Governance. Furthermore, the supervisor must assess the risk management policies and processes from different perspectives, to understand if they are comprehensive and adequate.</p> <p>JSTs have to assess risk management at the Board and Risk Committee level, to understand their awareness and their effective involvement in establishing those policies. JSTs have to assess if risk committee draws up risk management policies and the definition of the institution’s risk appetite for presentation to and approval by the management body in its supervisory function. It’s also to be analyzed if documents validated by the management body in its management function clearly reflect the institution’s risk management policies, in particular the existence of limits in relation to its risk strategy. Assessors saw evidence where JSTs met with BRC/BAC to assess risks management.</p> <p>An important step in this review is the assessment of the Risk Appetite Framework (RAF), to understand its use in strategic decision-making processes, considering that: (1) a bank’s overall risk profile is ultimately driven by its RAF and its implementation; (2) the RAF should link risks undertaken with the bank’s risk capacity and strategic objectives. From the</p>

	<p>processes perspective, the JST will verify whether the RAF implemented by the bank are adequate, especially considering the risk management function and the business lines, assessing their capability to provide a comprehensive “bank-wide” view of risk across all material risk types (including risk profile and systemic importance of the bank and risks arising from the macroeconomic environment).</p> <p>In performing a risk management function assessment, the JST should be aware that a sound and consistent risk culture is one of the key elements of effective risk management. Implementing appropriate standards for professional and responsible behavior throughout the institution should help reduce the risks to which an institution is exposed. In this context, the JSTs have to understand if the management body in its management function carries out periodic evaluations of the adequacy of the risk management function, possibly on the basis of the work performed by the internal audit department.</p> <p>A risk inventory is the starting point for the institution’s examination of which risks impair its financial position (including its capital resources), financial performance or liquidity position (“materiality”; AT 2.2 no. 2 MaRisk). In this context, risks arising from off-balance sheet entities (e.g., risks from special-purpose entities not subject to consolidation) shall be taken into account. Depending on the institution’s specific overall risk profile, other risks, such as reputational risks or business risks, should be considered material, where appropriate (annotations to AT 2.2 no. 2 MaRisk).</p>
EC3	<p>The supervisor determines that risk management strategies, policies, processes and limits are:</p> <ul style="list-style-type: none"> (a) properly documented; (b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank <p>The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank’s Board where necessary.</p>
Description and findings re EC3	<p>Supervisors use a variety of techniques to assess that risk management strategies, policies, processes and limits are effectively implemented and communicated within the bank (see also CP 8 & 9). Off-site analysis through the receipt and review of policies and processes; the annual EA long form report, periodic engagements with banks staff (including IA, risk management and Management Board); and in the case of SIs meetings with the Chair of the BAC and BRC.</p> <p>(a) To determine whether the risk management strategies, actions etc. are properly documented the supervisor assesses the risk appetite statement. Furthermore, there should be adequate documentation and formalization of the operation in place that can prove the establishment and on-going monitoring of risk appetite as well as material changes to existing risk appetite levels and regulatory expectations regarding risk appetite. From a supervisory perspective, the JSTs have to assess if the risk appetite statement is simple enough to be easily communicated and understood and at the same time sophisticated enough to be useful, it can be expressed through a series of documents. If that is the case, the supervisor determines whether the risk appetite statement is coherent and comprehensive enough to enable the Board to form a view of the bank’s risk appetite easily.</p> <p>The institution-wide risk appetite statement is often the first step, but it must not be the last. An effective risk appetite statement should at the least be allocated to various business lines, divisions and subsidiaries and closely aligned with their business plans. To accommodate this,</p>

	<p>the risk appetite statement must include quantitative metrics that can be easily aggregated and attributed to different business lines, divisions or subsidiaries.</p> <p>(b) When assessing the risk appetite framework, an important question that needs to be assessed by the JSTs is whether there are appropriate mechanisms in place to ensure that the risk appetite, risk management strategy, and business strategy are effectively aligned and embedded in decision-making and operations at all appropriate levels of the institution. This means that the mechanisms in place must be regularly reviewed and adjusted appropriately. The JSTs furthermore assess how often risk management strategies are updated (per risk). The sets of limits in place (per risk category) in the organization must be consistent with the risk management strategy and risk appetite of the institution.</p> <p>When assessing the risk management and control within the institution, it is important that if there are any exceptions to the policies made, these exceptions should be identifiable and well recorded by the institution, issues related to it must also be resolved. Of course, there must be sufficient compliance.</p> <p>(c) Through on-site examinations the JST in conjunction with ECB specialist teams (DG IV) confirm that policies and processes as well as culture are consistent with the overall RAF and tone at the top.</p> <p>Specifically for LSIs:</p> <p>(a) properly documented;</p> <p>At first the institution shall ensure that the contents of and adjustments to the strategies (business and risk strategy) shall be communicated within the institution in a suitable manner (which implies an appropriate documentation of the strategies; AT 4.1 no. 6 MaRisk). Furthermore, the institution shall ensure that business activities are conducted on the basis of organizational guidelines (e.g., manuals, work instructions or workflow descriptions). These guidelines shall be set down in writing and communicated to the staff members concerned in a suitable manner. It shall be ensured that the latest version of these guidelines is available to these staff members. The guidelines shall be swiftly amended in the event of changes to the activities and processes (AT 5 MaRisk).</p> <p>More concretely the organizational guidelines shall contain, in particular, the following:</p> <p>rules governing the organizational and operational structure as well as the allocation of tasks, the assignment of competencies, and responsibilities,</p> <ul style="list-style-type: none"> • - rules governing the organization of the risk management and risk control processes, • - rules governing the internal audit function, • - rules which ensure observation of legal rules and regulations (e.g., data protection, compliance), • - rules governing procedures for material outsourced activities and processes. <p>(b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and</p> <p>According to section 25a (1) sentence 5 KWG the appropriateness and effectiveness of the risk management (and its components; see preliminary remarks) shall be reviewed at regular intervals.</p>
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	<p>Moreover, the management board shall set up a strategy process which includes, in particular, the steps for planning, implementing, assessing and adjusting the strategies. By this way it is ensured that the objectives defined in the strategies and their achievement are meaningfully reviewed. The causes of any deviations shall be analyzed (AT 4.2 no. 4 MaRisk). Additionally, changes in risk appetite, risk profile and external factors (market factors, macroeconomic environment) can feed in the strategy planning process and lead to adjustments of the strategies.</p> <p>As said above the risk management and risk control processes shall be swiftly adjusted to changing conditions (AT 4.3.2 no. 7 MaRisk).</p> <p>While the structural and organizational arrangements also comprise controls embedded in the processes, the internal audit function (as a unit independent from these processes) has to audit the effectiveness and appropriateness of risk management in general, and the internal control system in particular, as well as the orderliness of all activities and processes regardless of whether these are outsourced or not (according to AT 4.4 no. 3 MaRisk).</p> <p>(c) communicated within the bank.</p> <p>According to AT 4.2 no. 6 MaRisk the contents of and adjustments to the strategies shall be communicated within the institution in a suitable manner. Furthermore, the organizational guidelines – on which the conduct of business have to be based - shall be set down in writing and communicated to the staff members concerned in a suitable manner (and shall enable the internal audit function to conduct an audit review; AT 5 no. 5 MaRisk). It shall be ensured that the latest version of these guidelines is available to these staff members. The guidelines shall be swiftly amended in the event of changes to the activities and processes (AT 5 MaRisk no. 2).</p> <p>The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary.</p> <p>Generally, information which is important from a risk point of view has to be communicated immediately to the management board, the responsible members of staff and, where appropriate, the internal audit function, so that appropriate measures and/or audits can be initiated at an early stage (AT 4.3.2 item 8 MaRisk). Substantial limit exceeds are subject to risk reporting (BTR 1 no. 7 MaRisk – credit risk; BTR 2.1 no. 5 MaRisk – market risk) and have to be followed by management decisions and actions. Credit decisions of material importance which deviate from the strategies should also be included in the regular reporting to the management board (BTR 1 no. 7 MaRisk).</p>
EC4	<p>The supervisor determines that the bank's Board and senior management obtain sufficient information on, and understand, the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.</p>
Description and findings re EC4	<p>Relevant articles of the CRD include: 74, 76, 97, 98 and 99. (See also EC 1). Article 97 sets out the expectations for NCAs to regularly review the activities, processes, arrangements and mechanisms to assess the risks to which the institution is exposed to. Specifically, paragraph 3 states the NCA shall determine whether the arrangements, strategies, processes and mechanisms implemented by institutions and the own funds and liquidity held by them ensure a sound management and coverage of the risks. The EBA guidelines (SREP and GL44) provide a description of expectations for an institution's managing body and senior</p>

	management in the risk management process (see EC1 – EC3). Specifically, Article 22.7 sets out an expectation regarding reporting mechanisms to management body and all relevant units. Guidelines do not provide an expectation that the Board or senior management regularly review the implications and limitations of risk management information.
EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	<p>The SREP guidelines establish a sound framework for the assessment of the ICAAP which broken down into a structured process of four elements. The concept of economic capital models is established in the ICAAP process for a large number of banks. To date, the assessment of the ICAAP has mainly been used as an input into the risk assessment and has not gone a step further and assessed the need for Pillar 2 add-ons. This process was completed in 2015 for SIs and for LSIs will be conducted starting in 2016 mainly driven by the need to align with the new EBA guidelines.</p> <p>Assessors confirmed that ICAAP assessments in Germany are an established process that commenced in 2008/09. An assessment of the ICAAP is also included as part of the on-site examination in certain circumstances and is a key input into the annual meeting with the Management Board. Capital plans are not typically included in the ICAAP but an assessment of capital is conducted to form a view about the risk bearing capacity of an institution. Typically, the review of the ICAAP will include, inter alia: risk strategy, risk appetite, risk organization, methodologies to measure capital, and an assessment of all Pillar 1 and Pillar 2 risks.</p> <p>Stress testing is an integral part of the ICAAP assessment process. LSIs are obliged to run various scenarios to assess the adequacy of capital as well as reverse stress tests.</p> <p>The ICAAP and ILAAP process forms the basis of a comprehensive evaluation of banks' capital and liquidity adequacy (CRD 2013/360 article 97). The internal arrangements to be reviewed as part of SREP comprise the ICAAP set out by article 73 CRD IV and the ILAAP set out by article 86 CRD IV and in the EBA Guidelines on SREP. In application of the CRD, the ECB is the competent authority to carry out the SREP.</p> <p>The ICAAP comprises of a risk-by-risk assessment of risks to capital in normal and under stressed conditions, these risks are i.e.: Credit and counterparty risk (article 79 CRD IV); Market risk (article 83 CRD IV); Operational risks (article 85 CRD IV); and Interest rate risk in the banking book (IRRBB) (Title 6 EBA Guidelines SREP).</p> <p>The assessments feed into a preliminary determination of a capital requirement to cover those risks and an assessment of capital adequacy.</p> <p>The ILAAP comprises of a risk-by-risk assessment of risks to liquidity and funding under normal and under stressed conditions. These assessments feed into a preliminary determination of a liquidity requirement to cover those risks and an assessment of liquidity adequacy. For further information on capital and liquidity see BCP 16 and BCP 24.</p> <p>The Board and senior management should be committed to establish, monitor and adhere to an affective RAF which is to be supported by an appropriate risk appetite statement underpinning the financial institution's risk management strategy.</p> <p>According to the SSM's internal procedures, a bank's overall risk profile is ultimately driven by its risk appetite framework (RAF) and its implementation. An effective RAF is a practical one which explicitly sets the boundaries within which the bank's management is expected to</p>

operate on achieving the bank's strategic business objectives. Its group-wide reach requires that implementation of an effective RAF involves a combination of policies, processes, controls, systems and procedures. All these elements should be carefully assessed by the JSTs, which should in particular analyze whether the framework is fully integrated into decision-making processes and group-wide risk management and closely aligned with the bank's business plan, strategy and capital planning and employee remuneration practice.

It is by means of its risk appetite statement that a bank identifies material risks under normal and stressed conditions and sets out a clear and unambiguous view and intended actions with regard to those risks, in line with its business strategy.

EBA guideline GL44 sets out the expectations for a bank to develop forward-looking and backward-looking tools for the identification and measurement of risks (see paragraph 22.3-5). SREP guideline sets out supervisory activities to assess the adequacy and soundness of capital and liquidity against a bank's inherent risk appetite. The SREP establishes the expectations for banks to fully consider all risks to capital within its ICAAP (see also CP16) and to liquidity in the ILAAP (see also CP24). Within the SREP guideline, specific reference to the activities expected of a supervisor when assessing an ICAAP and ILAAP include paragraphs 94 – 102.

The legal basis for a comprehensive assessment of capital and liquidity adequacy for LSIs is established in MaRisk. According to AT 4.2 no. 2 the management board in its executive function shall define a risk strategy that is consistent with the business strategy and its stated risk profile. In particular, risk tolerance levels (which are synonymously used for "risk appetite") shall be set for all material risks, taking account of risk concentrations. Risk concentrations shall also be taken into account with regard to the institution's profit situation (profit concentrations).

Currently the MaRisk are under revision to implement, amongst others, the aspect of an appropriate risk culture more explicitly. According to that the members of the management board (executive function) have the responsibility to develop, promote and integrate an appropriate risk culture within the institution and the group. In addition to that a code of conduct shall be developed as part of the organizational guidelines of the institution.

According to AT 4.1 MaRisk each institution shall establish an Internal Capital Adequacy Assessment Process (ICAAP). The institution's internal capital adequacy shall be taken into account when defining the strategies (AT 4.2) and adjusting them. Moreover, suitable risk management and risk control processes (AT 4.3.2) shall be put in place for implementing the strategies and ensuring internal capital adequacy.

The ICAAP of the institution is based on a conservative determination of risks and of the available financial resources to cover them and shall ensure that risks are constantly covered by available financial resources ("internal capital"). Furthermore, the procedures used for internal capital adequacy management shall take due account of ensuring an institution's continuation as a going concern and protecting creditors against economic losses.

According to MaRisk, the institution is responsible for choosing the methods and procedures for assessing internal capital adequacy. The assumptions underlying the methods and procedures are substantiated within the ICAAP and assessed by the supervisors. These reviews take due account of the limits and constraints arising from the methods and procedures employed, the underlying assumptions and the input data used in quantifying the risk. Assessors confirmed through meetings with banks and reviewing files that the ICAAP review process is a well-established process for assessing all material risks and calibrating the risk profile against an estimation of risk-bearing capacity.

	<p>In this respect the robustness and significance of the risk quantification shall be analyzed critically (e.g., by the means of a model validation). Additionally, German supervisors have published supervisory guidelines on the assessment of bank-internal capital adequacy concepts (published in January 2013). These guidelines specify supervisory expectations with respect to the appropriateness and effectiveness of institution-internal ICAAP (without prescribing a certain method or procedure; institutions are self-responsible for the selection and arrangement of such methodologies), especially with the view to the quality and composition of internal capital on one hand and to the risk measurement methodology (e.g., risk horizon, strictness of risk measurement etc.) on the other hand. The ICAAP has to be supplemented by a capital planning process which shall cover a suitably long period of several years. At least quarterly overall risk reports shall be submitted to the management board.</p> <p>As well as to “capital-related” risks a risk appetite statement is also required for liquidity risk (as part of the risk strategy; see above; AT 4.2 no. 2 MaRisk). Moreover, suitable risk management and risk control processes (AT 4.3.2) shall be put in place for implementing the strategies and ensuring that the material risks (which shall include liquidity risk) are identified, assessed, managed, monitored and reported. On this basis appropriate and effective liquidity risk management processes shall be implemented to ensure that the institution can meet its payment obligations at any time. This comprises the draw up of a liquidity overview for an appropriate period of time, frequent verification that it has permanent access to the funding sources that are relevant to it; sufficient sustainable liquidity reserves (buffers); a suitable internal allocation system for liquidity costs, benefits and risks; the conduct of appropriate stress tests on regular basis; a liquidity shortfall contingency plan and frequent risk reporting concerning liquidity risk to the management board (BTR 3.1). Furthermore detailed and stricter requirements concerning the quality and amounts of liquidity buffers as well as the assumptions underlying the stress tests are laid down in BTR 3.2 MaRisk for capital market oriented institutions.</p>
EC6	<p>Where banks use models to measure components of risk, the supervisor determines that:</p> <ul style="list-style-type: none"> (a) banks comply with supervisory standards on their use; (b) the banks’ Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) banks perform regular and independent validation and testing of the models <p>The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
Description and findings re EC6	<p>Article 78 of CRD requires that NCAs shall ensure that institutions permitted to use the internal approaches for the calculation of risk weighted exposure amounts or own fund requirements except for operational risk report the results of the calculations of their internal approaches for their exposures or positions that are included in the benchmark portfolios. According to this Article, institutions shall submit the results of their calculations, together with an explanation of methodologies used to produce them, to the NCA at an appropriate frequency, and at least annually.</p> <p>The EBA RTS on the assessment criteria includes a comprehensive set of expectations for the development, analysis, validation and verification of internal models that includes the need for models to be regularly and independently validated by independent bodies within the bank and for the managing body to be aware of the assumptions and inputs into models.</p>

	EBA has also produced an RTS on the conditions for assessing the materiality of extensions and changes of internal approaches for credit, market and operational risk which is aimed at harmonizing the assessment of the materiality of extensions and changes to internal model approaches across NCAs. This RTS specifies the conditions for assessing the materiality of extensions and changes to help drive consistency and compliance with the regulations.
EC7	The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.
Description and findings re EC7	SSM internal procedures are based on the EBA guidelines. GL44 sets out the expectations for an institution to have an effective and reliable information and communication system covering all its significant activities (see paragraph 30). Paragraph 26 sets out the overall expectations for an institution's risk control function (RCF) to identify, monitor, and manage all risks across the enterprise. The RCF should ensure that an institution's internal risk measurements and assessments cover an appropriate range of scenarios and are based on sufficiently conservative assumptions regarding dependencies and correlations. Furthermore, the RCF should ensure that all identified risks can be effectively monitored by the business units. The SREP guideline describes the supervisor activities to test and assess an institution's information systems (see paragraphs 106 & 107) where supervisor's should assess whether an institution has effective and reliable information systems and whether these systems fully support risk data aggregation capabilities at normal times as well as during times of stress. According to the SREP guideline, NCA's should assess whether an institution is at least able to: generate accurate and reliable risk data capture and aggregate all material risk data across the institution, generate aggregate and up-to-date risk data in a timely manner, and generate risk data to meet a broad range of on-demand requests from the management body or NCA.
EC8	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products, ⁴² material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings re EC8	MaRisk establishes the requirements for the new product process to have due regard to risk management. According to AT8.1, each institution shall have a sound understand of the business activities it conducts and decide on a strategic plan before commencing business activities involving new products. Supervisors of LSIs typically discuss new products through frequent contact and at least annually as part of the annual meeting with the Management Board. In relation to SIs, JSTs conduct periodic meetings with several layers of the management structure and importantly with heads of business to understand the business strategies and new products. The business model analysis as part of the SREP framework provides the JST with a structured process to assess the risks from new products. Assessors

⁴² New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	saw evidence where this process was working effectively and that the approval process was prudent.
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	SSM internal procedures are based on EBA's guidelines. GL44 sets out detailed criteria for the composition and functioning of the risk management function to be sufficiently resourced, independent and have access to the bank's board (see also EC1). The SREP guideline sets out the supervisory activities to assess the adequacy and functioning of the risk management framework. Paragraph 88 of the SREP guideline states that the supervisor should assess whether effective interaction exists between the management and the supervisory functions of the management body and the setting, overseeing and regular assessment of the internal governance framework with its main components by the managing body. Paragraph 104 sets out the supervisory assessment to ensure there is an independent risk control function (104 (a) to (d)). This paragraph also ensures that the independent risk function has the capacity to report directly to the management body.
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and findings re EC10	This EC has not been met. MaRisk 4.4.1 paragraph 5 only requires ex-post notification to the supervisory Board if the CRO is removed.
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	MaRisk sets out comprehensive standards for risk management including Pillar 1 risks (credit, market, operational risks) and IRRBB and liquidity as required in this EC. MaRisk is anchored in KWG section 25(a). Specifically in relation to the requirements of this EC: Credit risk – BTO 1; Market Risk – BTR2.2; Operational Risk – BTR4; IRRBB – BTR 2.3; Liquidity – LiqV.
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.
Description and findings re EC12	MaRisk sets out requirements for contingency plans (see AT7.3). Banks are required to establish plans in relation to disruption to time critical activities and processes aimed at reducing potential damage. As per this section, the plans are required to ensure back-up solutions are swiftly available in the event of contingencies. On-site examinations conducted by BBk and

	<p>BaFin routinely included an assessment of contingency plans as part of the overall review of compliance with MaRisk and more recently through dedicated IT risk on-site examinations.</p> <p>In relation to recovery planning, German legislation has expanded the earlier recovery plan obligations to include all banks, regardless of size, and elaborated on related powers and procedures. Requirements for recovery plans are adequate and in line with EBA standards and guidelines. Recovery plans must be submitted for review to BaFin and the Bundesbank and, where appropriate, to the ECB. FMSA also reviews recovery plans in the context of its resolution planning.</p> <p>All potentially SIs must prepare full scope plans. This includes the 22 banks/groups supervised by the ECB and 12 supervised by BaFin/Bundesbank. By early 2016 all such banks have submitted revised plans (in most case) or initial plans (in a few cases). The plans are to be submitted early each year. Feedback is to be provided by the authorities by mid-year and the banks then have 6 months in which to revise and resubmit their plans. This annual procedure is expected to result in continuous iteration, improvement and deepening of plans. Reportedly recovery plans are increasing imbedded into banks' strategic and risk management functions, which is a key medium term objective.</p> <p>In principle private banks with assets of less than € 30 billion will be able to submit plans under simplified obligations, though the bank's supervisors can propose to require more rigorous requirements, including full scope plans. Most savings banks and cooperative banks are expected to not have to prepare recovery plans, and will instead be covered under recovery plans developed by their respective IPSs. BaFin and Bundesbank have been meeting with the Institutional Protection Scheme (IPSS) to agree requirements and procedures for doing so. Savings and cooperative banks will retain the option to prepare their own plans, for example where the bank's supervisory board requests that management do so.</p> <p>The JST is formally responsible for reviewing recovery plans, and in practice the BaFin and Bundesbank sub-coordinators and staff are actively involved in the analysis, supported by horizontal (technical expert) units in BaFin, Bundesbank and ECB. Recovery plans are assessed using a standard template adopted by the ECB, itself based in part on inputs from the German authorities. The initial results of the assessment are presented during a meeting with the bank which provides feedback. In general, for each plan BaFin staff then prepares a draft feedback letter to the bank summarizing the assessment and indicating required improvements. The letter is finalized by the ECB JST coordinator in consultation with the JST members and sent by the ECB to the banks. The JST transmits its assessment of the recovery plans to the group's supervisory college when one exists, and has to take into consideration the views of college members in assessing the plan. The SRB and FMSA also review the recovery plans with a view to identifying any actions that may adversely impact the resolvability of the bank/group.</p>
EC13	<p>The supervisor requires banks to have forward-looking stress testing programmes, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing programme and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing programme:</p>

	<p>(a) promotes risk identification and control, on a bank-wide basis</p> <p>(b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks;</p> <p>(c) benefits from the active involvement of the Board and senior management; and</p> <p>(d) is appropriately documented and regularly maintained and updated.</p> <p>The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing programme or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process.</p>
Description and findings re EC13	<p>According to AT 4.3.3 (MaRisk) banks have to conduct stress tests regarding all material risks on a regular and ad-hoc basis. These stress tests shall reflect the nature, scale, complexity and riskiness of the institution's business activities. Furthermore, the stress tests shall cover the assumed risk concentrations as well as diversification effects within and between risk types. Risks resulting from off-balance-sheet entities and securitization transactions are also to be taken into account. In addition, these stress tests shall consider exceptional but plausible events. Historical as well as hypothetical scenarios should be represented taking into account changes of the institution's strategic orientation and its economic environment. This includes issues on capital adequacy and future capital development as well. Additionally, the stress tests shall be used to analyze the impact of a severe economic downturn on the firm-wide level of the institution. Furthermore, the institution shall carry out reverse stress tests.</p> <p>In order to assess a SI's risk from the macroeconomic perspective, the JST uses 'stress-tests' of the various risks, which allows for other factors to be taken into account in combination with gaining a possible forward-looking perspective. In line with EBA guidelines 2014/13 and 2010/32 on stress testing, SIs need to develop their own stress-testing programs and demonstrated to supervisors how they use the outcomes for risk management and internal liquidity adequacy assessment purposes.</p> <p>In accordance with the SSM's SREP methodology, the reliability of SI's ICAAP is assessed as part of Element 3 block 2. In block 3 the supervisor challenges the internal capital stressed estimates. A similar approach applies to the internal assessment of institutions' liquidity needs. When the JST assesses the use of stress testing by the bank, they assess both governance and documentation including that the tests are conducted regularly and if they are reported to the board. The JST also made an assessment of whether the outcome of the testing is integrated in the overall risk management framework (for capital and liquidity), and whether assumptions and scenarios are regularly reviewed and updated. This last step is typically a more detailed process and required interviews and discussions with various management personnel. Assessors viewed examples where this had taken place.</p> <p>Another factor that is tested by the supervisors is the management of capital and liquidity positions, namely by documenting the procedures, the reports and limits. With regard to how the supervisor assesses whether the bank's board and management obtain sufficient information concerning the risk analysis and if the risk management strategies, policies, processes and limits that are in place are adequate within the institution, we refer you to the answers given in BCP 15 EC 03 and EC 04.</p> <p>For the LSI sector, stress test results are reviewed critically and the need for action derived from this review should be established (e.g., capital backing, closer monitoring of risks).</p>

	When evaluating the risk-bearing capacity the stress test results are considered by the supervisor mainly as part of the ICAAP assessment in preparation for the annual meeting with the Management Board. The larger and more complex banks demonstrated a sound approach to stress testing and more recently have invested resources into stressing IRRBB. As part of the ICAAP, supervisors expect institutions to quantify all material risks with strict risk measures and parameters based on rare loss constellations at least in one risk management steering approach. This requirement does not affect to conduct further stress testing.
EC14	The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.
Description and findings re EC14	See also EC1. EBA SREP guideline sets out detailed guidance for supervisors to perform business model analysis as part of the SREP. Within the guideline, supervisors are expected to include both qualitative and quantitative factors which include risks associated with their internal pricing, performance measurement and new product approval (see paragraph 72). Supervisors are expected to determine the plausibility and consistency of the assumptions made by the institution that drive its strategy and forecasts; these may include assumptions in areas such as macroeconomic metrics, market dynamics, volume and margin growth in key products, segments and geographies (see paragraph 72(d)). Assessors saw evidence that during the process of performing analysis of the business model, JSTs assess elements contained in this EC. SSM internal procedures incorporate EBA's Guidelines.
Additional criteria	
AC1	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	MaRisk requires banks to have due regard to all material risks and the measures to be taken to manage those risks (MaRisk AT 4.2). Based on their overall risk profile, institutions are required to ensure that all material risks are constantly covered by available financial resources thus maintaining capital adequacy (MaRisk AT4.1). Through the requirements of MaRisk, banks are required to have appropriate policies and processes for assessing material risks. This process has typically taken place as part of the ICAAP where banks assess their Pillar 1 and Pillar 2 risks and make an assessment of capital based on its risk profile. Assessors confirmed that the ICAAP process is established as part of the supervisory process and included an assessment of Pillar 1 and Pillar 2 risks such as: strategic risk, reputation risk, conduct risk etc. SSM internal procedures for the SREP incorporate EBA's guidelines. The SREP guidelines include guidance for supervisors to assess Pillar 1 and Pillar 2 risks. All material risks including coverage of the key vulnerabilities to which an institution's business model and strategy are exposed to or maybe exposed to, including: Poor expected financial performance; Reliance on an unrealistic strategy; Excessive concentrations or volatility; Excessive risk-taking; Funding structure concerns; and Significant external structures Furthermore, the SREP includes consideration of assessing the sustainability of an institution's strategy and the risk level of the strategy.

Assessment of Principle 15	Largely compliant
Comments	<p>The risk management standards for German banks are anchored in MaRisk which require banks to have regard to all material risks calibrated against a bank's risk bearing capacity. MaRisk has been revised on several occasions and most recently in January 2016 to incorporate areas such as risk culture and risk data aggregation. The standards encourage a generally sound approach to risk management. For the largest and more complex banks, an enterprise-wide approach to risk management is often employed using more sophisticated measurement systems and tools to assess required capital, capital allocation etc. (e.g., economic capital models) consistent with their risk profile and systemic risk.</p> <p>Supervisory practice is also generally well developed and a number of techniques are used by the supervisor to confirm and assess the quality and effectiveness of risk management systems. On-site examinations verify adherence with MaRisk and are undertaken by BBk and BaFin through testing and interviews of management. The MaRisk Inspection Guide used by LSI supervisors lays the foundation for a consistent examination process. Use of the external auditor is also a key aspect of the supervision architecture to confirm compliance with MaRisk and the EA is required to prepare a detailed assessment of risk management annually as part of the long form report. Furthermore, the ICAAP is an integrated part of the risk assessment framework for German banks. Banks are required to submit the ICAAP at least annually, which is assessed by supervisors to determine whether available capital is commensurate with the risk profile of the credit institution and uses scenario analysis and stress testing to confirm resilience to unexpected shocks. ICAAP and ILAAP guidelines have recently been released by the ECB which will be the standard banks will be expected to adhere to going forward. To date, there have been no published minimum standards.</p> <p>Processes to assess risk management and the adequacy of risk bearing capacity are evolving. To date, a significant part of the assessment revolved around qualitative discussions on issues/data from external audit reports and BBk on-site MaRisk inspections. BaFin/BBk is implementing the new SREP approach in line with the EBA guidelines which formalizes the approach to some extent based on a more quantitative approach and will require a decision on Pillar 2 capital add-on which will be a new dimension to the process for German banks. For SIs, the SREP process was performed using a new methodology in 2015.</p> <p>Key aspects of this CP have not been met. The first is in relation to the involvement of the Supervisory Board. While the structure of the two tier system is not an issue here it is the degree of activity and oversight performed by the Supervisory Board for German banks which do not satisfy the requirements of this CP. The role of the supervisory board, although it may vary by bank, remains largely passive. These elements were taken in consideration in CP 14.</p> <p>Importantly for this CP, aspects of risk management standards in relation to the reporting obligations of the CRO have not been met. The reporting of risk management is through the Management Board and the CEO which is responsible for setting the business plan and risk taking. The risk function does not have a separate reporting line to the Supervisory Board independent of the Management Board (and therefore the CEO). This approach may weaken the independence of the risk management function and the CRO to raise issues. While banks had in place formal "whistle-blowing" processes, the structure may inhibit the independence of the CRO and the risk function to report weaknesses in the RMF. This is further aggravated</p>

	by the ex-post notification of removal of the CRO by the management board which is the prescribed minimum of MaRisk.
Principle 16	Capital adequacy. ⁴³ The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	<p>The CRR establishes the requirements to calculate prescribed capital requirements (Part Three, Art. 92-386 CRR), including thresholds by reference to which a bank might be subject to supervisory action and which banks are required to satisfy at all times (Article 92(1) CRR). Part II of CRR defines the components of capital following Basel capital tier structure, which reflect varying degrees of loss absorption capacity, and the deduction requirements. These provisions are supplemented and further specified by Delegated Regulations (EU) No. 241/2014, 2015/850 and 2015/923 (including the so called RTS on own funds Parts 1 to 4), and by delegated acts of the EU Commission. Also, Art. 54 CRR provides for the write down or conversion of Additional Tier1 instruments when the CET1 ratio of a bank falls below 5.125 percent. These are directly applicable by ECB, BaFin and Bundesbank to the supervised banks. The CRD IV gives countries some discretion on the application of macroprudential buffers and other measures to address systemic or macro-prudential risks set out in CRR and CRD IV, for which each Member State determines a designated authority. The designated authority may, or may not be, the competent authority for banking supervision –in Germany, where BaFin is both. For SSM members, the ECB is empowered to apply higher requirements for capital buffers or more stringent macroprudential measures (Art. 5(2) SSMR).</p> <p>The CRD IV was transposed in Germany by amendments to the KWG (and through the Solvency Regulation (Solvabilitätsverordnung; SolvV)). The KWG introduced a ‘capital conservation buffer’ (section 10c) and related capital conservation measures (section 10i) which entail restrictions on distribution of dividends, payments of variable remuneration, payments on Additional Tier 1 instruments whenever such dividends and/or payments would result in a breach of the combined buffer requirement.</p> <p>The additional requirements set out in EU Directive 2014/59/EU (BRRD) which incorporate the Basel III requirements that AT 1 and Tier 2 instruments have to be written down or converted at the point of non-viability (PONV) have been transposed into national law by Section 89 SAG.</p>

⁴³ The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

	<p>The eligible components of an institution's or a group's own funds (including positions to be deducted) are defined in Articles 26 et seq. CRR. The compliance of EU legislation with the Basel capital framework has been assessed by the Basel Committee in 2014 (Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III regulations – European Union, December 2014). The assessment has found the implementation of the Basel framework in the EU Materially Non-Compliant; in particular, the EU framework has been Largely Compliant for definition of capital. The deviations regarding the definition of capital do not seem to be material for German banks in general. It must be noted, however, that according to the national discretion allowed under Art. 467 para 2 CRR, BaFin allows institutions not to include in any element of own funds unrealized gains or losses on exposures to central governments. This discretion can only be used until the Commission has adopted a regulation endorsing the International Financial Reporting Standard replacing IAS 39. For DTAs that rely on future profitability and that existed prior to 1 January 2014 BaFin chose the extended transitional period until the end of 2023 as provided for in Art. 468 para 2 CRR. All details for the transitional provisions of the CRR have been implemented in sections 23 to 31 of the Solvency Regulation (Solvabilitätsverordnung; SolvV). Germany opted to phase out the deduction of goodwill in the transition period.</p> <p>The CRR establishes the following minimum capital requirements thresholds: Common Equity Tier 1 (CET1) capital, 4.5 percent, Tier 1 capital (including additional Tier 1), 6 percent, and total capital (including Tier 2 capital), 8 percent, capital conservation buffer by CET1 capital, 2.5 percent, and requires that other buffers (such as the G-SIB buffer and capital conservation buffer) to be covered by CET1 capital.</p> <p>The powers of the ECB as the competent authority for SIs are laid down in Chapter III of SSMR (Articles 9 to 18). See CP 1 EC 3 regarding powers of ECB under Article 16(2) SSMR.</p> <p>Compliance with the requirements regarding the adequacy of own funds is monitored on an ongoing basis via the institutions' quarterly returns submitted to BaFin and Bundesbank. The annual account auditors are required to assess whether the institutions' calculations regarding the adequacy of their own funds is appropriate (sections 18 to 21 PrüfbV).</p> <p>BaFin exercises the supervisory powers with regard to LSIs and institutions within the meaning of the KWG. In this regard BaFin has recourse to the full "toolbox" the KWG provides. In particular, Section 45 KWG addresses actual and impending breaches of capital and liquidity requirements. In accordance with Art. 104 (1) CRD the relevant thresholds do not only refer to the CRR requirements but also take into account additional capital requirements under Pillar 2 (see CP 11).</p>
EC2	At least for internationally active banks, ⁴⁴ the definitions of capital, risk coverage, method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Description and findings re EC2	The CRR and accompanying EU Regulations apply to all institutions captured by the definition of Article 4 (1) (3) CRR which includes the internationally active banks within the EU but is not restricted to them. The same applies to specifications to the CRR. The compliance

⁴⁴ The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

	<p>of EU legislation with the Basel capital framework has been assessed by the Basel Committee in 2014 (RCAP – see EC 1). The assessment has found the implementation of the Basel framework in the EU Materially Non-Compliant; in particular, the EU framework has been found Compliant in terms of scope of application, transitional arrangements, capital buffers, internal models approach for market risk, operational risk, supervisory review process and disclosure requirements; Largely Compliant for definition of capital, standardized approach for credit risk, securitization framework, standardized approach for market risk; Materially Non-Compliant for the IRB approach for credit risk; Non-Compliant for the counterparty credit risk framework.</p> <p>For Germany, a few elements for which the RCAP found deviations may be significant. For example, sovereign exposures under the permanent and temporary partial use under the CRR represent a relevant part of on-and off-balance sheet exposures of Germany banks. While this may generally overstate CET1 ratios, assessors have observed that in some cases these deviations were being addressed by banks' internal capital adequacy assessments and supervisory action. In addition, the EU's counterparty credit risk framework was considered non-compliant with the Basel framework, based on some exemptions allowed under the CRR. While EBA, ECB, and German authorities are seeking to possibly address the most significant aspects of this deviation through the SREP process, assessors were not in a position to determine if in practice this has been the case. This deviation can potentially signify that the exemptions may lead to materially higher reported capital ratios for some banks.</p> <p>National discretions with regard to capital definition and regulatory requirements can be found in Art. 89 para 3 CRR and in the transitional provisions, Art. 481 pp. CRR. German authorities have exercised some of these discretions. For example, the discretion for qualifying holdings in Art. 89 para 3 CRR has been implemented via a general decree. BaFin applies a 1250 percent risk weight in accordance with Art. 89 para 3 point a) CRR.</p> <p>For SIs in Germany the ECB applies until further notice the existing processes and practices in Germany related to competences now assigned to the ECB in the SSMR.</p>
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EC3	<p>The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g., securitization transactions)⁴⁵ entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.</p>
Description and findings re EC3	<p>See EC 1 and 2. According to Art. 97-98 CRD, to the extent risks and elements of risk are not already covered by CRR or the requirements for capital buffers, the ECB and BaFin must consider the individual risk profile of an institution, as identified in the SREP or the review of the permission to use internal approaches and establish capital requirements in excess of the CRR and the buffer requirements.</p> <p>Article 104 (1)(a) and (2) CRD IV which empowers competent authorities inter alia to require institutions to hold own funds in excess of the requirements set out in Chapter 4 of Title VII (Capital Buffers) and relating to elements of risks and risks not covered by Article 1 CRR has been transposed by Section 10 para 3 KWG. As it is largely a transposition of Union law, it</p>

⁴⁵ Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

	<p>can be exercised both by the ECB (with regard to SIs and only subsidiary to the immediate powers set out in Article 16 SSMR) and by BaFin (with regard to LSIs).</p> <p>Section 10 para 3 KWG consists of a general, discretionary power in sentence 1 and a non-discretionary sentence 2 setting out a list of cases in which the competent authority is obligated to issue a capital add-on. The power in sentence 1 is subsidiary to the power in sentence 2, i.e. measures according to sentence 1 are only possible if none of the cases listed in sentence 2 applies.</p> <p>Mandatory reasons for the request of a capital add-on according to sentence 2 are for example that risks are not covered by the minimum capital requirements of the CRR, the institution's risk bearing capacity is insufficient, it is likely that although the institution is complying with the regulatory requirements risks are underestimated, or the institution has no sound business organization.</p> <p>Regarding securitized transactions, the ECB and BaFin are to decide, on a case by case basis, when the possible reduction in risk weighted exposure amounts is not justified by a commensurate transfer of credit risk to third parties. In German legislation, a capital add-on can be required according to section 10 para 3 sentence 2, 7 KWG. Assessors have been informed there hasn't yet been such a case, but had access to cases when banks were required to address deficiencies and demonstrate at least 50 percent risk transfer had occurred.</p>
EC4	<p>The prescribed capital requirements reflect the risk profile and systemic importance of banks⁴⁶ in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.</p>
Description and findings re EC4	<p>See EC 1 and 2. The CRR sets the maximum requirements at the Basel minima, leaving, in principle, no room for diverging requirements at national level (except at individual bank level, see EC 3 on Pillar 2). BaFin may increase these requirements only under the strict conditions of Article 458 CRR in conjunction with Section 48t KWG, in particular for addressing macroprudential or systemic risk identified at the national level. Apart from Art. 458 CRR macroprudential and systemic aspects are reflected in the capital buffer requirements of Articles 128 et seq. CRD IV and their national transposition in Sections 10c et seq. KWG. The CRD IV foresees five capital buffers: capital conservation buffer, counter-cyclical buffer, systemic risk buffer, G-SRI-buffer and O-SRI-buffer.</p> <p>Unlike Pillar 1 and Pillar 2 requirements these buffer requirements do not address a particular risk of the institution but the systemic relevance of the particular institution (G-SRI and O-SRI-buffer), the particular point of the economic cycle (counter-cyclical buffer) or overall systemic risks (systemic risk buffer). Also, unlike Pillar 1 and Pillar 2 requirements, they are not designed as fixed minimum requirements but are meant to be used by the institution in an economic downturn and built up again at a later point. Consequently, breaches of the</p>

⁴⁶ In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	<p>combined buffer requirements do not lead to severe supervisory measures but will cause restriction in particular in the institution's freedom to distribute on its CET 1-capital instruments.</p> <p>Article 124 (2) CRR allows the competent authority (BaFin) to set higher risk weights for exposures secured by immovable properties where these are no longer appropriately based on the loss experience or forward looking immovable properties market developments. Similarly, according to Article 164 (5) CRR the competent authority may set higher minimum values of exposure weighted average LGD for exposures secured by immovable property in their territory.</p> <p>Article 98(6) CRD requires the supervisors to consider in their SREP the risk of excessive leverage. Art. 4(1)94 of the CRR defines excessive leverage, which is to be considered based on indicators such as the leverage ratio determined in accordance with Article 429. The leverage is taken into account in the SSM SREP methodology for the determination of the overall SREP score of the institution and the supervisory measures, including capital measures adopted as a result of the SREP.</p> <p>In terms of LSIs in Germany, the requirement for BaFin to consider excessive leverage in the context of the SREP is laid down in section 6b paragraph 2 number 13 KWG. This provision also forms the basis for the assessment of the risk of excessive leverage (see Article 87 (1) CRD IV). While institutions are expected to manage the risk of excessive leverage according to section 25a (1) (3) (b) KWG, which makes reference to Title VII Chapter 2 Section 2 Sub-Section III of Directive 2013/36/EU (which includes the risk of excessive leverage according to Art. 87 CRD), the assessment of this risk had not so far been incorporated in routine supervision. Assessors reviewed a file where leverage was discussed with the bank in the context of ongoing supervision, but this does not seem to be a customary component of BaFin's and Bundesbank's assessments. Since the European framework has some preferential treatments in risk weights which are not compatible with the Basel framework (such as for covered bonds and mortgages) it is crucial that leverage of banks is closely monitored. The new SREP process in development will consider the risk of excessive leverage more systematically.</p>
EC5	<p>The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use:</p> <ul style="list-style-type: none"> (a) such assessments adhere to rigorous qualifying standards; (b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor; (c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken; (d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and (e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.

Description and findings re EC5	<p>See CP 15. The EU framework for the regulatory approval of banks' internal models (IRB for credit risk, IMA for market risk, AMA for operational risk, IMM for counterparty credit risk) requires that such models adhere to qualifying standards analogous to the Basel capital framework, with the exceptions identified in the RCAP report (see ECs 1 and 2).</p> <p>For entities for which the ECB is the competent authority, ECB approves banks' internal assessments for the calculation of own funds requirements ("internal models") in accordance with Article 9(1) SSMR. ECB bases its decisions on internal models on Guidelines issued by the EBA (Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches (CEBS GL 10), Guidelines on AMA extensions and changes (EBA/GL/2012/1), Guidelines on stressed Value-at-Risk (stressed VaR) (EBA/GL/2012/2), and Guidelines on the Incremental Default and Migration Risk Charge (IRC) (EBA/GL/2012/3)). For Counterparty Credit Risk and Credit Valuation Adjustment there are neither mandates for RTS in the CRR or EBA Guidelines. For those risk types internal SSM guidelines are in preparation.</p> <p>For LSIs, the SolvV contains additional provisions on the application of the IRB Approach including further specifications on the conditions for initial application to use the IRB Approach and its sequential implementation. The IRB Approach approval examination in accordance with section 7 SolvV contains the review of the implementation plan, the monitoring of the plan during the entire implementation period and the suitability examinations of all rating systems prior to their use for calculating regulatory capital requirements. In the implementation plan, the institution has to describe the scope of application and the implementation dates of all rating systems for which it is seeking approval to use the IRB Approach. The roll-out period for implementing the IRB Approach is set to 5 years in accordance with section 8 (1) SolvV. The sequence that BaFin considers to be appropriate is decided on a case by case basis depending on the nature and scale of the activities and other circumstances. In the process BaFin determines conditions to ensure that IRB is not used selectively for the purposes of achieving reduced capital requirements. The plan must plausibly demonstrate that the institution will achieve the supervisory reference point pursuant to section 10 (2) SolvV⁴⁷ within two and a half years of reaching the entry threshold⁴⁸, and full implementation of the IRB Approach pursuant to section 10 (3) SolvV within five years at the latest⁴⁹. Once achieved, all relevant thresholds have to be fulfilled on a permanent basis pursuant to section 9 (3) SolvV. The assessment of the adequacy of rating systems takes place during on-site examinations pursuant to section 44 (1) sentence 2 KWG. With respect to the determination of exposure values for counterparty credit risk, an institution may use the Internal Models Method (IMM) subject to the approval of BaFin (pursuant to Article 283 para 1 CRR, in conjunction with section 18 SolvV). With respect to operational risk, the use of Advanced Measurement Approach (AMA) is subject to the approval of BaFin (pursuant to Article 312 para 2 CRR in conjunction with section 20 SolvV). Regarding market risk, authorization is granted pursuant to Article 363 para 1 CRR in conjunction with section 21 SolvV). The assessors reviewed application files and processes for the authorization of internal models by BaFin.</p>
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⁴⁷ At least 80 percent of exposures (before and after risk weighting) for which the use of internal rating systems is allowed under the CRR have to be covered by using internal ratings.

⁴⁸ At least 50 percent of exposures (before and after risk weighting) for which the use of internal rating systems is allowed under the CRR have to be covered by using internal ratings.

⁴⁹ At least 92 percent of exposures (before and after risk weighting) for which the use of internal rating systems is allowed under the CRR have to be covered by using internal ratings.

For institutions supervised by the ECB, approvals of models and material changes (collectively called "internal model investigations") are granted based on an investigation most of the cases performed on-site. An internal model investigation has four phases (a preparatory pre-application phase, the assessment phase, in which the actual assessment is performed, followed by a draft and final decision process phase). After the initial assessment of the (on-site) expert project team the draft assessment report is reviewed for consistency and adherence to standards in two stages: first at the BaFin/Bundesbank level and then at the ECB's Internal Model division level. The ECB has produced a practical guide to internal model investigations which explains the process in detail and provides a standard for models assessment reports, including details regarding each risk category (credit, CCR/CVA, market, and op risk).

Cessation of using individual internal models for determining the regulatory capital requirements is subject to prior approval by the ECB or BaFin (Articles 149, 225(1), 259(5), 283(5), 313 CRR); while the revocation of the general approval to use internal models is subject to the requirements in accordance with Article 101 (4) CRD IV as implemented by section 4 (5) SolvV. Any material change to an approved internal model needs prior permission by the competent authority, according to CRR Article 143(3) (IRB), CRR Article 312 for AMA for operational risk, and CRR Article 363(3) for IMA for market risk. The conditions for assessing a model modification as a material change of an internal model are laid out in Commission Delegated Regulation (EU) No 529/2014 of 12 March 2014 (IRB and AMA) as amended by Commission Delegated Regulation (EU) 2015/942 of 4 March 2015 (IMA). Similarly, ceasing of use of an internal model and thereby reverting to a standardized approach (reversion to a less sophisticated approach) requires permission by the ECB or BaFin according to CRR Article 149 (IRB approaches), CRR Article 283(5) (IMM method), and CRR Article 313 (AMA). For IMA a reversion to a standardized approach is considered a material change according to Commission Delegated Regulation (EU) 2015/942, Annex III, Part I, Section 1. The permission to use an Advanced-CVA model is linked to the permission for using an IMA for specific interest rate risk and the IMM approach according to CRR Article 383(1). As for the IMM method and Advanced-CVA models there are no provisions in CRR concerning material changes, SSM guidelines for assessing the materiality of model changes are in preparation.

For cases of non-compliance with the requirements for using internal models for calculating the regulatory capital requirements, ECB's can apply its powers under Article 16 SSMR (see CP 1 EC 3).

When an institution ceases to comply with the requirements, it has to notify BaFin. According to section 4 SolvV which transposes Article 101 (4) CRD IV into national law BaFin requires a plan for the timely return to compliance with relevant requirements unless the institution can demonstrate that the effects of non-compliance are immaterial. If BaFin considers it unlikely that a presented plan will result in full compliance or if the proposed time period for correction is inappropriate the permission to use the IRB Approach is to be revoked or to be limited to compliant areas or those areas where compliance can be achieved within an appropriate time period. With regard to significant institutions the ECB can apply section 4 SolvV directly in conjunction with Article 4 (3) SSMR.

Both BaFin and ECB have included follow-up examinations and ongoing monitoring of the models compliance with the requirement after approval.

All German banks using advanced approaches at the time of this assessment had been authorized before SSM came into force: 11 banks for market risk, 50 for the IRB Approach (8 only for their retail exposures, 23 for F-IRB, and 19 A-IRB), 14 banks for AMA, 3 for IMM.

EC6	<p>The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).⁵⁰ The supervisor has the power to require banks:</p> <ul style="list-style-type: none"> (a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and (b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings re EC6	<p>Art. 177 CRR requires IRB banks to have in place sound stress testing processes for use in the assessment of its capital adequacy; they must identify possible events or future changes in economic conditions that could have unfavorable effects on a bank's credit exposures;</p> <p>Art. 290 CRR requires banks with approved IMM for counterparty credit risk to have a comprehensive stress testing program in place, including for use in assessment of its capital requirements for counterparty credit risk; it must identify possible events or future changes in economic conditions that could have unfavorable effects on a bank's credit exposures;</p> <p>Art. 368 CRR requires banks with approved IMA for market risk to frequently conduct a rigorous program of stress testing, addressing a number of possible shocks.</p> <p>In accordance with Article 16(2)(a) SSMR, the ECB has the power to require institutions to hold own funds in excess of Pillar 1 requirements as set out in CRR. These requirements are to be defined at least once a year in the context of the SREP. The SSM SREP methodology anticipates the adverse effects of possible events and changes in market conditions by adopting a forward looking-view in the assessment of the risks institutions are exposed to. In particular, Element 3-Block 3 of the SSM SREP methodology is aimed at assessing the adequacy of institutions capital under stressed assumptions. This assessment is a key in determining the level of capital imposed by the supervisor in excess of Pillar 1 requirements.</p> <p>According to AT 4.3.3 MaRisk, German banks have to conduct stress tests regarding their main (material) risk factors on a regular and ad-hoc basis, reflecting the nature, scale, complexity and riskiness of the institution's business activities, and must cover the assumed risk concentrations as well as diversification effects within and between risk types. Risks resulting from off-balance-sheet entities and securitization transactions are also to be taken into account. Historical as well as hypothetical scenarios should be represented taking into account changes of the institution's strategic orientation and its economic environment. Shortcomings in the organizational set up may also lead to the application of a capital add-on (section 10 (3) sentence 2 no. 10 KWG). The results of the stress tests are taken into account when assessing internal capital adequacy, and banks are required to implement a process for future capital planning (AT 4.3.3 No. 5 MaRisk, and AT 4.1 MaRisk). According to section 10 (3) sentence 2 number 1 KWG, BaFin may set higher minimum capital requirements for institutions in order to consider risks that are not covered completely by pillar I. In addition to the requirement of internal stress tests, BaFin can also require institutions to carry out supervisory stress tests, the results of which are to be taken into account when it comes to the SREP (section 6b KWG).</p>

⁵⁰ "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

AC1	For non-internationally active banks, capital requirements, including the definition of capital, the risk coverage, the method of calculation, the scope of application and the capital required, are broadly consistent with the principles of the applicable Basel standards relevant to internationally active banks.
Description and findings re AC1	CRD IV and CRR apply to all credit institutions (i.e. banks) and investment firms in the European Union, irrespective of their size or intensity of international activity. According to section 1a KWG in Germany CRR requirements apply mutatis mutandis to other institutions that are not CRR-credit institutions (such as leasing companies). For these types of institutions (which are not banks) there are some exceptions (Section 2 para 8a, para 9, para 9a, para 9b and para 9c KWG) that reflect the principle of proportionality and adjust the regulatory requirements to the business models and risk situations of these entities.
AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks. ⁵¹
Description and findings re AC2	CRD IV and CRR are applied both on a stand-alone and consolidated basis, with few exceptions (art. 6 and 7 CRR) that are subject to conditions aimed at ensuring an adequate distribution of capital between parent and subsidiaries. However, the competent authority may waive the capital adequacy requirements for the individual basis, (but neither the liquidity requirements nor the leverage ratio calculation and reporting requirements) for the parent institution and/or for the subsidiaries in the country (Articles 7(1) and 7(3) CRR) provided there is no material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities. In the case of Germany, Article 7 CRR is complemented by Section 2a KWG which sets out further details regarding the application process if an institution wants to use a capital waiver. In addition, Section 2a paragraph 5 KWG contains a grandfathering clause for capital waivers used by institutions prior to the entering into force of CRR. Paragraph 6 establishes that the conditions for the waiver must be met continuously and competent authority may revoke waiver authorization when not met. The ECB supervision is developing criteria for waiver authorization to be applicable to all SSM institutions.
Assessment of Principle 16	Largely compliant
Comments	<p>The whole of Part II and III (Art. 25-386) of CRR and Title VI, Chapter 4 (Art. 128-142) of CRD IV implement the Basel capital standards in the EU. The CRR and CRD are complemented by EBA Regulatory Technical Standards (RTS) on Own Funds. The compliance of EU legislation with the Basel capital framework has been assessed by the Basel Committee in 2014 (Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III regulations – European Union, December 2014). The assessment has found the implementation of the Basel framework in the EU Materially Non-Compliant; in particular, the EU framework has been found Compliant in terms of scope of application, transitional arrangements, capital buffers, internal models approach for market risk, operational risk, supervisory review process and disclosure requirements; Largely Compliant for definition of capital, standardized approach for credit risk, securitization framework, standardized approach for market risk; Materially Non-Compliant for the IRB approach for credit risk; Non-Compliant for the counterparty credit risk framework.</p> <p>The deviations regarding the definition of capital do not seem to be material for German banks in general, although some may be for specific banks (deduction of participation in</p>

⁵¹ Please refer to Principle 12, Essential Criterion 7.

	<p>insurance, for instance). It must be noted, however, that BaFin allows institutions not to include in any element of own funds unrealized gains or losses on exposures to central governments, a national discretion that will be used until a European regulation endorsing IAS 39 is issued. For DTAs, that rely on future profitability and that existed prior to 1 January 2014, BaFin chose the extended transitional period until the end of 2023.</p> <p>For Germany, a few elements for which the RCAP found deviations regarding the calculation of capital requirements may be significant, such as sovereign exposures under the permanent and temporary partial use, lower risk weights for covered bonds, and in particular the counterparty credit risk framework. Assessors observed some cases where these deficiencies were being addressed by banks' internal capital adequacy assessments and supervisory action. Nevertheless, assessors do not feel comfortable that existing framework is not in general resulting in overstated CET1 ratios.</p> <p>National authorities can impose overall capital requirements above the Basel minima by resorting to the systemic risk buffer - or – in the case of the macroprudential authority – to macroprudential measures subject to notification obligation plus strict conditions. Germany has not availed itself of these instruments. Both ECB and BaFin can require banks to hold capital in excess of the minima under Pillar 2; however, the practice is not commonly used by German authorities, which in general prefer to address these through direct discussion with the banks on the adequacy of ICAAP. ECB as a supervisor has only concluded one SREP cycle, in which some banks were required to implement Pillar 2 add-ons.</p> <p>Leverage is specifically taken into account in the SSM SREP methodology. For BaFin's supervised institutions, leverage can be considered - assessors reviewed a file where leverage was discussed with the bank in the context of ongoing supervision - but it is not yet a routine part of the supervisory assessment. However, since the European framework has some preferential treatments in risk weights which are not compatible with the Basel framework (such as for covered bonds and mortgages) it is crucial that leverage of banks is closely monitored.</p> <p>In addition, the adequacy of capital requirements at individual level must be closely monitored given the waivers granted under article 7 of CRR.</p>
Principle 17	Credit risk. ⁵² The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk ⁵³ (including counterparty credit risk) ⁵⁴ on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile,

⁵² Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁵³ Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions and trading activities.

⁵⁴ Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

	systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	<p>Neither KWG or MaRisk or SREP Guidelines detail supervisory expectations on the classification of credit into various risk buckets, provisioning, setting parameters for cured, restructured, or nonperforming loans, or guidance on what it considers an effective risk management function.</p> <p>The legal basis for the regulation of risk management (including credit risk) is section 25a (1) KWG. BaFin issued the circular on Minimum Requirements on Risk Management (MaRisk) outlining its expectation on credit risk management. According to AT 2.2 item 1, of MaRisk, the management board shall, regularly and on an ad hoc basis, review the risks faced by the institution. Credit Risk is classified by the supervisor as a material risk category and thus has to be included in the analysis by bank management. Risk appetite (tolerance levels) shall be in relation to all material risks. According to AT 4.2, MaRisk the institution has to establish an appropriate and effective risk management function outlining a sustainable business strategy addressing the institution's objectives for each material business activity and the measures to be taken to achieve these objectives. Additionally, the institution shall define a risk strategy that is consistent with the business plans and the resulting risks. External factors have to be taken into account (e.g., market developments, competition, and regulation) as well as internal factors (e.g., risk bearing capacity, liquidity, profitability, and resources).</p> <p>Supervisory authorities verify: i) the clarity of the credit risk strategy and appetite as expressed by the management body, and their mutual consistency; ii) that senior management implements the bank's credit risk strategy and monitors the consistency of the bank's activities with the established strategy; iii) that senior management implements the bank's credit risk strategy and monitors the consistency of the bank's activities with the established strategy; iv) that the credit risk strategy is appropriate with respect to the bank's role in the financial system and the adequacy of its own funds and takes into account cyclical aspects of the economy.</p> <p>Supervisors determine compliance through a combination of on-site reviews, off-site analysis, external audit reports and thematic reviews. A review of Bundesbank (BBk) inspection reports and external audit reports denote a detailed review of policies, procedures and internal controls concerning credit risk. It is also required of external auditors that they certify compliance with MaRisk and address it in their annual reports. For SIs, the SSM has identified credit risk as a key objective for review and has initiated a thematic review to understand current practices. The review involves a review of how banks treat NPLs and results may form the basis for issuing guidelines on NPL provisioning. Another process involves issuing questionnaires to banks to determine best practices in credit risk policies and may result in a best practices guideline.</p> <p>The BBk in its on-site inspections reviews the bank risk bearing capacity and determines if it fully supports the risk generated by the business lines and whether the overall risk meets the risk appetite parameters. Stress testing is used in the computations and ICAAP results. Examples of reviews were provided by BBk.</p> <p>Additionally, external auditors verify compliance with MaRisk and KWG requirements in their annual audit.</p>

EC2	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming, ⁵⁵ identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.
Description and findings re EC2	<p>EBA guidelines on SREP require supervisors to verify that the management body approves the policies for managing, measuring and controlling credit risk and discusses and reviews them regularly, in line with risk strategies.</p> <p>According to the KWG, all transactions containing credit or counterparty risk, respectively (irrespective, if on-balance or off-balance) have to be addressed. The Management Board is required to conduct regular and – if needed – ad hoc reviews of the risk inventory to assess the overall level of risks that the institution or group is confronted with (AT 2.2 MaRisk). BTR 2 MaRisk requires that the policies and processes used for risk measurement be regularly reviewed. At least for stress test the appropriateness of assumptions and methods should be assessed on an annual basis at least (AT 4.3.3 MaRisk).</p> <p>Through reviews of board minutes, on-site inspections and reports from external audits, the supervisors determine and gauge the adequacy of the role of the management board in overseeing the operations of the bank.</p>
EC3	<p>The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:</p> <ul style="list-style-type: none"> (a) a well documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system; (d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an ongoing basis; (e) prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff;

⁵⁵ "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	<p>(f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and</p> <p>(g) effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.</p>
Description and findings re EC3	<p>The supervisory process, as outlined in SREP and MaRisk is followed for SI and LSIs.</p> <ul style="list-style-type: none"> • The requirements for the structural and operational arrangements for the lending business are laid down in AT 4.3.2 item 1 and 2, in BTO 1 and BTR 1 MaRisk. BTO 1 MaRisk states that the requirements can be applied in a proportional manner depending on the size of the institution, its business focus and its risk situation. All aspects of the following components are subject to supervisory review on a regular – at least annual – basis: segregation of duties, lending business processes, compliance with regulatory requirements and credit risk profile/strategies. Laws, MaRisk and SREP provide a broad and comprehensive framework on credit risk management. These are confirmed and reviewed by supervisors through on-site and off-site supervision and supplemented by external audit reports. In the aggregate, SREP and MaRisk guidelines establish procedures for the supervisor and provide banks with supervisory expectations. SSM focuses on SREP while LSIs are reviewed by BBk and external auditors based on MaRisk and increasingly SREP. External auditors must follow MaRisk and verify compliance in their annual report. Object of reviews is to verify that: <ul style="list-style-type: none"> • policies and procedures that are sound and consistent with the credit risk strategy, and cover, inter alia, credit granting processes and criteria for the review of borrowers' creditworthiness; and that there are clear lines of responsibility for taking on, measuring, monitoring, managing and reporting credit risk; however there is no recommendation for supervisors to verify the existence of well-defined criteria and policies and processes to identify the appropriate approval authority for the size and complexity of the exposures; • policies and procedures that cover, inter alia, the criteria for assessing borrowers' creditworthiness and collateral evaluation and those for loan classification; to verify that the bank can detect, measure and regularly monitor the credit risk inherent in all on- and off-balance-sheet activities with regard, inter alia, to collateral coverage, contractual terms and agreements, covenants; to assess the level and quality of credit risk mitigation; to assess whether the institution has appropriate skills, systems and methodologies to measure this risk at borrower/transaction and portfolio level, and, in particular, to differentiate between different levels of borrower and transaction risk. Art. 82 of CRD IV requires the supervisors to ensure that the risks arising from securitization are evaluated and addressed through appropriate policies and procedures; • data, information systems and analytical techniques are appropriate to enable the institution to fulfill supervisory reporting requirements, and to detect, measure and regularly monitor the credit risk inherent in all on- and off-balance-sheet activities; and to assess whether the institution has implemented regular reporting of credit risk exposures, including the outcome of stress testing, to the management body, senior management and the relevant credit risk managers; • policies and procedures are sound and consistent with the credit risk strategy, and cover, inter alia, credit limits; that such policies are adequate for the nature and complexity of the institution's organization and activities, and enable a clear

	<p>understanding of the credit risk inherent to the different products and activities under the scope of the institution and are clearly formalized, communicated and applied consistently across the institution;</p> <ul style="list-style-type: none"> the bank has appropriate internal controls and practices to ensure that breaches of and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.
EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.
Description and findings re EC4	<p>Banks are required to aggregate borrower credits to determine compliance with regulatory limits and thus must monitor total indebtedness within the institution. Private credit reporting companies help banks determine whether its borrowers have other credit outstanding and if there are performance problems.</p> <p>MaRisk states that transactions be aggregated towards the borrower-related limits immediately. Compliance with the limits has to be monitored (BTR 1 item 5 MaRisk). The rules for large exposures and for granting loans exceeding EUR 750,000 (or more than 10 percent of the own funds (section 18 KWG)) imply that an institution has to monitor the total indebtedness in order to comply with the rules at any time. Making use of the credit registry enables banks to monitor level of debt of its major clients (total debt exceeding € 1,000,000) across the German banking sector as a whole.</p> <p>MaRisk requirements and SREP guidelines address unhedged borrowing in foreign currency and require that the credit analysis include determining the borrowers' ability to repay if the currency position moves against the borrower.</p> <p>These requirements are monitored by the supervisor and the external auditor.</p>
EC5	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings re EC5	<p>Within the assessment of the overall internal governance framework, the EBA guidelines on SREP require the supervisors to assess whether the bank demonstrates to have in place policies to identify and avoid conflicts of interest.</p> <p>Furthermore, section 15 KWG in conjunction with section 19 KWG regulate the arm's length principle for credit decisions. These include loans to the management and parties related to the management, members of the Board as well as firms who have a close relationship to the management. In these cases, the conditions of the credit decision need a unanimous approval of all Executive Board members and can be approved only at market conditions, requiring also approval by the Supervisory Board. Compliance with these requirements is thoroughly checked by external auditors according to section 33 of audit standards. Section 33.4 PrüfbV specifically instructs external auditors to verify if "there are any indications, that loans have been granted with conditions not in conformity with market conditions or if there are indications of significant conflicts of interest that could affect the reliability of the Executive Board (section 25c KWG) or the Supervisory Board (section 25d KWG)."</p>
EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the

	bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	<p>According to article 392 CRR in conjunction with section 13 (2) KWG, loans to single borrowers or counterparties, which exceed 10 percent of the institution's own funds (large exposures), have to be granted unanimously by all members of the management board. The unanimous decision shall be made prior to the granting of the loan. Those loans have to be reported to BaFin. Moreover, such loans must not exceed 25 percent of the own funds without previous acceptance by BaFin (article 395 CRR or section 13 (3) sentences 5 KWG).</p> <p>Institutions are required to have well-defined credit-granting decision authority (BTO 1.1 item 6 MaRisk). For "risk-relevant lending decisions", that is, loans with risk characteristics not specifically addressed in the normal loan approval process; two consenting votes by both front office and back office are required. Front office is the loan officer.</p>
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC7	KWG, Article 44 (1) requires supervised entities to provide all information required to facilitate supervision.
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programs for risk management purposes.
Description and findings re EC8	<p>EBA guidelines on SREP require supervisors to assess whether the institution has undertaken stress testing to understand the impact of adverse events on its credit risk exposures and on the adequacy of its credit risk provisioning. For IRB banks art. 177 of CRR applies too.</p> <p>Institutions shall carry out, on a regular and ad hoc basis, stress tests in respect to all material risks (including credit risk), which are dependent on the nature, scale, complexity and riskiness of the business activities (AT 4.3.3 MaRisk). With use of stress tests the institution individually examines the effects and potential risks which it faces with regard to exceptional but plausible events. The level of execution can be e.g., at portfolio level, at firm level or at business unit level. Credit risk exposures shall be included in the institution's stress tests as well as e.g., market and liquidity risks.</p>
Assessment of Principle 17	Compliant
Comment	MaRisk provides guidance on risk management for banks. The guidance could be enhanced by for example, broad guidelines on general characteristics of various loan risk buckets; definitions of non-performing, restructured, forborne and cured loans. These deficiencies are reflected in the CP 18 rating.
Principle 18	Problem assets, provisions and reserves. ⁵⁶ The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves. ⁵⁷
Essential criteria	

⁵⁶ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁵⁷ Reserves for the purposes of this Principle are "below the line" non-distributable appropriations of profit required by a supervisor in addition to provisions ("above the line" charges to profit).

EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	<p>SREP addresses need to assess the overall credit quality at portfolio level and the different quality grades within the exposure categories of “performing,” “nonperforming,” and “forborne” to determine the institution’s overall credit risk. There are no specific definitions of nonperforming or forbearance in MaRisk.</p> <p>SREP sets out supervisory expectations on assessing whether the institution has a sound, clearly formulated and documented credit risk strategy, approved by the management body; to assess whether the institution has an appropriate organizational framework to enable effective credit risk management, measurement and control; and, to assess whether the institution has appropriate policies for the identification, management, measurement and control of credit risk. This also refers explicitly to non-performing assets and loan impairment.</p> <p>KWG sets the requirement for risk management. Under MaRisk institutions have to set up risk classification procedures for the initial, regular or ad hoc assessment of credit risk and, as appropriate, property/project risk. Furthermore, the institution has to set forth criteria to determine when an exposure requires special monitoring (intensified loan management). Those exposures are to be reviewed at regularly scheduled intervals in order to establish special monitoring or collection as needed. The institution determines at its own discretion whether or not the criteria trigger an automatic procedure, or whether they instead provide indicators which form the basis for an assessment. The objective is to identify problem exposures quickly so that the appropriate measures can be taken at an early stage (BTO 1.2.4 MaRisk58). Additionally, the institution has to set forth criteria governing the transfer of an exposure to the staff or units specialized in restructuring and winding up, and/or their involvement (BTO 1.2.5 MaRisk).</p> <p>Besides regulatory requirements, institutions have to comply with the HGB which refers to the booking of provisions and yearly valuation of loans. According to section 252 HGB in conjunction with section 253 HGB, all loans have to be valued annually on an individual basis (for homogenous loans a group valuation on a portfolio basis is also possible). According to section 340e HGB, this principle has to be adopted by credit institutions. As soon as full repayment of the loan by the borrower appears doubtful, provisions have to be made (as a minimum for that part not secured by collateral). In the event of a total default, loans must be written off immediately.</p>
EC2	The supervisor determines the adequacy of a bank’s policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor’s opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank’s policies and processes.
Description and findings re EC2	The BBk performs on-site reviews of the LSIs’ policies for compliance with MaRisk requirements for risk management relating to the loan portfolio. However, BBk does not conduct a valuation review of individual loans nor challenges bank assumptions on impairment, loan classification or provisions. LSI supervisors rely on the work of the external

⁵⁸ Mindestanforderungen an das Risikomanagement von Banken und Finanzdienstleistungsinstituten (Minimum Requirements for Risk Management for Banks and Financial Services Institutions)

	<p>auditors but do not have access to review the work papers of the external auditors and therefore do not test the depth of their loan valuation analysis. If for some reason supervisors have concerns about the work, they can ask for additional information from the auditor or ask a different auditor to review the loan portfolio. For SIs, a horizontal review of credit risk management and loan valuation has been conducted through on-site reviews using SSM procedures. An AQR exercise was conducted in 2014 that reviewed loan valuations. The findings produced recommendations to the institutions on reclassifying loans and increasing provisions and raised concerns from banks on ECB authority to make recommendations on accounting issues.</p> <p>Routine SI/LSI on-site inspections are conducted by BBk on MaRisk compliance concerning credit risk.</p> <p>The SREP process focuses on a review of banks' assessment of credit quality, establishing that "When assessing portfolio credit quality, competent authorities should pay particular attention to the adequacy of the classification of credit exposures and assess the impact of potential misclassification, with the subsequent delay in the provisioning and recognition of losses by the institution. In conducting this assessment, competent authorities may use peer analysis and benchmark portfolios, where available. Competent authorities may also use sampling of loans when assessing portfolio credit quality."</p> <p>The classification and provisioning policies and processes are subject to special audits, which are generally performed by BBk (according to section 44 KWG) in case of LSI and under the operational responsibility of the ECB in case of SIs.</p> <p>For LSIs, BBk on-site inspections focus on process, documentation and compliance with supervisory requirements. The supervisors review external audit reports and will review bank reports on problem loans, if concerns arise, they will be discussed with the bank/auditors. However, the supervisors will not re-classify loans or require increased provisioning. An own funds requirement may be imposed.</p> <p>BBk is currently initiating training and developing procedures for inspectors to be able to challenge bank management assumptions on impairment and valuations. SSM staff reported that in their inspections of credit quality they hold discussions on adequacy of provisioning and loan valuation with banks to challenge their assumptions.</p>
EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures. ⁵⁹
Description and findings re EC3	<p>SREP procedures address whether the data, information systems and analytical techniques are appropriate to enable the institution to fulfill supervisory reporting requirements, and to detect, measure and regularly monitor the credit risk inherent in all on- and off-balance-sheet activities (where relevant at group level).</p> <p>The term "credit" both in the MaRisk and in the PrüfV refers to all credits pursuant to section 19 para. 1 KWG. This encompasses all positions and transactions containing credit risk (including counterparty risk) regardless if on-balance or off-balance. Therefore, the assessment of auditors concerning the risk classification and provisioning includes off-balance sheet positions as well.</p>

⁵⁹ It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

	Supervisors review the relevant provisioning policies to verify that off-balance sheet exposures are taken into account.
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	<p>SREP procedures addresses whether the level of loan loss provisions and credit valuation adjustments are appropriate for the quality of the exposures and, where relevant, for the level of collateral. In particular, NCAS are expected to determine whether loan loss provisions are consistent with relevant macro-economic developments.</p> <p>The MaRisk contains requirements for the credit business processes (BTO 1.2 MaRisk), in particular the processes for intensified loan management and for the treatment of problem loans (BTO 1.2.4 and 1.2.5 MaRisk), requirements concerning the risk provisioning (BTO 1.2.6 MaRisk) and for the procedures concerning the early detection of risks (BTO 1.3 MaRisk), as well as the classification of loans (BTO 1.4 MaRisk).</p> <p>A main inspection objective for on-site inspections on credit risk is to assess the quality of the exposures of the bank and the robustness of the provisioning and collateral policies applied to them. Furthermore, the inspection teams evaluate the degree and quality of the actual implementation of the policies within the supervised institutions' loan loss accounting rules and whether it duly takes into account the macro-economic conditions in the country of exposure. BBk reviews process and compliance while the external auditors certify impairment and provisions.</p>
EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).
Description and findings re EC5	<p>Ongoing oversight of problem assets and collecting on past due obligations are not covered by the EBA Guidelines on the SREP.</p> <p>The supervisory reporting framework of the EBA governs the collection by supervisors of data on impaired loans and debt securities, non-performing exposures, forborne exposures, as well as past-due loans and securities and associated impairment (FINREP F4, F7, F12, F18 and F19 in Annex 3 of the ITS on supervisory reporting).</p> <p>According to BTO 1.2.4 and 1.2.5 MaRisk institutions have to establish appropriate processes for intensified loan management and for the treatment of problem loans. According to BTO 1.2.5 MaRisk, the institution has to set forth criteria governing the transfer of an exposure to the staff or units specialized in restructuring and winding up, and/or their involvement. More generally, the institutions' employees and their deputies must have the knowledge and experience required by their duties, competencies and responsibilities. Suitable measures have to be taken to ensure that the employees have the appropriate qualifications (according to AT 7.1 MaRisk). BTO 1.3 MaRisk addresses the early identification of risks.</p> <p>Predefined clusters are addressed in legislation. However, practice shows that German banks are using groupings of homogenous loans, most of them the same as those given as example and required by the EBA/ITS/2013/03 (30, 60, 90 days).</p>

	Supervisors rely on external auditors to test banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).
EC6	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.
Description and findings re EC6	<p>EBA ITS on Supervisory Reporting (Forbearance and non-performing exposures). Data on performing exposures are collected as per the ITS on NPL and forbearance. Whether the ITS would prevent NCAs from obtaining more granular information and imposing more granular classification systems for supervisory purposes depends for what purpose these systems are implemented: If it is for reporting on a consolidated basis by IFRS banks it is not possible. If it is for reporting on a consolidated basis for GAAP banks it may be possible under some circumstances, after consultation with EBA. If it is for supervisory reporting on an individual basis, for example for a horizontal review of a particular risk, then it is possible.</p> <p>SREP, on performing exposures, sets minimum elements for NCAs to determine that banks' risk categories are correct. Based on this, banks are supposed to have documentation to support their classifications. NCAs requirements for banks to have adequate documentation to support their classification and provisioning levels cannot be found and is supposed to be an implementation prerogative.</p> <p>According to the BBk's Financial and Internal Capital Adequacy Information Regulation (FinaRisikoV), institutions have to file corresponding information on loan quality and corresponding provisioning with BBk on a quarterly basis (including amount of hidden reserves and losses, amount of loans with increased PD or in default, provisions). This is intended to give BaFin and BBk an ongoing insight into the business performance and to put them in the position to be able to identify difficulties in a timely manner.</p> <p>The Monthly Balance Sheet Statistics do not contain a classification of the loans but rather a general overview of loans and assets during the course of a year. Details on risk classification of loans, profit and losses accounts and risk provisioning are provided to supervisory authorities through the annual reports performed by external auditors and the financial reporting according to the FinaRisikoV.</p> <p>The external auditor of the institution has to assess the appropriateness of the relevant processes and the quantitative appropriateness of risk provisioning on a yearly basis in the course of the audit. Once available, the LSI supervisor assesses the external auditor's report and considers the relevant findings as part of the ongoing assessment of a bank's supporting documentation, providing information on the internal classification and provisioning levels. If deemed necessary, according to German regulation, the supervisor is in a position to mandate the external auditor to look into one specific topic as part of the yearly audit and this mandate can be used to assess the adequateness of provisioning and classification documentation. ECB does not rely on external auditors to review asset classification and provisioning.</p> <p>Additionally, information on the classification of loans can be accessed by requesting internal risk reports of institutions and by means of special audits focusing on specific provisioning topics, including the recoverability of assets and risk provisioning (according to section 44 KWG).</p>

	Loan quality information collected on a regular basis lacks granularity on loan portfolio risk buckets, delinquencies, NPLs, restructured loans.
EC7	The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings re EC7	<p>MaRisk and KWG do not define nonperforming loans and guidelines for loan classification have not been issued. Banks are required to establish loan classification based on their individual characteristics. When existing systems are viewed as inadequate by the supervisors, a capital add-on may be imposed.</p> <p>The section in SREP on assessment of the portfolio credit quality, asks NCAs to assess the overall credit quality at portfolio level and the different quality grades within the exposure categories of "performing," "nonperforming," and "forborne" to determine the institution's overall credit risk. The Guidelines do not refer expressly to the EBA definitions for the concepts of "non-performing" and "forborne" exposures.</p> <p>If the processes and procedures for risk classification, intensified loan management, treatment of problem loans and risk provisioning – as well as for all other parts of risk management – are deemed to be inappropriate, supervisors have, according to German legislation following powers at its disposal:</p> <ul style="list-style-type: none"> • Capital add-on: <p>Once it is established that the shortcomings in the risk management result in an altogether inadequate business organization BaFin has to require additional own funds (section 10 (3) sentence 2 no. 10 KWG). This is a binding provision, i.e. BaFin has no discretion as to whether to issue the measure.</p> • If necessary and adequate, BaFin can issue an order to (re)establish an adequate business organization (section 25a (2) sentence 2 KWG). Such orders usually also contain a timeframe in which the institution has to take the necessary steps. • Business restrictions: <ul style="list-style-type: none"> • Order the institution to take measures to reduce risks (section 45b (1) no. 1 KWG); • Subject the opening of further branches to prior supervisory approval (section 45b (1) no. 2 KWG); • Prohibit or restrict the conduct of certain business activities (namely the deposit and the credit business) (section 45b (1) no. 3 KWG). <p>Additionally, risk classification and provisioning are object of the annual external audits (section 23 and 26 PrüfbV). The recoverability of the loans and the adequateness of provisions have to be assessed according to section 26 (1) PrüfbV and could be further explored in a dedicated on-site examination if deemed necessary. If German banking supervisors are in doubt of the accurate valuation of certain assets (although approved by the auditor), BaFin can impose an offsetting item on the own funds determined by the institution (according to section 10 (7) KWG). There are differing views on whether the supervisor has the power to require the bank to adjust its classifications of individual assets, and increase its levels of provisioning. In Germany, loan valuation and provisioning has been</p>

	viewed as an accounting issue and reliance is placed on the external audit review of bank management decisions and their compliance with accounting standards. Under the SSM, some loan valuation exercises have been conducted and banks were asked to re-classify loans and/or increase provisions. However, these actions were challenged by banks and their auditors as not in accordance with IFRS 39.
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.
Description and findings re EC8	<p>CRR Part II, Chapter 4, on credit risk mitigation, Arts. 192 – 217, establish requirements on risk mitigants. Additionally, SREP provides guidelines for supervisors to assess collateral valuations.</p> <p>According to MaRisk; BTO 1.2.1⁶⁰ items 2 and 3 MaRisk, the value and legal validity of the collateral has to be assessed prior to the granting of the loan. Existing collateral values may be used if there are no indications of changes in value. If the value of the collateral is dependent to a substantial degree on the financial situation of a third party (e.g., guarantee), the counterparty risk of the third party has to be reviewed as appropriate.</p> <p>Furthermore, within the framework of further loan processing, the value and legal validity of the collateral has to be assessed at suitable intervals to identify if a threshold to be set by the institution under risk aspects, depending on the type of collateral, is exceeded (BTO 1.2.2 item 3 MaRisk). In the context of the annual external audit, the viability of the collateral as far as relevant for the valuation of positions is assessed according to Art. 35.2 PrüfbV in connection with Art. 34.2 PrüfbV. This assessment is limited, according to the latter article, to exceptional exposures (“bemerkenswerte Kredite”). These are (1) loans where significant provisions have been established; (2) loans that face a high risk of impairment; (3) loans for which collateral of extraordinary nature exists or (4) loans to managers and related parties (“Organkredite”) of large size or where there is a risk of a conflict of interest.</p>
EC9	<p>Laws, regulations or the supervisor establish criteria for assets to be:</p> <p>(a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and</p> <p>(b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).</p>
Description and findings re EC9	CRR Art. 178 provides the definition of default. EBA ITS on Supervisory Reporting (Forbearance and non-performing exposures) develops technical standards. In general, a default shall be considered to have occurred when either the institution considers that the obligor is unlikely to pay its credit obligations in full without recourse by the institution to actions or the obligor is past due more than 90 days on any material credit obligation. NCAs may replace the 90 days with 180 days for exposures secured by residential or SME

⁶⁰ BTO 1.2.1., item 2 reads: “As a general rule, the value and legal validity of collateral shall be reviewed prior to granting the loan”. When reviewing the value of collateral, available collateral values may be relied on if there are no indications of any change in value.”

	<p>commercial real estate in the retail exposure class, as well as exposures to public sector entities).</p> <p>In addition, according to Para. 156 of “EBA Implementing Technical Standard (ITS) on Supervisory reporting (Forbearance and non-performing exposures)” establishes: “Exposures shall be considered to have ceased being non-performing when all of the following conditions are met: (a) the exposure meets the exit criteria applied by the reporting institution for the discontinuation of the impairment and default classification; (b) the situation of the debtor has improved to the extent that full repayment, according to the original or when applicable the modified conditions, is likely to be made; (c) the debtor does not have any amount past-due by more than 90 days. An exposure shall remain classified as non-performing while those conditions are not met, even though the exposure has already met the discontinuation criteria applied by the reporting institution for the impairment and default classification according to the applicable accounting framework and Article 178 of CRR respectively.”</p> <p>The CRR is unspecific as regards the discontinuation of the default status (cf Article 178.5) The criteria for discontinuation of the qualification of Non-performing and Forborne exposures are to be applied by institutions for supervisory reporting on the top of the criteria they already apply for the discontinuation of the quality of defaulted exposure as per Article 178 CRR.</p> <p>In general, there are no special provisions laid down in the KWG or in the HGB dealing with this topic. Only the “internal” commentary to section 25 PrüfV includes a reference, when a loan shall be considered as non-performing. At least one of the two following circumstances must be fulfilled:</p> <p>Either the institution considers it unlikely that the debtor pays his liabilities in full to the institution, the parent company or its subsidiary, without any further activities of the institution like realizing collateral (if held). Or a major liability of the debtor against the institution, the parent company or any of its subsidiaries is more than 90 days overdue.</p> <p>The focus of this EC is broader than default, forborne and NPL definitions or reporting standards. The EC refers to supervisory guidance to identify a problem asset. A problem asset is one whose repayment capacity is deteriorating but is not an NPL or in default. Nor has guidance been issued to define cured, restructured or extended loans.</p>
EC10	<p>The supervisor determines that the bank’s Board obtains timely and appropriate information on the condition of the bank’s asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.</p>
Description and findings re EC10	<p>As a general rule, risk reports, which contain both a description and an assessment of the risk situation (and the results of the stress tests as well) in a comprehensive and meaningful form (AT 4.3.2 item 7 MaRisk), have to be submitted to the management board. Risk reports have to address all material risks (including credit and market risks). Details on risk reporting concerning credit risk are laid down in BTR 1 MaRisk. Inter alia, risk reporting of credit risk (which has to be carried out at least quarterly) has also to address the following aspects:</p> <ul style="list-style-type: none"> • the performance of the lending portfolio, e.g., by sector, country, risk class and size or collateral category, taking special account of risk concentrations;

	<ul style="list-style-type: none"> • the extent of limits granted and external lines; moreover, large exposures and other noteworthy exposures (e.g., material problem loans) have to be listed and commented on; • where appropriate, a separate analysis of country risks; • development of new business; • limit overdrafts; • any exceptional business; • development of the institution's risk provisioning. <p>The management board provides a quarterly risk report to the supervisory board (AT 4.3.2).</p>
EC11	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	<p>There is no mandated regulatory threshold above which loans should be reviewed on an individual basis for banks under IFRS.</p> <p>According to section 340e HGB in conjunction with sections 252 and 253 HGB, valuation and provisioning generally has to be conducted on an individual item basis (exceptions from this principle are allowed for standardized retail loans, e.g., consumer loans). Moreover, in the annual report the external auditor has to report about notable loans on an individual basis (structured by risk classification). At least the following exposures have to be regarded as "notable":</p> <ul style="list-style-type: none"> • loans to members of the board (executive and supervisory board, including connected persons); • loans for which provisions are or will be necessary in a significant amount; • non-performing loans (if material related to the total volume of loans); • loans with exceptional collateral.
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	BaFin regularly collects relevant financial data of the institutions on an ongoing as well ad hoc basis, e.g., large exposures or country loans, considering whether there are any concentration risks in individual institutions or in the banking sector as a whole. Since 2008 the BaFin and Bundesbank frequently collect information on - for example - specific risk exposures, management approaches, profitability indicators and so forth. After the evaluation of the above described datasets, BaFin and Bundesbank develop recommendations to individual banks or to the whole market, if necessary. ECB also monitors system trends.

	<p>However, aggregated system-wide data based on bank-specific reporting is limited and most information is collected on an ad hoc basis. Aggregate concentrations and problem asset information is not available for all banks. Problem asset (watch list) is collected for FINREP reporting banks but no breakdowns by gravity.</p>
Assessment of Principle 18	Largely Compliant
Comments	<p>There are three players that play significant roles the loan classification and provisioning process. Their roles complement and balance each other. Bank management has broad and flexible authority to establish loan classification and provisioning within the accounting framework. Accountants review management assumptions on impairment and determine whether the assumptions meet impairment definition under the accounting framework for financial disclosure. The third pillar is the banking supervisor that must introduce prudential considerations to narrow bank's management judgment and influence impairment assumptions.</p> <p>The focus of the prudential input is to provide bank management with prudential considerations when setting loan classification parameters and provisioning such as items to consider for residential mortgages, commercial real estate triggers. Important are collateral valuation considerations; such as, conservative valuations of realizable net values.</p> <p>Traditionally, in Germany, supervisors have viewed loan valuation as an accounting function. However, thematic reviews have recently conducted at SIs and recommendations made to banks on the need to increase provisioning and reclassify loans. Supervisors are considering collecting real estate data to provide support for inspectors to challenge banks' collateral valuations.</p> <p>It is important for the supervisory pillar in this triad to become more robust. In strengthening the supervisory role there should be:</p> <ul style="list-style-type: none"> • Consultation with banks and accounting firms on proposed prudential guidelines. • Training for supervisors on valuing loans and challenging assumptions on collateral values. • Develop market data to be able to gauge the reasonableness of collateral valuations by the bank. Not to set a value but to question significant variances from market values or trends. <p>As recommended in the previous BCP assessment: authorities should investigate possibilities to improve consistency in practices on the review of asset classifications and provisioning for example, across audit firms, allowing for better comparisons across individual institutions; and should evaluate their capabilities with regard to the supervision of credit risks and continue to improve the depth and frequency of their own credit risk related inspections.</p>
Principle 19	<p>Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.⁶¹</p>

⁶¹ Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. ⁶² Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings re EC1	<p>The EU-wide requirements regarding concentration risk do not fully cover the broader definition detailed in the footnote to this CP (“also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies”). CRDIV Article 81 generally states that NCA “shall ensure that the concentration risk arising from exposures to each counterparty, including central counterparties, groups of connected counterparties, and counterparties in the same economic sector, geographic region or from the same activity or commodity, the application of credit risk mitigation techniques, and including in particular risks associated with large indirect credit exposures such as a single collateral issuer, is addressed and controlled including by means of written policies and procedures.” The CRR provides a framework for large exposures (see EC 2).</p> <p>The ECB requires SIs to have a concise and practical definition of what constitutes a credit concentration. The definition should encompass the different types of credit concentration, including exposures to the same counterparties, exposures to groups of connected counterparties, exposures to counterparties in the same economic sector, geographical concentrations of asset exposure and concentrations in a particular commodity or currency, as well as large indirect credit exposures (e.g., to a single collateral issuer). The definition could also cover the application of credit risk mitigation techniques to the credit concentrations.</p> <p>ECB supervision pays close attention to the following types of credit risk concentration:</p> <ul style="list-style-type: none"> a) Concentrated exposures to the same counterparties, including compliance with the large exposures regulation on an individual and aggregate basis, the weight and evolution of the largest 10, 20 or 50 exposures, the Herfindahl index for the total loan portfolio to evaluate the share of each borrower in the total portfolio; and single-name concentration, where a granularity adjustment is used for assessing, also in comparison with the peers. b) Concentrated exposures to the same sectors: excessive concentration in one sector (real estate, agriculture, etc.) should be monitored closely, for instance, using the Herfindahl index based on NACE sector aggregated data. c) Concentrated exposures to specific products, e.g., credit cards or consumer loans, causing dependence on certain business lines, and concentrated exposures to specific collateral. d) Concentrated exposures to specific geographical regions/countries should be taken into account when assessing credit risk, linking these results to the macroeconomic analysis. In case of large banking groups with an important international activity, the geographical diversification benefits may be thoroughly analyzed and could lead to a positive adjustment.

⁶² This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

	<p>To allow the JSTs to perform a comprehensive analysis, the following indicators could be used: a) Breakdown of loans and advances and debt securities by country and type of counterparty; b) Breakdown of non performing exposures by country and type of counterparty; d) Breakdown of forborne exposures by country and type of counterparty.</p> <p>The German framework for concentration risk consists of KWG and GroMiKV with detailed provisions on counterparty default risk and MaRisk (concentration risk resulting from exposures to individual counterparties or to groups of connected counterparties, sector concentration, but also concentrations stemming from market risk, liquidity and operational risk and, if necessary, concentrations stemming from other risks considered as material for the institution).</p>
EC2	<p>The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure⁶³ to single counterparties or groups of connected counterparties.</p>
Description and findings re EC2	<p>CRR Article 393 requires that institutions need to have adequate procedures and internal control mechanisms for identifying, managing, monitoring, reporting and recording large exposures (i.e. exposures equal or in excess of 10 percent of the institutions' eligible capital in accordance to Art. 392 of CRR). According to CRR Article 389 an "exposure" means any asset or off-balance sheet item recognized as exposure under the standardized approach for credit risk. Following CCR Article 390 (4) & (5) these exposures are to be calculated by adding exposures of the trading and non-trading books, and the exposure to a group of connected client shall be calculated by adding exposures to individual clients in the group of connected clients.</p> <p>The ECB expects SIs to have data architecture and IT infrastructure that fully support its risk data aggregation and risk reporting practices not only in normal times but also during times of stress or crisis and also that the bank is able to generate and aggregate up-to-date risk data in a timely manner to meet all risk management reporting requirements including ad-hoc risk-management reporting requests, both from supervisors and internally. The data should be of sufficient granularity to enable identification of business lines, legal entities, asset types, industries, geographical regions or other segments relevant for the risk in question. Such data should give the bank the ability to identify and report risk exposures, concentrations and emerging risks. A bank's risk infrastructure must enable it to collect up-to-date risk data in a timely manner while also respecting the principles of accuracy and integrity, completeness and adaptability. A thematic review on risk data aggregation is planned over 2016-2017.</p> <p>For LSIs, the EBA Guidelines on Internal Governance are implemented in Germany by the BaFin circular "MaRisk". The EBA Guidelines on SREP only started being implemented in Germany on January 1st 2016. (See CP 15). Institutions must take suitable measures to effectively limit and monitor risks and associated risk concentrations, taking into account internal capital adequacy and risk appetite. According to AT 4.3.2 item 3 MaRisk, risk reports on the risk situation, including a description and an assessment thereof, must be submitted to the management board at appropriate intervals. These risk reports shall address risk</p>

⁶³ The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e. it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see "Measuring and controlling large credit exposures, January 1991).

	<p>concentrations and their potential impact separately (item 4). Details on risk reporting are set forth in BTR 1 to BTR 4 MaRisk.</p> <p>Specific requirements for counterparty risk as one of the material risks are determined in BTR 1 MaRisk. According to BTR 1 item 2 MaRisk, no credit transaction may be concluded without a counterparty-related limit (single counterparty limit, connected counterparty limit), i.e. without a credit decision. In addition, counterparty limits and issuer limits generally have to be set for trades (BTR 1 items 3 and 4 MaRisk). The counterparty-related limits have to be monitored and any instances in which limits are exceeded, as well as any measures taken as a result, have to be recorded. The responsible members of the management board have to be informed on a daily basis if counterparty and issuer limits exceed a level determined from a risk point of view (BTR 1 item 5 MaRisk). According to BTR 1 item 6 MaRisk risk concentrations have to be identified, with due account taken of any interdependencies. The assessment of risk concentrations must be based on qualitative and, where possible, quantitative procedures. Risk concentrations must be managed and monitored using suitable procedures (e.g., limits, traffic light systems or other precautionary measures).</p> <p>According to BTR 1 item 7 MaRisk a risk report containing the main structural features of credit business must be drawn up and made available to the management board periodically, at least once a quarter. The risk report has to contain, among others, information about the performance of the credit portfolio, broken down, for example, by sector, country, risk class and size or collateral category, taking particular account of risk concentrations, the scope of the agreed limits and external lines; in addition, large exposures and other noteworthy exposures (e.g., problem loans of material importance) must also be listed and, where applicable, commented on, a separate analysis of country risk.</p> <p>According to section 31 (1) PrüfbV, the audit of the annual accounts conducted by the external auditors must cover compliance with the large exposure rules at the level of the individual institution. According to section 34 (2) PrüfbV, the auditors have to report on remarkable contingents of credit lines. Contingents of credit lines have to be considered as remarkable when they reach or exceed the large exposure limits set forth in Article 392 CRR.</p> <p>Banks' compliance with the large exposures rules is, in addition to the regular valuation conducted by the external auditors, also examined in the course of special audits ordered by BaFin pursuant to section 44 KWG.</p>
EC3	<p>The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.</p>
Description and findings re EC3	<p>Article 392 CRR establishes that an exposures equal or in excess of 10 percent of the institutions' eligible capital is to be included in mechanisms to identify, manage, monitor, report and record risks.</p> <p>The ECB expects for SIs that the oversight function defines the risk management policies and determines the acceptable levels of risks which can be incurred. This process should include all risks that are material for the institution. In addition, when assessing credit risk controls, supervisors have to check whether a set of limits regarding credit risk is clearly established and periodically reviewed. However, there is no specific requirement that all material concentrations should be reviewed and reported to the bank's supervisory board.</p> <p>In Germany, AT 2.2 MaRisk requires that institutions can identify their material risks, as well as risk concentrations associated with these risks as a basis for an adequate risk management. In</p>

	<p>the context of the risk inventory (overall risk profile), the institution has to examine which risks may materially impair its financial position (including its capital resources), financial performance or liquidity position. When determining the risk strategy, appropriate consideration has to be given to the limitation of risk concentrations (AT 4.2 item 2 MaRisk). See EC 2 above - in order to assess risk concentrations, qualitative and, if possible, quantitative techniques should be used. Additionally, risk concentrations have to be managed and monitored using appropriate procedures (e.g., limits, "traffic light systems" or using other precautions).</p> <p>BTR 1 item 7 MaRisk requires the preparation of a risk report for the management board at least on a quarterly basis, which has to include the main structural features of the lending business. Among others, the report has to contain information about the performance of the lending portfolio (e.g., by sector, country, risk class and size), the extent of limits granted, external lines, large exposures and other noteworthy exposures, a separate analysis of country risk, where applicable, and significant limit breaches including reasons (please refer to BTR 1 item 7 MaRisk). There is no specific requirement that material concentrations are to be regularly reviewed and reported to the bank's supervisory board. For reporting from the management board to the supervisory board, see CPs 14 and 15.</p>
EC4	<p>The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.</p>
Description and findings re EC4	<p>Art. 394 CRR sets out reporting requirements for large exposures and certain largest exposures. These include the identification of a client or a group of connected clients, the value of the exposure before CRM, type of credit protection, and expected run-off of the exposure. An institution reports all exposures to a counterparty or a group of connected counterparties reaching or exceeding the threshold of 10 percent of its eligible capital to the supervisor. In addition, Regulation (EU) No 680/2014 on supervisory reporting and subsequent amendments, Annex VIII and IX, developed common reporting templates and instructions in relation to large exposures, which need to be submitted quarterly. The annexes include identification of the counterparty by general sector (government, credit institutions, households), and statistical sectoral codes for individual counterparties which are non-financial corporations. For geographical location, the place of residence of the individual counterparty is used.</p> <p>In the ECB, the concentration risk template of the STE requests the 100 largest loans overall and 100 largest loans to non-financial corporations. This data comprises also information on counterparty categories reported according to the FINREP counterparty breakdown. At a later stage more detailed information on the classification by sector may be requested, to complement the quarterly information in FINREP and COREP available to the supervisors.</p> <p>For LSIs, GL 31 but also the ESRB Recommendation 2011/C 342/01 are implemented in Germany by the BaFin circular "MaRisk". Besides the Large exposures reporting requirements, according to section 14 KWG, loans to an individual counterparty or a group of connected counterparties of EUR 1 million or more have to be reported to Bundesbank including geographical and sectoral information about the clients. This data base on borrowers (central credit register - CCR) is located at BBk. The CCR collates all such reports, computes the total indebtedness of an individual counterparty or a group of connected counterparties. The information derived from the reports on loans of EUR 1 million or more are regularly analyzed by the CCR for identifying potential risks to the stability of the overall financial system or to detect where there is a danger of firms becoming insolvent. In accordance with section 25a KWG and the MaRisk, a regular exchange takes place, especially with complex groups, concerning their lending policy for the purposes of managing and limiting sector and</p>

	country risks. The management instruments and information systems used for portfolio management are also analyzed in special audits under section 44 KWG. Additionally, in recent cases such as the financial crisis of Greece, institutions with large portfolios can be requested pursuant to section 44 (1) sentence 1 KWG to provide information on their country exposures. (see CP 21).
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a “group of connected counterparties” to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC5	<p>Articles 387 to 403 CRR set out the large exposures regime. Article 390 (4, 5) states that the overall exposures to individual clients or groups of connected clients are to be calculated by adding exposures of the trading and non-trading books, and the exposure to group of connected client shall be calculated by adding exposures to individual clients in the group.</p> <p>Article 4 (1) (39) CRR explicitly defines conditions under which counterparties, owing to control or economic connections, have to be treated as a group of connected counterparties. According to this definition, two or more natural or legal persons are regarded as a group of connected clients constituting a single risk if (i) one of them has directly or indirectly control over the other or others; or (ii) if – without any such control – they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties. For the further definition of the control-criterion, the CRR refers to the accounting framework, i. e. the European Directive on the preparation of consolidated financial statements, which includes detailed criteria for determining a relationship of control, see Art. 4 (1) (37) CRR and the reference to Art. 1 of Directive 83/349/EEC, now Arts. 21 and 22 of Directive 2013/34/EU and to a “similar relationship”. Regarding the second criteria, i.e. economic interdependence, a level II-text, i.e. the EBA-Guidelines from 2009 on connected clients, give further detailed guidance to institutions on how to apply this criterion. The 2009 EBA-Guidelines are applicable in Germany via a specific circular (Rundschreiben 8/2011). According to section 31 (2) PrüfbV, the audit of the annual accounts conducted by the external auditors must also assess the institution-specific procedures for the formation of groups of connected clients in compliance with Article 4 (1) no. 39 CRR. The EBA will review its-Guidelines in the context of the CRR and the new accounting rules.</p> <p>Commission Delegated Regulation (EU) No 1187/2014 defines the conditions and methodologies used to determine the overall exposure to a client or group of connected clients resulting from an exposure to a transaction with underlying assets (securitized and shares in collective investment entities) and the risks inherent in the structure of the transaction itself.</p> <p>In the event of diverging views between supervisors and the institution on how to apply the definition of connected counterparties supervisors may exercise discretion and enforce its opinion (the institution can challenge the supervisor’s opinion before court). Assessors had access to files where German supervision challenged the bank on the basis of economic interdependence and supervisory measures were applied.</p>
EC6	Laws, regulations or the supervisor set prudent and appropriate ⁶⁴ requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. “Exposures” for this purpose include all claims and transactions (including

⁶⁴ Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

	those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	<p>The definition of exposure for large exposures purposes is set out in Article 389 CRR and includes both on-balance sheet assets as well as off-balance-sheet items. According to Article 392 CRR, an institution's exposure to a client or group of connected clients shall be considered as large exposure where its value is equal to or exceeds 10 percent of its eligible capital. An institution shall in accordance with Article 395 (1) CRR not incur an exposure to a client or group of connected clients the value of which exceeds 25 percent of its eligible capital. If the client is a credit institution or investment firm, the limit is 25 percent of its eligible capital or EUR 150 million, whichever is higher. As for Article 11 (1) (parent institution) and (2) CRR (parent financial holding), the rules on large exposure limits also apply to consolidation at group level.</p> <p>If, in an exceptional case, exposures exceed the limit set out in Article 395 (1) CRR, the competent authorities may, where the circumstances warrant it, allow the institution a limited period of time in which to comply with the limit.</p> <p>For LSIs, the correspondent German rules are found in the circular "MaRisk" and section 13 KWG. The competent authority is under section 56 KWG empowered to impose a fine for the case that in violation of Article 395 (1) sentence 1 and 2 CRR, an exposure incurs. In relation to the counterparty limits which need to be set in order to limit counterparty default risks of the trading activities under BTR 1 items 3 and 4 MaRisk, BTR 1 item 5 MaRisk stipulates that excesses of counterparty limits which exceed a level determined from a risk point of view have to be reported to the responsible manager on a daily basis. The KWG sections mentioned also apply to SIs.</p> <p>Section 13 (2) KWG rules that an institution may incur a large exposure only by virtue of a unanimous decision by all its senior managers. The decision should be taken before the exposure is incurred. If this is not possible in individual cases owing to the urgency of the transaction, then the decision is to be taken promptly thereafter. The decision is to be placed on record.</p> <p>The annual account auditors are required, pursuant to section 31 (1) PrüfBV, to verify and assess institutions' compliance with the large exposure limits.</p>
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and findings re EC7	<p>In the SSM SREP Methodology, the inclusion of the impact of concentration on banks' stress-testing is part of the assessment of bank's ICAAP, and in particular Block3 (assessment of capital quantification under stress). In this context, banks' ICAAP stressed estimated figures are assessed taking into account and among other risks, concentration risk. To that purpose, the ECB relies on supervisory proxies dedicated to concentration risk which are tools used by supervisors to challenge banks' ICAAP stressed figures. Note that concentration is factored into the SREP only at consolidated level.</p> <p>EBA's GL 31 and 32 are implemented in Germany by the BaFin circular "MaRisk". According to AT 4.3.3 item 1 MaRisk, institutions have to carry out appropriate regular and ad hoc stress tests in respect of their material risks, which have to reflect the nature, scale, complexity and riskiness of the business activities. To this end, institutions have to identify the material risk factors pertaining to the respective risks. In addition to that, stress tests have to cover the assumed risk concentrations and diversification effects within and between risk types. The</p>

	stress tests must also take account of risks resulting from off-balance-sheet entities and securitization transactions.
Additional criteria	
AC1	<p>In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following:</p> <p>(a) 10 percent or more of a bank's capital is defined as a large exposure; and</p> <p>(b) 25 percent of a bank's capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties.</p> <p>Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.</p>
Description and findings re AC1	<p>See EC 6 above. Article 396 CRR outlines that excesses of the large exposure limits generally are not accepted. If in an exceptional case an exposure exceeds the limit set out in Article 395 (1) CRR, the institution has to report the value of the exposure to the supervisory authority which may, where the circumstances warrant it, allow the institution a limited period of time in which to comply with the limit.</p> <p>For both SIs and LSIs, according to section 56 (5) no. 17 KWG, excesses over the large exposure limits constitute in the event of negligence or deliberate intent a breach of administrative regulations and may entail the imposition of a fine. Repeated and particularly serious contraventions of the large exposure rules could also raise doubts whether the institution has sound administrative procedures and adequate internal control mechanisms for large exposures purposes. BaFin is empowered to require from a bank to hold additional own funds in the case that the bank does not have these kind of procedures and mechanisms in place (see section 10 (3) no. 1 KWG in connection with Art. 393 CRR).</p>
Assessment of Principle 19	Largely compliant
Comments	<p>There EU-wide requirements do not cover concentration risk in the broader sense of this CP. In general, both ECB and BaFin focus on concentration as part of credit risk, and discuss concentration of other types less systematically when some material risk is detected. Regarding LSIs, MaRisk provides a general framework for the supervision of concentration risk. While the ECB internal procedures for credit concentration are aligned with the CP, the expectations of the supervisor with respect to concentration risk management are not clearly communicated to the banks. More needs to be done for both LSIs and SIs on management of concentration risk derived from markets, currencies, funding, i.e., beyond credit risk.</p> <p>In addition, there is no requirement that all material concentrations to be regularly reviewed and reported to the bank's supervisory board (see CPs 14 and 15).</p> <p>The CRR sets the large exposures regime and determines the limits to be observed. While the framework is broadly aligned with the Basel 2014 Large Exposures framework (which will take effect from 1 January 2019 and will be applicable to internationally active banks, regardless of size), some exceptions under CRR 400(1) seem to be beyond the Basel LE framework and weaken the limit, such as for some off-balance sheet contingent facilities (which in the LE framework are subject to a 10 percent CCF floor). In addition, some exemptions under national discretion provided by 400(2) are not compliant with the LE regime: for instance, the Basel LE regime establishes that a covered bond meeting certain conditions can be assigned an exposure value of no less than 20 percent of the nominal value of the banks covered bond</p>

	holding, while Germany and other countries have exercised the option of completely exempting covered bonds from the LE framework. The eligible covered bonds under CRR article 129 also seem to be broader than the eligible covered bonds under paragraph 70 of the LE framework, as underlying assets in the EU can be exposures to banks, and maritime liens on ships. In addition, there is no stricter LE limit for G-SIBs as per the Basel LE framework. As the Basel LE regime is not yet in force, these gaps have not weighted on the grade. However, supervisors are urged to address these as soon as possible in their risk assessments.
Principle 20	Transactions with related parties. In order to prevent abuses arising in transactions with related parties ⁶⁵ and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties ⁶⁶ on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
Essential criteria	
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties". This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	<p>There is no EU-wide framework regarding related parties.</p> <p>In Germany, Sections 15 and 17 KWG contain rules governing the granting of loans to related parties of an institution (Organkredite). According to section 15 (1) sentence 1 KWG, these parties include, for example, managers of the institution, shareholders / partners in the institution who are not managers and members of supervisory body. They also include proxy holders (Prokuristen – the highest level of representation below director / senior management level) and other persons authorized to represent the institution in all aspects of its business (Handlungsbevollmächtigte), as well as the spouses and underage children of all aforementioned persons and silent partners of the institution (please refer to section 15 (1) sentence 1 numbers 4 to 6 KWG).</p> <p>"Organs" within the meaning of section 15 KWG also include enterprises organized in the form of a legal person or partnership provided: a) a manager, a proxy holder or another person authorized to represent the institution is a statutory representative or a member of the supervisory body of the legal person or a partner in the partnership; b) a statutory representative of the legal person, a partner in the partnership, a proxy holder or another person authorized to represent this enterprise is a member of the institution's supervisory body; c) a statutory representative of the legal person or a partner in the partnership holds a participating interest in the institution amounting to more than 10 percent of its capital; d) the institution or one or more of its managers hold a participating interest amounting to more than 10 percent of the enterprise's capital or are general partners of the enterprise; e)</p>

⁶⁵ Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

⁶⁶ Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

	<p>the enterprise holds a participating interest in the institution amounting to more than 10 percent of the institution's capital. Finally, according to section 15 (1) sentence 1 no. 12 KWG, these organs also include general partners, managing directors, members of the executive board or of the supervisory bodies, proxy holders or other persons authorized to represent an enterprise controlled by the institution or controlling the institution as well as their spouses, life partners and underage children.</p> <p>According to section 15 (1) sentence 4 KWG, the permission of withdrawals in excess of the remuneration due to a manager or a member of the supervisory body and in particular the authorization of advances on such remuneration are deemed to be equivalent to the granting of a loan. For loans to related parties according to section 15 KWG, the concept of loans as defined by section 21 KWG applies, which is very broad and includes on and off balance sheet exposures as well as leasing agreement.</p> <p>While it is clear supervisors can decide on control or economic connection of parties (see CP 19 EC 5), it is unclear in the legal text if in case of doubt regarding the definitions listed in section 15 KWG, supervisors could similarly decide on a case by case basis. Authorities believe supervisors would always be able to decide on a case by case basis, but there was no case or evidence that could be provided at the time of the mission.</p>
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties. ⁶⁷
Description and findings re EC2	Section 15 (1) sentence 1 KWG requires that, with the exception of staff loan schemes, loans to related parties are only granted on prevailing market terms. According to section 15 (1) sentence 5 KWG, loans to related parties not granted on prevailing market terms shall, at the decree of BaFin, be backed by Common Equity Tier 1 items in terms of Article 26 CRR (please refer to section 15 (1) sentence 5 KWG).
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	<p>According to section 15 (1) sentence 1 KWG, loans to related parties may only be granted on the basis of a unanimous decision by all managers of the institution and only with the explicit consent of the supervisory body. There is no requirement that members with conflict of interest are excluded from the approval and management of such transactions.</p> <p>Both decisions can be waived for intra-group exposures provided that the enterprise, to which the loan is granted, qualifies for a 0 percent risk weight under the standardized approach (please refer to Article 113 CRR).</p> <p>According to section 15 (3) KWG, other exemptions from the general rule apply to: a) loans to proxy holders or other persons authorized to represent the institution or to their spouses, life partners and under age children if the loan does not exceed one year's salary; b) loans to persons or enterprises specified in section 15 (1) sentence 1 nos. 6 to 11 KWG, if the loan amounts to less than 1 percent of the institution's eligible capital in terms of Article 4 (1) no.</p>

⁶⁷ An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., staff receiving credit at favorable rates).

	<p>71 CRR or to less than 50,000 Euros; and c) loans which are increased by not more than 10 percent of the amount approved in accordance with section 15 (1) sentence 1 KWG. These exemptions are meant to take account of the principle of proportionality and practicality.</p> <p>Section 15 (4) KWG sets out more detailed decision-making requirements. It stipulates that the decisions of the managers and the supervisory body to give their consent must be taken before the loan is granted. The decisions must include provisions on the interest rate payable and the repayment of the loan. These provisions must be documented. If a loan covered by section 15 (1) sentence 1 nos. 6 to 11 KWG has to be granted urgently, it is sufficient if all managers and the supervisory body subsequently approve the granting of the loan without undue delay. If the managers' decision has not been taken retroactively within two months, or if the supervisory body's decision has not been taken retroactively within four months of the date on which the loan was granted, the institution must report this fact to BaFin/ECB without undue delay.</p> <p>For certain lending operations and types of lending operations, the decisions of the managers and the supervisory body to give their consent to loans to the persons specified in section 15 (1) sentence 1 nos. 1 to 5 and 12 KWG may be taken up to a year in advance.</p> <p>If a related party loan is granted contrary to the rules, it must be repaid immediately, unless all managers and the supervisory body approve the granting of the loan retroactively. In addition, according to section 17 KWG, breaches of these decision-making requirements may possibly give rise to claims for damages against the senior managers and the members of the supervisory body.</p>
EC4	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	<p>BTO 1.1 MaRisk requires a general segregation of functions and voting for all credit risk exposures (see CP 17). The explanations of BTO 1.1 item 1 MaRisk state that these organizational requirements often cannot be implemented one-to-one in the case of loans to management board since there is no front office involvement. In addition to the provisions of the KWG, the German banking supervisors have usually required that members of the management board or supervisory board benefiting from the loan do not vote in the meetings which approve the loans.</p> <p>In case one or more managers of an institution abuse their competences to grant loans for their own benefit or the benefit of third parties or evade control procedures, the trustworthiness of the managers would be affected and this conduct may result in BaFin's or ECB's demand of dismissal according to section 36 (1) KWG in conjunction with section 35 (2) no. 3 and section 33 (1) sentence 1 no. 2 KWG. Supervisors did not recall this power ever being used in this situation.</p>
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	According to section 15 (2) sentence 1 KWG, BaFin may impose upper limits for the granting of loans to related parties on a case by case basis; BaFin is also entitled to do so even after the loan has been granted. According to section 15 (2) sentence 2 KWG, loans to related parties which exceed limits must be reduced; in the interim period they must be backed by CET1. According to article 9(1) 3rd subparagraph of the SSMR, the ECB may instruct BaFin

	to use these powers. However, to date there has been no imposition of upper limits on the granting of loans to related parties. BaFin considers such measure extreme, and understands as long as related party exposures are part of the risk appetite and are adequately covered no action by supervisors should be warranted.
EC6	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	See EC 1 and 2. Loans to related parties may be granted only on the basis of a unanimous decision by all general managers of the institution and with the explicit approval of the supervisory board. General requirements on risk management apply (see CP 15). There is also a corresponding obligation under section 33 (1) sentence 4 PrüfbV, which stipulates that the auditor must report about the institution's compliance with the rules governing loans to related parties. Beyond the annual auditor's report, there is no specific requirement that exposures and transactions with related parties are regularly monitored and reported. In the files reviewed by assessors the comment of the auditors regarding related party lending is very limited and only states no serious issues have been identified.
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	For LE reporting, see CP 19. There is no regular reporting of exposures to related parties other than the notification that a missing decision / approval of managing and supervisory board was made good, or the exposure is granted to a significant stakeholder (holding more than 25 percent of the voting rights or the of the bank's capital) but not at arm's length conditions. The long form report of the annual audit has to contain information on loans to related parties, see EC 6. More stringent reporting requirements can be imposed if particular loans to related parties are considered "noteworthy" loans because of their size or the way they are structured according to section 34(4) PrüfbV. Section 44 (1) KWG provides BaFin, Bundesbank or ECB the right to ask an institution for more information about its business including loans to related parties if necessary. Supervisor could not recall an instance when these measures have been applied regarding related party exposures.
Assessment of Principle 20	Materially non-compliant
Comments	There is no directly applicable EU wide framework for exposures to related party, the German regulation and legislation apply. The definition of related parties is wide and very detailed. While supervisors can decide on control and economic connection of parties (see CP 19 EC 5), the law is not explicit if in case of doubts regarding the definitions listed in section 15 KWG (Loans to managers) supervisors could similarly decide on a case by case basis. The framework covers loans in a broad definition that includes off-balance sheet exposures and leasing operations, albeit not all exposures which are required by this CP ("dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements,

	<p>derivative transactions, borrowings, and write-offs"). Related party loans must be granted on market terms.</p> <p>There is no requirement that individuals with conflict of interest are excluded from the whole process of granting and managing such exposures.</p> <p>There is no requirement that related party exposures are monitored and controlled separately and in aggregate.</p> <p>There is no regular reporting of exposures to related parties. Supervision of related party risk is mostly carried out by external auditors, whose analysis of related party risk seems to be very limited and compliance based. No limits on related party are imposed by laws, regulation, or the supervisor. The supervisor has the power to do so but to the date of this assessment has not used this power. BaFin considers such measure extreme, and understands as long as related party exposures are part of the risk appetite and are adequately covered no action by supervisors should be warranted.</p>
Principle 21	Country and transfer risks. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk ⁶⁸ and transfer risk ⁶⁹ in their international lending and investment activities on a timely basis.
Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	In the SSM SREP methodology Country Risk is detailed as a Credit Risk Subcategory which forms part of the SREP Process. Country and transfer risk are defined and also the guidelines for SREP assessment established. The SREP should take into account specific considerations about countries and markets to which these transactions are allocated taking into account political, regulatory and institutional frameworks. For this purpose, the following indicators for the country could be taken into account: a) its payment record, including compliance with renegotiation agreements and the payments to be made to international financial institutions; b) its external financial position, in particular total external debt, short-term external debt, debt service in relation to GDP and to exports, and external reserves; c) the economic situation, considering indicators relating to budgetary, monetary and balance-of-payments aggregates; indicators relating to economic growth (level of income, savings or

⁶⁸ Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporates, banks or governments are covered.

⁶⁹ Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country. (Reference document: *IMF paper on External Debt Statistics – Guide for compilers and users*, 2003.)

	<p>investment rates, GDP growth, etc.) and to vulnerability (export diversification, dependence on aid, etc.); Market indicators, e.g., credit ratings, secondary market debt prices and yield spreads. Debt instruments and contingent exposures to countries experiencing (at least) a significant macroeconomic deterioration that may affect the country's ability to pay should be adequately classified and provisioned for in the country risk impairment estimation.</p> <p>BaFin has issued on the basis of section 25 (3) KWG the Länderrisikoverordnung (LrV). According to section 1 LrV, credit institutions whose lending to borrowers domiciled outside the EU, the EEA, Switzerland, USA, Canada, Japan, Australia, and New Zealand, exceed a total of EUR 10 million on March 31, June 30, September 30, or December 31 in any year must provide BaFin and Bundesbank with details of these transactions, guarantees given and risk provisioning for country risk. If this reporting requirement applies, details must be provided of the transactions with those countries, in which the loans amount to at least EUR 1 million (section 1 (4) LrV). The report provides information on the end-borrower. These rules also apply to groups of institutions and financial holding groups.</p> <p>General risk management guidelines in MaRisk apply (see CP 15 and CP 17). AT 4.2 item 2 MaRisk specifically includes country and transfer risk as part of the credit risk. According to AT 4.3.2 item 3 MaRisk, risk reports on the risk situation have to be submitted to the management board at appropriate intervals. This risk report has to contain, where applicable, a separate analysis of country risks (please refer to BTR 1 item 7 and BTO 1.2(3) MaRisk). Assessors had access to files where country risk was a separate part of the risk report, including regarding countries excluded from LrV.</p>
EC2	The supervisor determines that banks' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	<p>See EC 1 for the approach to SIs. Among others the JST should assess if the management body of institutions approve strategies, policies and processes for the management of credit risk (including country risk).</p> <p>For LSIs, the obligations to have adequate policies regarding country and transfer risks arise from section 25a KWG and the MaRisk. According to MaRisk, responsibilities are given to the management board, not to the supervisory board. The scope of the MaRisk encompasses the management of all material risks, including credit risk and country risk. Pursuant to section 32 PrüfbV, the auditor must assess the scale of country risk incurred by the institution and the way in which they are managed and monitored. In particular, the auditor has to comment on the appropriateness of the analysis for estimating country risk.</p>
EC3	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	<p>In the SSM SREP Methodology, general Internal Governance and Risk Management requirements apply.</p> <p>For LSIs, see EC 1. The obligations to have specific systems regarding country exposures arise from section 25a KWG and the MaRisk. According to BTR 1 item 6 MaRisk, risk concentrations have to be identified and assessed by using qualitative and, if possible, quantitative methods. For the management and the monitoring of risk concentrations, appropriate methods, e.g., limits or "traffic light systems", should be applied. A risk report, which has to include the key structural characteristics of the lending business and therefore including country risk, where</p>

	<p>applicable, has to be drawn up and provided to the management board at least on a quarterly basis (BTR 1 item 7 MaRisk). Pursuant to section 32 PrüfV, the auditor must assess the scale of country risk incurred by the bank and the way in which they are managed and monitored. In particular, the auditor has to comment on the appropriateness of the analysis for estimating country risk. The files reviewed by the assessor approached country risk in general but did not discuss bank's MIS adequacy to identify and mitigate country risk.</p>
EC4	<p>There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include:</p> <ul style="list-style-type: none"> (a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate. (b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate. (c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.
Description and findings re EC4	<p>See EC 1 for SIs. In the SREP process, supervisors are expected to assess if debt instruments and contingent exposures to countries experiencing (at least) a significant macroeconomic deterioration that may affect the country's ability to pay are adequately classified and provisioned for in the country risk impairment estimation. Transactions should be allocated to the obligor's country of residence as at the date of the analysis, except in the following cases: a) those transactions that are guaranteed by residents of another better-rated country should be allocated, for the guaranteed portion of the credit, to the same group as the guarantor, provided that the guarantor has sufficient financial capacity to meet the commitments assumed; b) transactions that are secured by collateral, for the secured portion of the credit, should be allocated to the country of the collateral, provided that the collateral is sufficient and located in a better-rated country; c) exposures to an entity's foreign branches should be classified on the basis of the situation of the country of residence of the central headquarters of these branches – which therefore may not adequately reflect transfer risk.</p> <p>For LSIs, the German banking supervisors set no minimum risk provisioning amount for lending per country. Nor do the banking supervisors set any ranges for risk provisioning per country. For general provisioning framework, see CP 18. The Federal Central Tax Office (Bundeszentralamt für Steuern) publishes annually a list which provides information about the range of valid value adjustments on country risks (which excludes EU countries) based on assessments by international rating associations which are accepted by the tax authorities for taxation purposes.</p>
EC5	<p>The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.</p>
Description and findings re EC5	<p>For SIs, see EC 1. There is no specific requirement to include country risk in bank's stress testing; only general requirements that stress testing should cover material risks.</p>

	<p>For LSIs, according to AT 4.3.3 item 1 MaRisk, banks have to carry out regular and ad hoc stress tests in respect of the material risks (including country and transfer risks), which have to reflect the nature, scale, complexity and riskiness of the business activities. To this end, banks have to identify the material risk factors pertaining to the respective risks. In addition to that, stress tests have to cover the assumed significant risk concentrations (e.g., in countries) and diversification effects within and between risk types. The stress tests must also take account of risks resulting from off-balance-sheet entities and securitization transactions. Assessors reviewed some annual presentations by banks to BaFin where stress testing regarding country and transfer risk was shown.</p>
EC6	<p>The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).</p>
Description and findings re EC6	<p>For SIs, see EC 1. The JSTs could require any information needed.</p> <p>For LSIs, see EC 1 on the quarterly LrV reporting. In addition, information on country risk is available through CCR reports. Not only the overall exposure of an individual bank towards a given country is available, but also the breakdown of this exposure by certain types of credit, by economic sector of the borrower and by certain categories of borrowers, for example lending to companies, credit institutions, public sector, or private persons, as well as information like internal risk classification, probability of default, provisions and collateral. Furthermore, pursuant to section 44 (1) sentence 2 KWG, special audits can be ordered by BaFin, with or without a special reason. BaFin and BBk require more information and conduct more in depth analysis when significant international developments occur. Assessors had access to peer reviews, which also made use of information contained in the Central Credit Register and also considered indirect (second round) effects. As a result, banks reduced exposures or increase provisions.</p>
Assessment of Principle 21	<p>Largely compliant</p>
Comments	<p>Banks have little guidance from supervisors on their expectations regarding country risk. LSIs need to inform and stress country and transfer risk when this is a material exposure to the bank, and assessors had access to files which show the issue is occasionally addressed by ongoing supervision. This approach may be adequate for LSIs which have little international exposure. ECB has a more detailed and established procedure for addressing country and transfer risk in SIs (which comprise most of Germany's internationally active banks). However, such expectations and procedures under the SREP process are contained in internal documents, and banks have little guidance on how country risk is to be measured, monitored, and mitigated.</p> <p>Standard regular reporting on the basis of LrV excludes several countries, in particular all EU. To monitor and assess country risk, supervisors have had to make use of the CCR or ad-hoc special reports when international developments indicate the need. Assessors had access to peer reviews when this was the case. While this can be effective on specific situations, depending on ad-hoc requests may hinder the timeliness of supervisory analysis.</p> <p>There is no specific requirement that banks MIS themselves are able to identify, aggregate, monitor and mitigate country risk. There is no specific requirement to include country risk in bank's stress testing; only general requirements that stress testing should cover material risks. Assessors saw no evidence that country risk is indeed a regular part of stress testing.</p> <p>While an increase in Pillar 2 or imposition of provisions would be possible if country risk concentrations are detected, there is no specific guidance for banks on measures to provision</p>

	and mitigate country risk. The verification on whether internal limits and controls are adequate is mostly delegated to external auditors' annual report.
Principle 22	Market risk. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.
Description and findings re EC1	<p>MaRisk sets out expectations of bank's measurement and management processes associated with market risk which relies upon KWG section 25 for its legal basis. Within MaRisk, a number of sections are directly applicable to this EC:</p> <ul style="list-style-type: none"> - AT 2.2 MaRisk and AT 4.3.2 no. 1, deems market price risk as a material risk and as such banks are required to establish appropriate risk management and risk control processes which ensure that material risks can be identified, assessed, managed and monitored and reported. These processes should be included in an integrated risk-return management system. - AT 4.3.2 no. 2 MaRisk stipulates that the risk management and risk control processes shall ensure that the material risks can be identified early, fully captured and adequately presented. - AT 4.1 no. 2 MaRisk requires each institution shall establish an Internal Capital Adequacy Assessment Process (ICAAP). The institution's internal capital adequacy shall be taken into account when defining the strategies (AT 4.2) and adjusting them. Moreover, suitable risk management and risk control processes (AT 4.3.2) shall be put in place for implementing the strategies and ensuring internal capital adequacy. - BTR 2 includes specific requirements in relation to market risk and sets out the procedures for assessing market risk which need to be reviewed regularly according to BTR 2.1 no. 3 MaRisk. Such reviews shall examine whether the procedures produce robust results also in the event of severe market disruptions. Alternative valuation methods shall be defined for material positions in the event that market prices are unavailable, out of date or distorted for a prolonged period. These processes as well as the related tasks, competencies, responsibilities, controls and reporting channels shall be clearly defined and coordinated. This includes regular and ad hoc reviews of IT access rights, authorities to sign and other competencies that have been assigned. The same shall apply to interfaces to material outsourced activities and processes (AT 4.3.1 no. 2). <p>An important dimension of MaRisk is the concept of proportionality where institutions with more complex and sophisticated traded market risk strategies and positions are expected to make more extensive risk management arrangements than smaller institutions with less complexly structured business activities that do not incur significant risk exposure. For example, the larger and more sophisticated banks with more risk oriented approaches to traded market risk are expected to comply with additional market risk practices e.g., EBA's</p>

	<p>“High level principles for Risk Management” (February 2010). Taken together, the requirements described above form a generally sound set of regulations to establish the requirements for banks to implement effective risk management frameworks to measure and manage market risk.</p> <p>The supervisor relies upon a number of sources of information to confirm banks have in place a comprehensive framework to manage market risk. A key input into assessing the risk level is understanding the business model, strategy and key risk drivers of the bank. Supervisors take a number of actions to derive an adequate understanding of a bank’s strategy, risk profile, measurement approaches and risk management systems. A key input is the external audit report that is received annually which contains a detailed description of the bank’s business, traded positions, and risk management systems. The report also includes an assessment of risk. The report is a key input into the risk assessment the Bundesbank performs at least annually. Other inputs into the Bundesbank’s assessment include results of off-site analysis of routine regulatory reporting and ad hoc reporting. The risk profile is submitted by the Bundesbank to the BaFin assessing the risk profile and recommending any actions if necessary. At least annually, the German supervisory authorities will meet with the bank’s Management Board to discuss, inter alia, market risk.</p> <p>For those bank’s that are deemed higher risk, larger and more complex with a greater reliance on traded market risk for earnings, the Bundesbank will adjust its supervisory activities to obtain a broader range of inputs into its risk assessment. For example, on-site market risk examinations, specialized audits by the external auditor, and enhanced reporting from the institution. The frequency of on-site examinations for LSIs range from 12 years for the very smallest institutions with essentially no traded market risk to every three years for the largest LSIs. The on-site schedule for SIs is still under construction and a MEL is based upon the SREP score and the strategic priorities set for all SIs.</p> <p>The greater intensity of activities for SIs owing to their complexity, size and risk profile, allows a broader range of inputs into the assessment of risk level and risk controls available. Assessors were able to confirm that the JSTs regularly discussed market risk with senior management at various times throughout the supervisory cycle as well as with the chairs of the Board Audit Committee and Board Risk Committee.</p>
EC2	<p>The supervisor determines that banks’ strategies, policies and processes for the management of market risk have been approved by the banks’ Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks’ overall risk management process.</p>
Description and findings re EC2	<p>See EC1 above. The expectations for approving the bank’s strategy, policies and processes are directed to the management Board rather than the Supervisory Board (see also CP14). In relation to SIs, MELs require ongoing engagement with various levels of the bank’s governance structure i.e. Board Risk Committee Chair, Chair, Chair Board Audit Committee, CEO, CRO, COO and heads of departments - importantly head of markets divisions. Through these discussions the JSTs are able to obtain assurance that the Board has approved a market risk management framework and that management has effectively implemented the framework.</p> <p>Board oversight of the management of market risk is assessed through these engagements which, according to the SSM framework, will be conducted depending up the individual institution’s risk profile, size and complexity. Assessors saw examples where this process was working effectively.</p>

	<p>The assessment of bank's strategies and processes for the management of market risk is conducted using a number of inputs, including: request of documentation, meetings, on-site inspections with a view to assessing the level of awareness of the Board of the market risks generated by the different businesses, identify the reporting lines and accountabilities and the approval processes. The definition of the risk appetite framework, its translated into an articulated set of limits, the framework for monitoring and timely detecting market risk deterioration and the existence of a contingency plan are key areas of focus in this regard.</p> <p>Engagement with the Supervisory Board is not uniform across banks. JSTs have implemented meetings with members of the Supervisory Board (e.g., Chair, Chair of BAC/BRC). In relation to LSIs, the process of meeting with Supervisory Board's is exceptional and in relation to market risk there were no recent examples where a meeting with the Supervisory Board had taken place to discuss market risk issues. Assessors saw evidence that for the larger more systemic and risk oriented banks with a trading bias greater supervisory intensiveness and intrusiveness took place.</p> <p>For banks with a higher market risk profile (via the SREP score for market risk) where there are concerns with respect to governance and management of market risk, excessive risk taking etc. the supervisor adjusts their supervisory activities to achieve a greater level of assurance that the Management Board is involved in setting an appropriate strategy, measurement and management framework for market risk.</p> <p>For LSIs, a key input into the assessment of market risk starts with the receipt of the EA's annual report which contains a detailed description of a bank's policies and processes and business strategy of which market risk is one element. Once the report is received, the BBk will make an assessment resulting in a risk profile where market risk is rated. Other inputs into the process include off-site reporting, and inputs from previous market risk examinations. The culmination of this process is a meeting with the Management Board where all material risks will be discussed. Inputs into the annual meeting with the Management Board varies depending upon the risk profile but typically includes board minutes, management reporting and specific documents such as the ICAAP. Through this process the German supervisory authorities gain assurance that the management Board is effectively implementing the market risk strategy and management framework.</p>
EC3	<p>The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including:</p> <ul style="list-style-type: none"> (a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management; (b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff; (c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, where necessary; (d) effective controls around the use of models to identify and measure market risk, and set limits; and (e) sound policies and processes for allocation of exposures to the trading book.

Description and findings re EC3	<p>See also EC1 above. Specifically, on policies and processes for SIs, supervisors assess whether the bank's market policies and procedures are sound and consistent with the market risk strategy and cover all the main businesses and processes relevant for managing, measuring and controlling market risks. Market risk is included in the third element of the SREP assessment as part of the assessment of capital adequacy and Pillar 1 risks. An important input into the assessment is a bank's ICAAP which includes detailed information on market risk strategies, business models, measurement and management systems. In particular, supervisors assess whether the banks have effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk activities supervisors perform a mix of on-site and off-site analysis. For SIs with more complex trading operations and with offshore trading books the ability to aggregate risk positions in a timely manner is critical where positions can move quickly both daily and intra-day. For this reason, greater attention is dedicated to the effectiveness of information systems to support near real-time risk management at the consolidated balance sheet.</p> <p>According to AT 4.3.2 no. 3 MaRisk risk reports on the risk situation have to be submitted to the management board at appropriate intervals. Where necessary, the risk report shall also include proposals for action, for example on mitigating risk. Furthermore, BTR 2.1 no. 5 MaRisk states that a risk report on the market risk incurred by the institution shall be drawn up and made available to the members of the management board periodically, at least quarterly.</p> <p>As mentioned in CP 15, the MaRisk are currently under revision to integrate the requirements of the Paper of the Basel committee concerning risk data aggregation. For this purpose, a new module concerning risk data aggregation (AT 4.3.4) will be part of the MaRisk in the near future. Furthermore, the timely and accurate preparation of risk reports will be emphasized.</p> <p>JSTs assess whether there are operating limits aimed at ensuring market risk exposures do not exceed levels acceptable to the institution in accordance with the parameters set by the management body and senior management and the institutions' risk appetite. The JST meets regularly with various staff in the management structure to gain insight into risk levels and risk management, including the adequacy of the limit framework.</p> <p>MaRisk (AT 4.3.2 no. 1) establishes the legal basis for policies and processes to implement appropriate risk management and risk control processes in order to ensure that the material risks and associated risk concentrations are identified, assessed, managed, monitored and reported. According to the framework, these processes need to be embedded into an integrated performance and risk management (Gesamtbanksteuerung). This implies that suitable measures have to limit risks and associated risk concentrations can include quantitative instruments (e.g., limit systems, traffic-light systems) and qualitative instruments (e.g., regular risk analyses). BTR 2 and BTR 2.1 no. 1 MaRisk demand that a threshold system has to be set up on the basis of the institution's risk bearing capacity in order to limit market price risks. BTR 2.1 no. 2 MaRisk requires that no transaction, which entails market price risks, may be concluded in the absence of a market price risk limit. According to BTR 2.1 no. 5 a risk report on the market price risks incurred by the institution has to be drawn up at regular intervals, but at least on a quarterly basis, and provided to the management board. Assessors saw evidence of market risk examinations for LSIs where supervisors performed an assessment of the following: risk development and performance of positions that entail market price risks; any instances in which the limits have been substantially exceeded; changes to key assumptions or parameters which form the basis of the market price risk assessment procedures; irregularities occurring during the reconciliation of trading positions (e.g., with regard to trading volumes, repercussions on the P&L, cancellation rates).</p>
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	<p>According to AT 4.3.2 no. 5 MaRisk material risk related ad hoc information shall be promptly passed on to the management board, the responsible officers and, where applicable, to the internal audit function, so that suitable measures or audit activities can be initiated at an early stage. A suitable procedure has to be established for this purpose. Additionally, BTR 2.2 no. 1 implies that measures have to be taken to ensure that trading book transactions subject to market risk are promptly counted towards the relevant limits and that the person responsible for the position is kept up to date concerning the limits relevant for him/her and their current level of utilization. Suitable measures shall be taken in the event that limits are exceeded. An escalation procedure shall be initiated, where applicable.</p> <p>As all risk quantification methods and procedures are incapable of fully reflecting reality, the assessment of internal capital adequacy should take due account of the fact that the risk amounts contain inaccuracies – at both individual risk and aggregate level – or may underestimate the risk. If the risk amounts calculated using comparatively simple and transparent procedures are discernibly sufficiently conservative in terms of the limits and constraints of the procedures, a deeper analysis may be waived. Furthermore, the results of the quantified risk amounts derived from models shall be compared with the actual outcomes on an ongoing basis (BTR 2.2 no. 4).</p> <p>As a basic principle, only financial instruments and commodities held by an LSI either with trading intent or in order to hedge positions held with trading intent may be allocated to the trading book. According to Article 102 CRR positions in the trading book shall be either free of restrictions on their tradability or able to be hedged. Furthermore, the trading intent shall be evidenced on the basis of the strategies, policies and procedures set up by the institution to manage the position or portfolio in accordance with Article 103 CRR. Additionally, institutions have to establish and maintain systems and controls to manage their trading book in accordance with Articles 104 and 105. According to Article 103 CRR the institution shall have in place a clearly documented trading strategy for the position/instrument or portfolios, approved by management board and the institution shall have clearly defined policies and procedures for the active management of positions entered into a trading book. Furthermore, the institution shall have in place clearly defined policies and procedures to monitor the positions against the institution’s trading strategy. Article 104 CRR implies that institutions shall have in place clearly defined policies and procedures for determining which position to include in the trading book for the purposes of calculating their capital requirements.</p> <p>Regarding SSM practices, supervisors need to examine whether policies and processes regarding the positions to include in, and to exclude from, the trading book for regulatory purposes, are sound and consistent with the market risk strategies of the banks. The JST should verify that the institutions have Management Information Systems (MIS) that allow an accurate, timely identification, aggregation, monitoring and reporting of market risk exposures. The JST also assesses if there are data quality checks put in place to assure consistency of data, and that the management body and risk committee obtain regular and sufficient information on the nature and level of the bank’s market risk.</p> <p>The assessors saw evidence where the JST had verified that the bank’s risk appetite framework reflected the bank’s market risk strategies and policies defined by the management body translated into a set of binding limits, the breach of which is promptly reported and triggers adequate actions. The activity to perform this assessment was a mix of desk-based reviews of documentation, meetings with management, internal audit and compliance staff and on-site examinations.</p>
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	<p>When models are used, the JST verifies that the market risk management includes policies, procedures and controls around the use of models to identify and measure market risk. The JST verifies that the market risk management includes policies and processes for allocation of exposures to the trading book.</p> <p>For LSIs under the direct supervision of the German authorities, the requirements for market risk are contained within MaRisk, as the EBA Guidelines have not yet been implemented into national law.</p> <p>Standards on internal market risk models to calculate capital requirements (Pillar 1) are anchored in Articles 362 – 377 CRR. Especially Article 368 no. 1 CRR refers to the qualitative requirements regarding internal models. Among other things, this article implies that any internal model used to calculate capital requirements for position risk, foreign exchange risk or commodities risk shall be closely integrated into the daily risk-management process of the institution and serve as the basis for reporting risk exposures to the management board. Furthermore, the institution shall have a risk control unit that is independent from business trading units and reports directly to the management board.</p>
EC4	<p>The supervisor determines that there are systems and controls to ensure that bank' marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.</p>
Description and findings re EC4	<p>The legal basis for SIs is established in CRR Article 105 that sets out a number of requirements for banks regarding prudent valuation of trading book positions, including:</p> <ul style="list-style-type: none"> - establishing and maintaining systems and controls sufficient to provide prudent and reliable valuation estimates, that includes reporting lines for the valuation process that are clear and independent of the front office; - revaluing trading book positions at least daily; - performing independent price verification; - when marking to model, the model developed by the institution itself to be based on appropriate assumptions which have been assessed and challenged by suitably qualified parties independent of the development process; and. - establishing and maintaining procedures for considering valuation adjustments. <p>The framework for ensuring that all positions measured at fair value are subject to prudent valuation adjustments in accordance with the relevant legislation, in particular Commission Delegated Regulation (EU) No 526/2014 with regard to RTSs for determining proxy spread and limited smaller portfolios for credit valuation adjustment risk, are sound and consistent with the market risk strategy. This framework includes requirements for complex positions, illiquid products and products valued using models.</p> <p>In addition, the EBA Guidelines oblige supervisors to assess whether stress testing used by banks to complement their risk measurement system identifies relevant risk drivers, where illiquidity/gapping of prices, concentrated positions and one-way markets are provided as</p>

examples. Based on the above mentioned CRR article, EBA has published draft RTSs on prudent valuation of fair-valued positions, which provides details of calculating additional valuation adjustments (AVAs).

The SSM manual includes the controls and checks referred to in the EC4. Daily revaluation and reporting of risk measures (including VaR, Sensitivities, MtM, Stressed Exposure) of the trading book are minimum requirements. The JST assesses whether an independent function is responsible for verifying market data and prices, whether this function is adequately staffed, both in qualitative and quantitative terms, so as to be in a position to challenge the front office models. The Guidelines recommend supervisors to assess whether:

- The framework for ensuring that all positions measured at fair value are subject to prudent valuation adjustments in accordance with the relevant legislation, in particular Commission Delegated Regulation (EU) No 526/2014 with regard to RTSs for determining proxy spread and limited smaller portfolios for credit valuation adjustment risk, are sound and consistent with the market risk strategy.
- This framework includes requirements for complex positions, illiquid products and products valued using models.

Effective middle and back office functions are crucial to the effectiveness of market risk controls. The JST obtains routine reporting from IA and EA which provide an insight into the effectiveness of the risk management processes. The CRO report to the Management Board is another source of information for the JST. On-site examinations will routinely verify that there is an appropriate separation between front and back office, that rates are sourced externally and independently and verified for accuracy. The assessors saw evidence to confirm that the separation of front/middle/back office functions is included in on-site examinations.

For LSIs, BTR 2.1 no. 3 MaRisk in particular demands that the procedures used to assess market price risks have to be reviewed in order to verify that they also lead to useful results during periods of severe market disruptions. Alternative valuation methods must be determined for material positions in the event of longer periods during which market prices are unavailable, outdated or distorted. Additionally, in BTO 1 detailed rules are setup on how the credit institutions have to organize their trading and credit business. Additionally, BTO 2 describes in detail how the trading business has to be organized to ensure that all transactions are captured on a timely basis.

According to BTO 2.1 no. 1 MaRisk, the basic principle, which applies to processes in the trading business, is the clear structural segregation between the trading unit and the "risk control function" and "settlement and control function" up to and including management board level. BTO 2.2.1 no. 5 MaRisk implies that trades have to be promptly recorded after conclusion of the trade together with all the relevant transaction data, included in the calculation of the relevant position (updating of positions) and passed on to the settlement office together with all the documentation. Transaction data may also be passed on automatically via a settlement system. Furthermore, BTO 2.2.2 no. 4 MaRisk requires that transactions are subject to ongoing monitoring. In particular, assessments have to be made to ascertain whether the terms agreed upon are in line with market conditions. BTR 2.1 no. 4 MaRisk implies that the results calculated by the accounting department and the risk control function are subject to regular plausibility checks. AT 4.1 no. 8 MaRisk states that the choice of methods and procedures for assessing the risk-bearing capacity is the responsibility of the institute. The assumptions underlying the methods and procedures must be plausibly

	justified. The adequacy of the methods and procedures should be reviewed at least annually by the responsible staff.
EC5	The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.
Description and findings re EC5	<p>Regarding market risk specifically, as noted in EC1, CRD IV Article 83 requires supervisors to ensure that the internal capital is adequate for material market risks that are not subject to an own funds requirement.</p> <p>The JST verifies that the bank has in place a sound self-assessment process of the adequacy of the capital held against its market risks, as part of the ICAAP assessment. In addition, the SSM methodology includes “in-house” capital quantification tools based on both, reporting and managerial data for market risk, that the JST supervisor can use as a base for a, dialogue with the bank and, if necessary, challenge of the bank’s internal capital estimations.</p> <p>According to Article 105 CRR all trading book positions shall be subject to the standards for prudent valuation specified in this Article. Institutions shall in particular ensure that the prudent valuation of their trading book positions achieves an appropriate degree of certainty having regard to the dynamic nature of trading book positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of trading book positions. When marking to market, an institution shall use the more prudent side of bid and offer unless the institution can close out at mid-market.</p>
EC6	The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.
Description and findings re EC6	<p>SSM supervisors must assess whether an institution has implemented adequate stress tests regarding market risk that complement its risk measurement system, observing in particular stress test frequency; whether relevant risk drivers are identified (e.g., illiquidity/gapping of prices, concentrated positions, one-way markets, etc.); assumptions underlying the stress scenario; and internal use of stress-testing outcomes for capital planning and market risk strategies.</p> <p>On valuation adjustments, as noted in EC4, CRR Article 105 provides detailed requirements. (See EC4.)</p> <p>An adequate stress testing framework is a specific requirement for institutions using approved internal models. However, the JST should expect that banks using the standardized approach which are the most engaged in market activities have also developed some stress tests for risk management purposes.</p> <p>According to AT 4.3.3 no. 1 MaRisk, appropriate regular and ad hoc stress tests shall be carried out in respect of the material risks, which shall reflect the nature, scale, complexity and riskiness of the business activities. To this end the material risk factors pertaining to the respective risks shall be identified. The stress tests shall additionally cover the assumed risk concentrations and diversification effects within and between risk types. The stress tests shall also take account of risks resulting from off-balance-sheet entities and securitization transactions. The stress tests shall also be carried out at the firm-wide level. AT 4.3.3 no. 2 MaRisk requires that the stress tests also have to show exceptional but plausible events. Appropriate historical and hypothetical scenarios have to be defined. Additionally, the stress tests shall be used to analyze the impact of a severe economic downturn on the firm-wide level of the institution. The institution’s strategic orientation and its economic environment are likewise to be taken into consideration when defining the scenarios. AT 4.3.3 no. 4 MaRisk</p>

	further states that the appropriateness of the stress tests as well as their underlying assumptions have to be reviewed periodically, but at least once a year.
Assessment of Principle 22	Compliant
Comments	<p>The obligations in MaRisk are generally sound and establish the requirements for banks to implement effective risk management frameworks to measure and manage market risk. Assessors saw evidence that for the larger more systemic and risk oriented banks with a trading bias, greater supervisory intensiveness and intrusiveness took place. Market risk has been a focus of the supervisors during 2014 and 2015. In addition, a targeted review of banks' internal models will be carried out over several years. Supervisors periodically review banks to assess that their market risk management processes are consistent with the risk bearing capacity and the market risk management framework. Banks with the largest trading books are subject to enhanced focus mostly SIs and the remaining banks are on a normal cycle based upon their SREP score and risk profile. Assessors observed supervisory practice for both SIs and LSIs and verified compliance with this principle.</p> <p>Engagement with the Supervisory Board is not uniform across banks. JSTs have implemented meetings with members of the Supervisory Board (e.g., Chair, Chair of BAC/BRC). In relation to LSIs, the process of meeting with Supervisory Board's is exceptional and in relation to market risk there were no recent examples where a meeting with the Supervisory Board had taken place to discuss market risk issues.</p>
Principle 23	Interest rate risk in the banking book. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk ⁷⁰ in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	The legal basis for SIs to have an appropriate interest rate risk strategy and management framework is established in CRD IV Article 84 and requires the supervisor to ensure that institutions implement systems to identify, evaluate and manage the risk arising from potential changes in interest rates that affect an institution's non-trading activities. CRD IV Article 98.5 requires supervisory authorities to include the exposure of institutions to IRRBB in their SREP process. EBA IRRBB guidelines of May 2015 specify how the calculation of the standard supervisory shock required by the CRD IV shall be performed. The standard shock is measured as an economic value decline by more than 20 percent of own funds as a result of a sudden and unexpected change in interest rates of 200 basis points. These are complemented by the EBA's "Guidelines on SREP methodologies and processes". The guidelines set out elements that supervisors should cover when assessing the management

⁷⁰ Wherever "interest rate risk" is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

	<p>of interest rate risk from non-trading activities, including: interest rate risk strategies and appetites; organizational frameworks; policies and procedures; and, risk identification, measurement, monitoring and reporting; and, internal control framework.</p> <p>At the time of the mission, the framework to assess IRRBB was in the process of being integrated with the SREP. During the Phases 2 and 3 of the Risk Control assessment for IRRBB, supervisors specifically assess Governance arrangements as well as the Risk Appetite Framework related to IRRBB. An example of the framework included an assessment of whether the institution had a sound, clearly formulated and documented IRRBB strategy, approved by the management body, Whether the institution's IRRBB strategy and appetite were appropriate for the institution considering its business model; its overall risk strategy and appetite; its market environment and role in the financial system; and its capital adequacy; and whether the institution's IRRBB strategy broadly covered all the activities of the institution where IRRBB is significant.</p> <p>The off-site review of IRRBB within the SREP cycle is organized around the assessment of a) Risk Levels and b) Risk Controls. In both cases, the assessment distinguishes among three phases: 1) Collect available information, including quantitative estimates; 2) Screen information available against a set of pre-determined outcomes; 3) An in-depth review. Supervisors assess both the risk levels and risk controls. The assessment of risk levels is based on quantitative information mostly derived from COREP submissions but also complemented by management reporting and other sources. The assessment of controls is based on information gathered from a variety of sources including internal and external audit reports, meetings with management, meetings with risk control functions and results of on-site examinations.</p> <p>On-site examinations complement off-site surveillance and are designed to provide direct input into the assessment of risk management and the adequacy of the control environment, risk levels and whether bank policies and processes have been implemented. The on-site inspectors are also intended to assesses whether changes in external environment (macroeconomic conditions, market developments); regulatory conditions as well as internal factors (internal capital adequacy, liquidity, profitability) are reflected in IRRBB management framework.</p> <p>Moreover, the framework provided supervisors with a good foundation to assess both the quantitative and qualitative aspects. Owing to the relatively early stage of implementation of the framework however, the assessment was relatively high level and it was not demonstrated that the assessment of the control environment was based on first-hand knowledge.</p> <p>The legal requirements for the management of IRRBB for all banks are implemented in Germany by the KWG. KWG establishes the overall risk management obligations for LSIs (see section 25a (1) sentence 3, also AT 2.2 item 1 MaRisk). The specific requirements in relation to IRR governing LSIs is set out in BTR 2.3 item 5 MaRisk institution's procedures for assessing interest rate risk in the banking book shall capture the material features of interest rate risk. BaFin Circular 11/2011 (BA) sets out additional expectations about the measurement and management of IRRBB. Taken together, MaRisk and the Circular clearly establish the requirements for banks to have an effective interest rate risk management framework.</p>
EC2	<p>The supervisor determines that a bank's strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.</p>

Description and findings re EC2	<p>See EC1.</p> <p>During the SREP of SIs, the supervisor must confirm that the Board had approved the policies and processes for IRRBB. The JST used board minutes and board reporting as the basis for this assessment as well as confirmation from IA and EA reporting. This assessment is to be carried out at least annually but more frequently where necessary (for example in those cases where ad-hoc analyses or the results of on-site inspections might inform supervisors' assessment.</p> <p>On-site analyses complement off-site checks described above: on-site inspectors are best placed to verify the extent to which there is a real involvement of the management body in IRRBB management framework thanks to direct access to banks' key persons/intrusive view into the banks' internal governance. Owing to the early stages of implementation coverage of IRRBB on-site examinations was infrequent so that for only a small sample of banks the assessment of controls for IRRBB could be confirmed via on-site activities.</p> <p>For LSIs also see EC1. MaRisk sets out the expectations for the management body to establish, implement and regularly review/approve policies and processes in relation to IRRBB.</p> <p>The Bundesbank performs a comprehensive assessment of LSIs' risk profile at least annually which includes a consideration of IRRBB. As part of this assessment, the oversight of the Management Board is a key factor and whether policies and processes have been effectively implemented. In making this assessment, the Bundesbank makes an assessment based on information from a variety of sources: internal and external audit reports, quarterly reporting, meetings with risk controls functions as required, on-site examinations and annual meetings with the Management Board.</p> <p>The frequency of the assessment is at least annually. An update of information is obtained where changes occur and the LSI is expected to advise the supervisor in the event material changes have taken place.</p> <p>Evidence during the mission showed that the higher risk profile LSIs were given greater attention both as part of the on-site examination schedule as well as the review of policies and processes which was a key input into the annual meeting with the Management Body.</p>
EC3	<p>The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including:</p> <ul style="list-style-type: none"> (a) comprehensive and appropriate interest rate risk measurement systems; (b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions); (c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff; (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary; and (e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.

Description and findings re EC3	<p>See EC 1.</p> <p>For SIs, coverage of the requirements has not yet been fulfilled.</p> <p>Owing to the low rate environment, LSIs have been subject to heightened supervisory intensity throughout 2015 and 2016. All 1690 LSIs have been required to conduct a standard 200 bsp shock scenario as a way to identify outliers. Those LSIs with more complex portfolios have been required to conduct more complex measurement approaches. Across the LSI sector, the supervisor has conducted an analysis of outliers - IRRBB has been a special focus of LSI supervision.</p>
EC4	<p>The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.</p>
Description and findings re EC4	<p>CRD IV Article 97.1.c specifies that risks revealed by stress testing should be taken into consideration in the SREP, having taken into account the nature, scale and complexity of an institution's activities. Also, see EC 1 on EBA's guidelines.</p> <p>As part of the SSM framework for SIs, stress tests are assessed during on-site inspections: on-site practices include testing multiple scenarios; the breakdown of key assumption (e.g., behavior of assets/liabilities, correlations); changes to market and macro conditions and possible developments related to the business model. The coverage of simulations is also tested: stress tests should cover all sources of risks that institutions are exposed to and they should encompass all relevant group entities. Owing to the early implementation of the SSM framework, this was a work in progress.</p> <p>The aforementioned requirements are implemented in Germany by the KWG and the Circular 10/2012 (BA) MaRisk. AT 4.3.3 items 1 and 2 MaRisk state the obligation to carry out appropriate regular and ad hoc stress tests in respect of the material risks, which shall reflect the nature, scale, complexity and riskiness of the business activities. To this end the material risk factors pertaining to the respective risks shall be identified.</p> <p>The stress tests cover the assumed risk concentrations and diversification effects within and between risk types. The stress tests shall also take account of risks resulting from off-balance-sheet entities and securitization transactions. The stress tests shall be carried out at the firm-wide level of the institution. The stress tests shall also reflect exceptional but plausible events. Appropriate historical and hypothetical scenarios shall be defined. Additionally, the stress tests are used to analyze the impact of a severe economic downturn on the firm-wide level of the institution. The institution's strategic orientation and its economic environment are likewise to be taken into consideration when defining the scenarios. This risk has been a particular focus of on-site examinations and meetings with Management Boards given the low interest rate environment and pressure on NIM.</p>
Additional criteria	
AC1	<p>The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.</p>
Description and findings re AC1	<p>In relation to SIs, as part of the SREP process the JST is expected to review and evaluate the exposure of SIs to IRR arising from non-trading activities and that measures shall be required at least in the case of institutions whose economic value declines by more than 20 percent of their own funds as a result of a sudden and unexpected change in interest rates of 200 basis points or such change as defined in the EBA guidelines (legal basis in CRD IV Article 98 (5)).</p>

	<p>To ensure consistency in the measurement of IRRBB, SIs are expected to apply a standard shock as to be broadly equivalent to the 1st and 99th percentile of observed interest rate changes (five years of observed one day movements scaled up to 240 days a year) which is set out in the EBA technical guidelines currently effective.</p> <p>For all SIs, the ECB receives on a quarterly basis banks' estimates over the impact of a +/- 200bps shock on both the economic value of its equity and its one-year Net Interest Margin projections based on internal measurement systems (IMS). Both types of metrics contribute in the Pillar 2 assessment performed by bank supervisors at least on a yearly basis. Moreover, the evolution by banks' IMS risk figures is monitored by SSM horizontal functions on a regular basis.</p> <p>Supervisors are expected to use this scenario a starting point but need to take into account factors such as the general level of interest rates, the shape of the yield curve and any relevant national characteristics. It also recommends supervisors to review the size of the shock and discuss with the institution periodically the relevance of this standard shock. In addition to this standard shock, the JST used their own designated shock scenarios when analyzing the impact on the institution's economic value which took account of the unique risk characteristics of certain SIs based on their portfolio composition and basis risks, yield curve.</p> <p>In relation to LSIs, the requirements of AC1 for calculating standardized interest rate shocks is implemented by Circular 11/2011 (BA), the KWG and Finns- und Risikotragfähigkeitsinformationenverordnung (FinaRisikoV).</p> <p>Institutions have to calculate the impact of a sudden and unexpected parallel interest rate shock (± 200 basis point) on a regular basis (at least quarterly) and report the results to the Bundesbank (according to section 25 (1) and (2) KWG and FinaRisikoV). If the economic value of an institution declines by more than 20 percent of own funds (so-called "outliers"), an institution has to report this decline to BaFin and Bundesbank. The data was included in the assessment of capital as part of the SREP decision and it was evidenced that the supervisor had acted to increase the capital buffer based upon an assessment of IRRBB.</p>
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.
Description and findings re AC2	<p>The SI SREP framework establishes the basis for supervisors to assess whether own funds adequately cover the risks. Supervisors assess whether an institution is able to demonstrate that internal capital is commensurate with the level of risk, and, in this respect, they calculate the potential changes in economic value and impact on earnings. As part of the framework, horizontal cross-checks are performed by horizontal divisions of the SSM for SIs to ensure consistency across the assumptions and outcomes of institution's ICAAPs. JSTs assess whether the institution's ICAAP is reliable from multiple aspects: scope, validation and control, endorsement by management, embedding into operational decisions, outcome of quantifications, etc. The JST then sums up all capital requirements and calculates the TSCR (Totals SREP Capital requirement) ratio.</p> <p>This process was demonstrated for a sample of SIs and shown to be adequate.</p> <p>In regards to LSIs, the savings and cooperatives sector has been a particular focus of the supervisor owing to the low interest rate environment and the pressure on earnings. As a result, supervisors have been engaging with banks on this risk as part of the annual meeting with the Management Board and on-site examinations. The risk profile process has also been used to identify the most exposed banks and has resulted in increased frequency and</p>

	intensity of supervision for these institutions. While this remains an ongoing risk for German LSIs, the supervisor is responding accordingly and has engaged the highest risk profile banks.
Assessment of Principle 23	Compliant
Comments	IRRBB has received a significant amount of the supervisor's attention during the last several years and features as a key supervisory priority. Banks are required to measure, calculate and report their IRRBB exposure on a quarterly basis. Banks are also required to conduct regular stress testing using both standardized and bespoke scenarios, especially for those banks with more complex business models and optionality in the portfolio. Supervisors make an assessment of IRRBB through the SREP process and assessors saw evidence that showed this risk featured in the SREP assessment as well as a key topic in discussions with bank senior management. The German authorities have conducted short term data collection exercises in the last several years to deepen the understanding of system risks and exposure. There was also evidence to show that the assessment of IRRBB is included in the Pillar 2 assessment and capital add-ons for banks where the risk is material and where risk management needs attention.
Principle 24	Liquidity risk. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.
Description and findings re EC1	<p>A modified-LCR has been effective for all SI from October 2015. CRR Article 412 (1) provides that "Institutions shall hold liquid assets, the sum of the values of which covers the liquidity outflows less the liquidity inflows under stressed conditions so as to ensure that institutions maintain levels of liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under gravely stressed conditions over a period of thirty days. During times of stress, institutions may use their liquid assets to cover their net liquidity outflows." On this liquidity coverage requirement, the CRR Recital 101 provides that it "should be comparable to the liquidity coverage ratio set out in the final international framework for liquidity risk measurement, standards and monitoring of the BCBS taking into account Union and national specificities."</p> <p>The commission delegated regulation (EU) 2015/61 ("DA" in this CP) supplements the CRR with regard to the liquidity coverage requirement and provide details. The requirement follows the LCR set by the BCBS broadly, but with a number of divergences, which mostly are less conservative than the BCBS and as a result improve the ratios. These include, most notably:</p>

- the inclusion of covered bonds that meet certain requirements to Level 1 HQLA with a 7 percent haircut and a cap of 70 percent (DA Article 10);
- inclusion of non-externally rated covered bonds into Level 2BV HQLA (DA Article 12);
- inclusion of assets and representing claims to or guaranteed by the central government, the central bank, regional governments, local authorities or public sector entities (PSEs) of a Member State to Level 1 HQLA even if they are not marketable securities (DA Article 10); and,
- securitization of auto, SME and consumer loans to Level 2B HQLA (DA Article 13).

Treatments more conservative than the Basel rule includes application of 15-20 percent run off rates for certain retail deposits (DA Article 25 (2) (3)). Also, the 3 percent outflow rate for stable retail deposits cannot be applied during the phase-in period.

According to the calculation by the EBA (EBA 2014 LCR IA Report, December 2014), these changes lead to an increase in LCR of 13.9 percentage points for all the European sample banks (322) and decline in the number of banks failing to meet the 100 percent LCR from 74 to 17 (although one bank that is compliant under the Basel III LCR fails under the DA). This analysis shows the impact from the increase in the HQLA 2B instruments is by far the biggest for Europe. Assessors saw more recent analysis for German which suggested the impact was less.

The requirement entered into force from October 1, 2015 with 60 percent as the minimum ratio. The minimum ratio increased to 70 percent from January 1, 2016, and will increase to 80 percent from January 1, 2017, and 100 percent from January 1, 2018, one year ahead from the internationally agreed schedule (DA Article 38).

The EU has not taken a formal decision for implementing the Net Stable Funding Ratio (NSFR) yet. The EU commission is charged with presenting a legislative proposal by end 2016. While the ratio is not yet binding, SIs are expected to calculate and monitor the NSFR and the JSTs actively included this ratio in their assessment of liquidity following-up with institutions NSFR data.

In terms of the supervisory practices and procedures for supervising liquidity risk, the LCR is used as one of the indicators as input into the risk assessment (RAS). Additional liquidity monitoring metrics are used to compliment the assessment. Binding and non-binding thresholds in combination with supervisory judgment are applied in setting the risk score (1–4) using all available information to assess the risk level and the quality of controls. The balance of the different components in the final liquidity adequacy narrative depends on the judgment of the supervisor. The output of the liquidity adequacy assessment is then considered in the overall SREP assessment.

Qualitative requirements are also considered in the SREP process. During Phase 2, SIs are asked to respond to a number of questions in relation to the implementation of liquidity risk management strategies and policies and processes designed to measure, monitor and manage liquidity funding risk. The results of the questionnaire are filed within IMAS. The questions have been designed to reflect minimum regulatory standards as set out within the CRD, etc.

Regarding liquidity monitoring tools, a final draft Implementing Technical Standards on additional liquidity monitoring metrics, which covers tools prescribed in the BCBS LCR text, was adopted by the EBA and submitted to the European Commission. Alongside the LCR monitoring tools, a key component of the JSTs assessment of a SI's liquidity risk and adherence to risk limits is the review of an institution's Internal Liquidity Adequacy

	<p>Assessment Process (ILAAP) which institutions are obliged to perform according to CRR Article 86 (Block 2 assessment).</p> <p>The relevant liquidity regulations and minimum requirements for LSIs include:</p> <ul style="list-style-type: none"> - German Banking Act in the wording of the announcement of 9 September 1998, Federal Law Gazette I, page 2776, as last amended by Article 2 Abs. 5 G as of 12.06.2015 Federal Law Gazette I page 926 - Liquidity Ordinance (Verordnung über die Liquidität der Institute - Liquiditätsverordnung – LiqV) of 14.12.2006, Federal Law Gazette I, - MaRisk; revised version for the banking sector published on 14.12.2012, circular 10/2012 (BA) for financial institutions. <p>Section 25a (1) sentence 3 no. 3 lit. b) KWG in connection with Art. 86 of CRD IV imposes a general obligation on institutions to have suitable arrangements for managing, monitoring and controlling risks and to have adequate internal controlling procedures. MaRisk contains explicit requirements for the liquidity risk management and controls (see BTR 3 MaRisk). Quantitative requirements concerning liquidity risk are laid down in the Regulation on the liquidity of institutions (Liquiditätsverordnung - LiqV) as of December 2006 which is based on section 11 KWG. Section 11 KWG states that institutions must invest their funds in such a way that ensures that adequate liquidity for payment purposes is guaranteed at all times. In accordance with section 2 LiqV, the liquidity of an institution shall be deemed to be adequate if the liquidity ratio to be calculated does not fall below the value of one. The liquidity ratio denotes the ratio between the inflows including the liquid assets available in the first maturity band (1-month time horizon) and the liabilities likely to be called during this period. The liabilities comprise all relevant on-balance sheet items and off-balance sheet items such as liquidity facilities or lending commitments.</p> <p>In addition to the standardized approach of the LiqV, all banks can apply to use an internal liquidity risk and measurement approach which requires supervisory approval. Currently two LSIs have been granted approval of their internal liquidity model.</p> <p>Since October 2015, the EU-Implementation of the LCR as a binding minimum standard applies directly to all deposit taking and credit granting institutions in Germany. The level of application is extended to all credit institutions (except of guarantee banks and housing undertakings with a saving facility). Therefore, all institutions-which include LSIs- that carry material liquidity risks are captured by the LCR requirement. The phase-in of the thresholds aligns with that of SIs.</p> <p>The LiqV applies to all credit institutions including branches of foreign non-EU institutions in Germany additionally to the LCR until the LCR is fully implemented (100 percent requirement). LSIs are expected to calculate and monitor their NSFR. Supervisors conducted routine analysis on LSIs NSFR and deviations away from the 100 percent threshold, while not enforceable, will be followed up with bank senior management.</p>
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	See also EC1. A modified-LCR became effective from October 2015, which is designed to calculate the liquidity risk profile of banks under stressed assumptions for assets and liabilities (both idiosyncratic and market-wide). The calculation of the LCR includes on- and off-balance sheet risks. In particular, there is an additional outflow for collateral outflows for derivatives under market stress, for which the EBA has delivered a final draft RTS. Also there is an additional outflow for all contracts entered into the contractual conditions of which lead

<p>within 30 calendar days and following a material deterioration of the credit quality of the credit institution to additional liquidity outflows or collateral needs. The final draft ITS by the EBA (to be adopted by the EC) includes reporting on rollover of funding and pricing of funding. This will allow supervisors to monitor the ability of institutions to refinance in the markets.</p> <p>In terms of supervisory practices and processes for SIs, the full liquidity risk profile of the bank is covered by Element 4 of the SREP methodology and includes: i) an assessment of an institution's capacity to meet its short-term financial obligations (short-term liquidity risk); and ii) a longer-term assessment of the sustainability of its funding profile (funding sustainability risk). The inter-linkage between these two dimensions is taken into account in the overall assessment of this element. By taking into account both dimensions, short and long term, the context of markets and macro circumstances are considered. By applying a full suite of risk metrics (Block 1) and challenging the internal perspective of the bank through the challenge of the ILAAP (block 2) and supervisory stress tests (Block3) the liquidity requirements determined by the supervisor should reflect the individual liquidity risk profile of the bank.</p> <p>Analysis of liquidity adequacy by the JSTs followed this three step process evaluating, in Block 1, risk level and risk controls. In line with the EBA GL, short-term liquidity risk and funding sustainability risk level ratings are combined, using the average approach at the end of the process into a single liquidity risk level rating. The risk control assessment is performed together for short-term liquidity risk and funding sustainability risk, and one combined risk control rating is assigned. The final outcome is summarized in an overall liquidity risk narrative and score. It reflects the dynamic nature of short-term liquidity and funding risks which can materialize rapidly.</p> <p>The purpose of Block 2 is to assess the reliability of an institutions internal determination of liquidity and funding. This relies on the assessment of the institution's ILAAP or comparable framework – i.e. the process it uses for the identification, measurement, management and monitoring of liquidity. In block 3, the JST challenges the institution's assessment of its liquidity needs in stressed conditions. The assessment relies on a scenario inspired from recent real-life liquidity runs. It considers a weekly outflow of 3 percent and no-roll over of wholesale.</p> <p>The SREP processes for SIs are performed at least annually. The annual process is complemented with ongoing analysis of liquidity risk indicators which are reported monthly. Other information sources are also used in the ongoing assessment such as reports by internal and external audit, meetings with management, management reports and board reporting. The gathering of these information sources enables the JST to gauge how changes in the markets and macroeconomic environment are incorporated into the institutions liquidity risk profile and whether management actions are appropriate.</p> <p>In relation to LSIs, the quantitative Pillar 1 liquidity requirements (LiqV and LCR) are standardized measures whereas the approved liquidity models are tailor-made to the liquidity risk of an institution. Art. 11 KWG nevertheless allows the supervisor to impose specific liquidity requirements, taking into account the particular business model of the institution; the institution's risk management arrangements, processes and mechanisms, the outcome of the SREP and systemic liquidity risk that threatens the integrity of the financial markets of the Member state concerned.</p> <p>The individual liquidity risk profile of each bank is addressed in the MaRisk BTR 3. The general requirements of BTR 3.1 are that every institution has to have adequate liquidity risk management and monitoring tools. The following instruments are applied to varying degrees</p>
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	<p>depending upon the size, scale and complexity of the LSI: Maturity ladder, liquidity shortfall contingency plan, liquidity stress testing, liquidity buffers and an internal allocation system for liquidity costs, benefits and risks.</p> <p>BTR 3.2 contains additional requirements applicable to capital market-oriented institutions and therefore applies to all internationally active banks. BTR 3.2 is the national implementation of the CEBS (predecessor of EBA) "Guidelines on Liquidity Buffers & Survival Periods" from December 2009. It prescribes a four-week liquidity stress test that banks have to survive while relying only on high quality liquid assets. The stress scenarios comprise an institution specific scenario, a market stress scenario and a combined scenario. The scenarios have to be customized to the individual bank but have to contain several prescribed supervisory requirements:</p> <ul style="list-style-type: none"> - no rollover of unsecured funding by institutional investors at least during the first week of the institution-specific stress scenario; - withdrawal of part of the retail deposits for the institution-specific scenario. - general decline in the prices of marketable assets, particularly securities in the market stress scenario and - general deterioration in funding conditions in the market stress scenario. <p>These requirements include conservatism in the treatment of liabilities as there is no concept of operational deposits is applied and the definition of institutional investor is relatively broad which attracts higher outflows (institutional investors under the MaRisk are all financials and large corporates that manage liquidity professionally). All these instruments have to be customized to the individual liquidity risk profile of an institution and have to reflect all material liquidity risk drivers and the macro-economic conditions.</p>
EC3	<p>The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance.</p>
Description and findings re EC3	<p>The legal basis requiring SIs to maintain sufficient liquidity to withstand a range of stresses and to have a robust liquidity management framework is established in CRD Article 86 which provides an overall obligation for liquidity risk management, including that competent authorities ensure that institutions have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intra- day, so as to ensure that institutions maintain adequate levels of liquidity buffers. Also, EBA SREP guidelines apply (see CP 15).</p> <p>In terms of supervisory practices and procedures for SIs, the assessment of an institution's liquidity risk framework is a key component of the SREP methodology. The JST assess the SI's internal risk controls and policies, complemented by on-site inspections on the functioning of these arrangements. Secondly, the assessment of sufficient liquidity is the key process of the SREP for liquidity in which the liquidity adequacy of the institution is assessed against key metrics in Block 1. The JST's assessment of risk and controls for the SREP is conducted via meetings with management, review of documentation e.g., liquidity framework and policies, contingency funding plans Internal and external audit reports, relevant management information, such as CRO report to board and results of stress tests. Where necessary, on-site examinations are performed to assess the risk management framework and the implementation of policies and processes of which governance is a key topic to confirm that</p>

	<p>the framework has been approved and implemented by the Board. Meetings with senior management gain additional insight into the ongoing management of liquidity risk across the entire enterprise.</p> <p>The JST uses a standardized stress scenario to evaluate liquidity buffers and resilience to shocks. The scenario is applied across all SIs supervised by the SSM which allows benchmarking of the results. The scenario incorporates retail and wholesale stresses. The JST also assesses the results of the SI's internal stress testing which is based on assumptions unique to the institution. In block 3 the SSM supervisory liquidity stress test is used to challenge the bank internal stress test and assess if the level of liquidity is adequate. The assessment of the SIs liquidity risk tolerance (LRT) is a key step in determining whether the SI's policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance appropriately defined and communicated.</p> <p>MaRisk require banks to have a risk management strategy and policies and procedures on processes including liquidity risk which needs to be defined by the executive board and has to be reviewed at least yearly. The executive board is responsible for ensuring that policies and processes for risk-taking are developed to monitor, control and limit liquidity risk, and that management effectively implements such policies and processes. Supervisors receive confirmation that the requirements within MaRisk have been complied with via the annual external audit report. In relation to LSIs, at least annually, the Bundesbank performs a comprehensive assessment of an institutions risk profile and makes an assessment of liquidity risk management. Inputs into the assessment include monthly liquidity reporting, meetings with senior management, an assessment of controls and processes and results of stress testing.</p> <p>The frequency of on-site examinations depends upon the size, complexity and risk profile of the institution ranging from a cycle of three years for the larger and higher risk LSIs to once every five years and for the lowest risk and smallest LSIs every ten years. Ongoing monitoring of LSIs occurs through a combination of analysis of monthly liquidity reporting as well as liquidity calls with treasury staff (calls to treasury staff commenced during 2007 in response to the liquidity phase of the financial crisis where money markets began to seize up. The calls have continued albeit far less frequent). Inputs into the assessment of the sufficiency of liquidity buffers include regular stress testing that LSIs are required to conduct on at least an annual basis. The results of stress tests are submitted to the supervisor for assessment.</p>
EC4	<p>The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including:</p> <ul style="list-style-type: none"> (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and

	<p>(e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.</p>
<p>Description and findings re EC4</p>	<p>See also EC3.</p> <p>Specifically for SIs, JST must ensure that the liquidity risk strategy and liquidity risk tolerance are established and approved by the management body, and the liquidity risk tolerance is appropriate for the institution considering its business model, overall risk tolerance, role in the financial system, financial condition and funding capacity. The liquidity risk strategy and policies regarding their risk control are assessed primarily through Block 1 Risk control for liquidity. In this aspect of the assessment, at least annually. Phase 2 incorporates a compliance check on the existence of the bank strategies, policies regarding liquidity risk and phase 3 incorporates a more elaborate assessment on their appropriateness. A score of 1-4 is assigned on the risk control assessment which forms a key part of the assessment, influencing strongly the overall assessment.</p> <p>Supervisors must also ensure the limit and control framework is adequate for the SIs complexity, size and business model and reflects the different material drivers of liquidity risk, the risk limits are regularly reviewed and clearly communicated, and there are clear and transparent procedures regarding risk limits monitoring and how limit breaches are handled. Specifically on intraday liquidity risk, the institution adequately monitors and control cash flows and liquidity resources and forecasts when cash flows will occur during the day, and the institution carries out adequate specific stress testing for intraday operations.</p> <p>SIs must have an appropriate framework and IT systems for identifying and measuring liquidity and funding risk, in line with the institution's size, complexity, risk tolerance and risk-taking capacity. Supervisors must assess whether all material legal entities, branches and subsidiaries in the jurisdiction in which the institution is active are included, and whether the institution understands its ability to access financial instruments wherever they are held, having regard to any legal, regulatory and operating restrictions on their use, including, for example, the inaccessibility of assets due to encumbrance during different time horizons. Regarding reporting, supervision must assess the quality and appropriateness of information systems, management information and internal information flows supporting liquidity and funding risk management and whether the data and information used by the institution are understandable for the target audience, accurate and usable.</p> <p>JSTs must ensure the management body discusses and reviews the governance and policies for managing liquidity and funding risk and senior management ensures that the decisions of the management body are monitored. Also, specific reports and documentation containing comprehensive and easily accessible information on liquidity risk are submitted regularly to the appropriate recipients (such as the management body, senior management or an asset-liability committee). In addition, the liquidity risk strategy and liquidity risk tolerance need to be updated by the management body.</p> <p>The framework for JSTs to assess bank's compliance against the requirements listed in this EC is still being developed, though much has been achieved. The extent of verification and testing will need time to mature.</p> <p>In relation to LSIs, see also EC3. The strategies and the risk tolerance levels have to be defined by the management board. They have to be assessed and updated regularly and when necessary. In this context changes of the risk profile of an institution and the</p>

	<p>development of external factors have to be taken into account. BTR 3.1 item 1 requires that institutions have to ensure that they can meet their payment obligations at all times and that they have to manage and control their intraday liquidity risk adequately if relevant. This is complemented by the requirements to produce adequate liquidity overviews (BTR 3.1 item 3) and to have procedures in place for identifying imminent liquidity shortfalls as early as possible. Therefore, a sound day-to-day liquidity risk management has to be implemented. To gain assurance that banks are satisfying the specific elements of this EC, supervisors review bank policies and processes (at least annually), receive confirmation from the external auditor that MaRisk has been complied with (annually), an annual meeting with the management body, on-site inspections and routine calls with treasury staff.</p>
EC5	<p>The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include:</p> <ul style="list-style-type: none"> (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders; and (e) regular assessment of the capacity to sell assets.
Description and findings re EC5	<p>See above ECs on requirements regarding liquidity management which also covers funding. Specifically on funding plans, JSTs assess whether the funding plan is feasible and appropriate in relation to the nature, scale and complexity of the institution, its current and projected activities and its liquidity and funding profile. Regarding interaction between funding risk and other risks, JSTs take into account whether a SI recognizes the interaction between different risks arising from both on- and off- balance sheet items, when assessing whether the institution has an appropriate framework for identifying and measuring liquidity and funding risk.</p> <p>Internal SSM procedures establish that supervisors must assess whether the funding plan is robust in terms of its ability to support the projected business activities under adverse scenarios; whether the institution has adequate controls regarding the liquid assets buffer, including the whether the control framework covers the timely monitoring of the buffer and immediate availability to the group entity using the assets to cover liquidity risk; if the limit and control framework helps the institution to ensure availability of diversified funding structure; the institution's approach to developing strong relationships with funding providers to lower the risk of its access being reduced; and the institution's approach to maintaining an ongoing presence in the markets (testing market access).</p> <p>Supervisors assess the adequacy of the institution's liquidity buffer and counterbalancing capacity to meet its liquidity needs. But SSM's internal procedures do not recommend supervisors to assess whether the institution's policies and processes include the maintenance of the liquidity buffer. Also, procedures do not provide detailed recommendations on funding diversification, including regular review of concentration limits.</p> <p>In terms of supervisory practices and processes of the JST for SIs, the funding plan is assessed both qualitatively and quantitatively, first and foremost via the risk control questions in block</p>

1. As part of the assessment, the JST reviews the policies and processes to ensure that they include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy. The LST will assess whether the funding plan has been approved and regularly updated by the board and that the plan reflects the profile of the SI. Block 1 is a comprehensive framework for assessing the funding plan.

The maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress is assessed by the analysis of the LCR and the specific data collected on the liquidity buffer (STE) and on Asset encumbrance (ITS) on at least quarterly basis. The JST performs supervisory stress tests in Block 3 on at least annual basis and also via the banks internal reporting via Block 2 on the bank's internal determination of liquidity needs (stressed and unstressed) on at least annual basis.

Diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits is assessed by the analysis of the specific STE templates (future AMM) on the concentration of funding and indicators on the quality of the liquidity buffer. The JST does this assessment through the review of the funding plan, and not routinely assess this aspect of a SIs profile. Regular assessment of the capacity to sell assets is ensured via the operational requirements regarding the liquidity buffer according to the CRR and by a specific question on the test for market liquidity in the phase 2 risk assessment.

In relation to LSIs, the funding risk is addressed in several supervisory metrics:

- LiqV: The quantitative liquidity standard of the LiqV can be interpreted as a combined stock and maturity mismatch approach with different maturity buckets (up to 1 month, 1 up to 3 months, 3 up to 6 months and 6 months up to 1 year). Banks have to ensure that the identified cash outflows / liabilities with maturities up to one month (i.e., in the first maturity bucket) are covered by the respective inflows and liquid assets. This regulatory requirement makes a regular monitoring of the liquidity position indispensable.

Additional Monitoring Metrics:

- In the near future a supervisory reporting of additional monitoring metrics for liquidity will be introduced by an ITS of the EU Commission based on Art. 415 (3) (b) CRR. The EBA's proposed metrics to be covered by this ITS include the following:
- A maturity ladder (template and instructions). This comprises one contractual maturity mismatch template which provides insight into the extent to which a bank relies on maturity transformation under its current contracts. It includes time buckets ranging from overnight to up to 10 years.

Some additional monitoring tools (templates and instructions) relating to:

Concentration of funding by counterparty: this instrument allows the identification of those sources of wholesale and retail funding of such significance that their withdrawal could trigger liquidity problems. It is required that institutions report the top 10 largest counterparties from which funding obtained exceeds a threshold of 1 percent of total liabilities, together with information on the counterparty name, counterparty type and location, product type, currency, amount received, weighted average and residual maturity.

Concentration of funding by product type: this instrument seeks to collect information about the institution's concentration of funding by product type, broken down into different funding types relating to retail and wholesale funding. It is required that institutions report

	<p>the total amount of funding received from each product category when it exceeds a threshold of 1 percent of total liabilities.</p> <p>Concentration of counterbalancing capacity by issuer/counterparty: this instrument seeks to collect information about the reporting institutions' concentration of counterbalancing capacity by the 10 largest holdings of assets or liquidity lines granted to the institution for this purpose.</p> <p>Prices for various lengths of funding: this instrument seeks to collect information about the average transaction volume and prices paid by institutions for funding with different maturities ranging from overnight to 10 years.</p> <p>As part of the Guidelines on Funding Plans the EBA introduced a set of templates in spreadsheet format that contain harmonized definitions of the data items to be reported by institutions to their competent authorities. The set of templates and definitions assist the competent authorities in assessing the feasibility of the funding plans of credit institutions and their impact on the supply of credit to the real economy. BaFin has notified to the EBA full compliance with these guidelines. Before implementation of the guidelines there was no standardized reporting of funding plans. However, within the SREP supervisors required the institutions to deliver their funding plans upon request.</p> <p>For the first standardized delivery of funding plans as of 30.06.2015 BaFin and BBk have collected data from 30 institutions. Beginning with the reporting date 31.12.2015 the data will be collected annually.</p> <p>The requirements of the MaRisk regarding the liquidity and funding risk are listed in section "BTR 3". The following funding specific requirements are given:</p> <ul style="list-style-type: none"> - The overall principle is that institutions shall ensure that they can meet their payment obligations at all times. Further on, they are required to ensure sufficient diversification, particularly regarding their asset and capital structure. Additionally, they shall implement appropriate procedures and regularly review their suitability. Thereby the impact of other risks on the institution's liquidity shall be taken into account. Furthermore, the institutions shall draw up an informative liquidity overview for an appropriate period of time listing the anticipated inflows and outflows of funds. They shall take due account of the usual volatility in payment flows that also occur in normal market phases. They shall specify the assumptions on which inflows and outflows of funds are based. - The institutions shall continuously review their ability to cover any liquidity requirement that may arise, including requirements that may arise in a tense market environment. The review shall focus particularly on asset liquidity among other aspects. Besides that, the institutions shall regularly verify that they have permanent access to the funding sources that are relevant to them. This includes the requirement to establish and maintain relationships with liquidity providers if necessary. The institution shall maintain sufficient sustainable liquidity reserves (e.g., highly liquid, unencumbered assets) to cover any deterioration in the liquidity position that may occur. Furthermore, institutions have to monetize a sufficiently representative sample of its liquid assets at least yearly to test market access and to minimize the risk of sending negative market signals as a result of monetizing assets (Delegated Regulation Article 8 paragraph 4).
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	<p>Additionally, a deterioration of the funding situation is a stress assumption the institutions have to take into account with in their stress tests. It is mandatory for banks to analyze the impact of alternative stress scenarios.</p>
EC6	<p>The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.</p>
Description and findings re EC6	<p>The JST assess whether the SI's liquidity contingency plan (LCP) adequately specifies the policies, procedures and action plans for responding to severe potential disruptions to the institution's ability to fund itself. Supervisors need to assess: whether the actions described in the LCP are feasible in relation to the stress scenarios in which they are meant to be taken; the appropriateness of escalation and prioritization procedures detailing when and how each of the action can and should be activated; whether the institution has adequate policies and procedures with respect to communication within the institution and with external parties.</p> <p>The appropriateness of the assumption regarding the role of central bank funding in the institution's LCP is taken into consideration. On at least an annual basis, the JST makes an assessment of the adequacy and appropriateness of a SIs LCP.</p> <p>In relation to LSIs, the requirement to establish detailed contingency plans to handle unforeseen liquidity squeezes is set out in BTR 3 item 9 MaRisk. This also involves specifying the sources of liquidity available in these cases, taking into account any liquidity shortfalls. The institutions also have to determine the communication channels to be used in the event of a liquidity squeeze. The planned measures are to be reviewed regularly with regard to their feasibility and have to be adjusted if necessary, taking into account the results of the stress tests. Contingency funding plans are part of the annual review of the chartered accountants, as well, and play an important role within MaRisk on-site inspections. BTR 3.1, item 9 MaRisk requires banks to test the contingency plans regularly. The assessment of the contingency funding plans by supervisors is part of ongoing supervision.</p>
EC7	<p>The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies and positions and to develop effective contingency funding plans.</p>
Description and findings re EC7	<p>See also EC1 and EC3.</p> <p>In relation to SIs, the JST assess the adequacy of stress testing and scenario analysis, including whether an institution has implemented adequate liquidity-specific testing as part of its overall stress testing program; whether short-term and prolonged, and if institution-specific and market-wide scenarios are considered by the institution. On assumptions, supervisors assess whether the institution takes a conservative approach to setting them; that assumptions and scenarios are reviewed and updated sufficiently frequently. JSTs also assess the whether the outcomes of stress testing are integrated into the institution's strategic</p>

	<p>planning process for liquidity and funding and used to increase the effectiveness of liquidity management in the event of a crisis, including in the institution's liquidity recovery plan.</p> <p>The LCR which is applied to SIs is predicated on stressed assumptions regarding how assets and liabilities are calculated (both market-wide and idiosyncratic stressed scenarios). According to the SSM Manual "Book 7", stress tests play a key role in the quantitative assessment of institutions' liquidity needs and their ability to continue their operations throughout periods of stress. They also indicate the kind of backstop actions that credit institutions (and supervisors) need to take to ensure at an early stage that they are able to maintain their resilience if the simulated adverse scenario actually occurs. As part of the SREP, the JST evaluated the outputs of ST and the quality of ST frameworks (in line with CRD article 86 -9 and CRD article 98 1e).</p> <p>For LSIs, the LCR applies which provides a standardized stress scenario to understand LSI's resilience to short term disruptions in funding and liquidity markets. LSIs report the LCR on a monthly basis where supervisors assess the results on an individual basis but also using sector benchmarks and peer group comparisons.</p> <p>In addition to the LCR, LSIs are required to conduct regular liquidity stress tests as specified in BTR 3.1 item 8. LSIs are required to use the results of the stress tests when setting up the contingency funding plan. The supervisor will make an assessment of the results from stress testing at least annually, and will review the assumptions. The outcomes of the stress testing have to be linked to the risk management strategy and the risk appetite. The internal transfer price system of an institution has to be consistent with the stress testing results and parameters as well as with the limit system. LSIs run a standard stress test over a four-week survival horizon using conservative assumptions for the run-off rates (e.g., 100 percent for all institutional such as banks, cooperatives).</p>
EC8	<p>The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities.</p>
Description and findings re EC8	<p>The obligations for SIs in terms of FX liquidity are set out in CRR Article 415 (2) which requires an institution to report LCR separately in the currencies in which it has more than 5 percent of the total liability or it has a significant branch in a Member State using a different currency. DA Article 4 (5) requires institutions to also observe the LCR requirement in these currencies. While an FX LCR is calculated and reported, it is not a binding ratio. In terms of supervisory practices and processes, supervisors assess, in relation to liquidity in different currencies: a) the institution's liquidity needs taking into account the currency of the liquidity needs and, where an institution operates in different material currencies, the separate impacts of shocks in the different currencies to reflect currency convertible risk; b) the institution's ability to monetize its liquid assets taking into account whether the denomination of the liquid assets is consistent with the distribution of liquidity needs by currency, and c) whether the limit and control framework reflects the different material drivers of liquidity risk, such as currency mismatches.</p>

	<p>The current COREP data collection on the LCR and NSFR collects information on a significant currency basis - >at least 10 percent in order to receive specifications of the risks in different currencies. The reporting of different currencies makes institutions and supervisors aware of the risks to foreign currency transformation (where applicable). The additional liquidity monitoring metrics (ALMM) will provide further specification of these mismatches per significant currency when they are in force in 2016.</p> <p>In relation to stress testing and the risk control assessment the JST considers FX convertibility, access to FX markets and the ability to transfer liquidity across entities when making an assessment. The JST sets limits on the extent of liquidity transformation through the application of stress tests via the LCR in a foreign currency.</p> <p>In terms of LSIs, material liquidity risks stemming from foreign currencies is addressed in the MaRisk (BTR 3.1 item 12) which requires that institutions have to implement appropriate procedures for managing foreign currency liquidity risk in major currencies in order to safeguard any payment obligations. LSIs are required to have at least a separate liquidity overview, separate foreign currency stress tests and explicit inclusion in the liquidity shortfall contingency plan when they carry material foreign currency liquidity risk.</p> <p>As part of the pillar one reporting every institution has to provide separate LCR reports for each significant currency. BaFin did not set any formal limit on foreign currency liquidity risk, for example special thresholds for the foreign currency LCR. The review of currency mismatches is part of the normal ongoing supervision. Currency mismatches are discussed with the institutions and mitigating instruments tested for availability under stressed conditions (swaps, hedges). Supervisors take appropriate measures when institutions carry excessive foreign currency liquidity risks. Hereby transfer risks as well as regulatory or operational issues are taken into account. Few LSIs have significant FX liabilities, nonetheless, risks from FX liabilities and the need for assets in the same currency are considered as part of the risk profile assessment. The stress testing exercises conducted by banks form the basis for supervisors to discuss contingency arrangements and alternative funding sources.</p>
Additional criteria	
AC1	<p>The supervisor determines that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the implications for the sustainability of their long-term liquidity position. The supervisor requires banks to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.</p>
Description and findings re AC1	<p>When assessing risks to sustainability of the funding profile from concentrations in funding sources, the JST take into account the risk that asset encumbrance may have an adverse effect on the market's appetite for the unsecured debt of the institution. The banks risk control framework regarding asset encumbrance is also assessed, allowing the JST the basis to determine the level of asset encumbrance and the potential risks. The JSTs need to assess if the limit and control framework helps the institution to ensure the availability of sufficient and accessible liquid assets.</p> <p>ISs are required to calculate and report an asset encumbrance ratio: measuring the extent to which the assets of the bank are encumbered. It is calculated as a ratio between the encumbered assets and total assets. Asset encumbrance can increase during the times of stress since the investors are seeking for more protection and are only prepared to provide financing against additional collateral. Secured funding such as covered bonds and ABS- or</p>

	<p>REPO-based funding increase the level of asset encumbrance and decrease the amount of free unencumbered assets the bank can securitize or pledge in times of emergency</p> <p>SIs also calculate and report an unencumbered eligible assets ratio: measures the institutions static balance of liquid assets that are eligible as collateral for Euro system credit operations. It is calculated as a ratio between the unencumbered ECB eligible assets and total assets of the bank. During the times of severe stress ECB funding was the only source of funds for many credit institutions. Also many credit institutions use eligible collateral for managing intra-day liquidity needs.</p> <p>Regarding disclosure, following CRR Article 443, the EBA published Guidelines on disclosure of encumbered and unencumbered assets. The disclosure guidelines provide the set of principles and templates that enable the disclosure of information on encumbered and unencumbered assets by products on a consolidated basis. The disclosure guidelines, which were published in June 2014, were reviewed in 2015 and form the basis for binding technical standards which are currently being developed and likely implemented in 2016. In relation to asset encumbrance, this is as part of the "Pillar 3" disclosure by banks of which further binding technical standards are expected. In addition, part of IFRS 7 requires institutions to provide information related to collateral and pledged assets in financial statements.</p> <p>In relation to LSIs, the issue of asset encumbrance is currently addressed in the MaRisk which requires that all material risks have to be considered in the risk management of credit institutions and investment firms (MaRisk AT 2.2 item 1). By obliging LSIs to consider all material risks, LSIs are assumed to regularly measure, monitor and manage risks from asset encumbrance.</p> <p>There are two types of assets encumbrance which are covered by the MaRisk. Firstly, the risk of unsecured or only partially secured debtors of credit institutions affected by asset encumbrance, which may result in higher losses on uncollateralized exposures in case of an insolvency. Secondly, the risk arising from asset encumbrance for the bank itself, which might result in a lack of unencumbered, but encumberable assets and / or a restricted access to a sufficient amount of such assets.</p> <p>The risk associated with asset encumbrance for debtors of credit institutions is covered by MaRisk BTO 1.2.2 item 2 and 3, which requires a regular review of counterparty and credit risks, including the assessment of the value and the legal validity of collateral obtained by the bank. Thus, risks arising from a high asset encumbrance for debtors of credit institutions have either to be mitigated by collateral or have to result in higher risk parameters (e.g., LGDs) on unsecured exposures.</p> <p>MaRisk BTR 3.1 item 4 requires that institutions shall continuously review their ability to cover any liquidity requirement that may arise, even in a tense market environment. The review shall focus, among other aspects, particularly on asset liquidity. Institutions shall regularly verify that they have permanent access to funding sources that are relevant for them. Institutions shall maintain sufficient sustainable liquidity reserves (e.g., highly liquid, unencumbered assets) to cover any deterioration in the liquidity position that may occur in the short term.</p> <p>Moreover, according to MaRisk AT 2.2 item 2 of the MaRisk the institution shall, regularly and on an ad hoc basis, gain an overview of the risks to which it is exposed by setting up a risk inventory (overall risk profile). Since this risk inventory shall examine all risks which may materially impair the banks financial position, financial performance or liquidity position, it also covers all risks arising from asset encumbrance, independent of any "standard" risk type in which these risks might materialize.</p>
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	<p>MaRisk AT 5 item 2 requires that all guidelines addressing internal organization, including the rules governing the risk management and control processes, shall be set down in writing. MaRisk AT 3 ensures the responsibility of the management board for all material aspects of risk management. With regard to a general monitoring framework that provides timely information to the management and the relevant management bodies, BTR 3.1 item 11 requires that the liquidity position, stress test results and material modifications of the liquidity shortfall contingency plan shall be reported regularly to the management board. Particular liquidity risk arising from off-balance-sheet entities shall be addressed separately. Monthly reporting to the Bundesbank by LSIs shows asset encumbrance levels which is monitored by the supervisor. Changes in encumbrance are followed up as part of the routine liquidity calls.</p> <p>The upcoming version of the MaRisk will contain explicit requirements for institutions to have sound processes for the identification and reporting asset encumbrance, including the assessment of the impact of asset encumbrance in stress tests and in the liquidity contingency plan.</p>
Assessment of Principle 24	Largely compliant
Comments	<p>Since 2007/08 German supervisors have stepped up the frequency and intensity of interaction with credit institutions regarding their management of liquidity risk, contingency plans and funding requirements. Over time the level of frequency of contact has moderated given considerably more stable market conditions, where calls were daily at the height of the crisis to weekly and now less frequent but periodic. Supervisors have built-up in-depth understanding for liquidity funding risks at individual institutions through over this period.</p> <p>The LCR and LiqV requirements apply to all credit institutions as a Pillar 1 minimum standard. Banks are also required to run regular stress tests where the results are incorporated into the assumptions for contingency funding plans. While coverage is comprehensive across all banks, the LCR adopted in EU has a number of elements which are less stringent than the Basel agreed rule, most notably wider definition of HQLA. Given EC 1 clearly states that for internationally active banks the prescribed liquidity requirement should not be lower than the applicable Basel Standard, and the analysis by the EBA shows for the EU relatively large impact from these changes, the EU regulatory framework's compliance with the EC is problematic, even if the impact of these modifications concentrates on non-internationally active banks. Discussions with the authorities at the time of the mission suggested that banks make use of the benefits from the modifications although the impact has been reduced since the EBA study.</p> <p>Aspects of the assessment of liquidity risk management as part of the SREP were under improvement at the time of the mission. For example, benchmarks for liquidity risk indicators and will be developed during 2016. Also, guidance for assessing ILAAPs will be implemented for 2016. As a result, the analysis of the ILAAP was not fully implemented at the time of the mission and many aspects of the qualitative assessment of ILAAP had not featured in the SREP for SIs. Supervisors are aware however of bank's liquidity risk management processes and have established relationships with key areas within the bank managing liquidity funding risk. To this regard, SSM issued a letter in the beginning of the year on Supervisory expectations on ILAAP and harmonized information collection on ILAAP to enhance the analysis of ILAAP and its integration in the SREP.</p>

	Regarding EC8, SSM internal procedures do not specifically recommend banks to conduct separate analysis of liquidity risk strategy and monitoring of liquidity needs for each significant currency, including use of stress testing and regular review of limits.
Principle 25	Operational risk. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk ⁷¹ on a timely basis.
Essential criteria	
EC1	Law, regulations or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).
Description and findings re EC1	<p>See CP 15. The legal basis for banks to have established appropriate risk management frameworks is according to section 25(a) of KWG and expanded within MaRisk (BTR4). According to AT 2.2 MaRisk, operational risk is, in principle, a material risk.</p> <p>AT 4.3.2 item 1 MaRisk states that institutions have to establish appropriate processes for identifying, assessing, controlling, monitoring and reporting material risks. These processes should be included in an integrated risk-return management system. AT 4.3.2 item 7 MaRisk demands that the processes for identifying, assessing, controlling, monitoring and reporting material risks have to be amended to reflect any changes in the overall situation as soon as possible.</p> <p>CRR: Article 312: establishes the use of standardized approach and AMA depend on compliance with some criteria and standards. The criteria for standardized approach are detailed in article 320 and say that the bank must have in place: (a) a well-documented assessment and management system for operational risk with clear responsibilities assigned for this system. It shall identify its exposures to operational risk and track relevant operational risk data, including material loss data. This system shall be subject to regular independent review carried out by an internal or external party possessing the necessary knowledge to carry out such review; (b) the operational risk assessment system shall be closely integrated into the risk management processes of the institution. Its output shall be an integral part of the process of monitoring and controlling the institution's operational risk profile; (c) an institution shall implement a system of reporting to senior management that provides operational risk reports to relevant functions within the institution. An institution shall have in place procedures for taking appropriate action according to the information within the reports to management.</p> <p>The qualitative requirements for AMA are described in article 321 and state that: " (a) internal operational risk measurement system shall be closely integrated into its day-to-day risk management processes; b) an institution shall have an independent risk management function for operational risk; (c) an institution shall have in place regular reporting of operational risk exposures and loss experience and shall have in place procedures for taking</p>

⁷¹ The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

appropriate corrective action; (d) an institution's risk management system shall be well documented. An institution shall have in place routines for ensuring compliance and policies for the treatment of non-compliance; (e) an institution shall subject its operational risk management processes and measurement systems to regular reviews performed by internal or external auditors; (f) an institution's internal validation processes shall operate in a sound and effective manner; (g) data flows and processes associated with an institution's risk measurement system shall be transparent and accessible"

In terms of the risk assessment of operational risk, the EBA's SREP Guidelines form the basis for JST action, as operational risk is one of the key risks assessed as part of the SREP.

Importantly the supervisory engagement is proportional to the bank's size, complexity and risk profile. Potential supervisory activities that could be performed in relation to operational risk include the following:

- analysis of supervisory reporting (e.g., CoRep Templates 16 and 17), financial statements (e.g., provisions for legal risk /other risks and charges) and internal documentation of the supervised institution (e.g., operational risk internal reporting, minutes of operational risk relevant committees, risk management policies, internal audit reports and progress on remediation programs, validation reports)
- assessment of internal controls and procedures
- analysis of reports from external auditors
- meetings with external audit
- regular and ad-hoc meetings with the supervised credit institution's representatives at various levels of staff seniority (e.g., the risk management function, model development, validation unit etc.)
- ongoing analysis including regular monitoring of risk level indicators (operational risk losses, legal disputes, regulatory sanctions, major incidents, capital, stress-testing) and developments of the risk control framework (including aspects regarding governance, risk appetite, control tools and internal audit activity)
- thematic reviews (IT risk and cyber security)
- analysis of approved risk models (model developments and model changes, input data and parameters, model validation); approval of material model changes, extensions and new models
- benchmarking and peer analysis
- deep-dives on specific incidents/ topics
- on-site inspections
- assessment of ICAAP and SREP
- cooperation with supervisory authorities with local supervisory competence

ITS data submitted to the JST for routine assessment will depend on whether the SI is AMA, standardized or BIA. While some SI benchmark analysis has been performed, this is still work in progress. Additional data on Operational Risk losses is now being collected. DGIV is currently in the process of developing benchmarks which will help improve the ability for the JSTs to compare and contrast operational risk indicators against peer groups as a way to identify outliers in a more systematic way. Currently the process is manual and was not fully developed at the time of the mission. As a result, there is scope to strengthen the analysis of internal loss data against peer groups

During on-site inspections, obtain assurance that operational risk policy and procedures include all the relevant operational risk areas and establish a minimum set of operating instructions in order to have an effective risk management, and verify if they are adequately documented, updated, and available to all relevant staff.

	<p>Of the population of LSIs, the majority are BIA banks, 28 are standardized and one is an AMA bank. In terms of off-site analysis, supervisors receive information from a number of sources: annual external audit which includes a description of compliance with MaRisk and information associated with risk management frameworks; management reporting, meetings with the management Body, internal audit reports and information from on-site examinations.</p> <p>Unlike credit and market risk, the Bundesbank does not have a dedicated team of operational risk specialists to conduct targeted on-site examinations except for IT risk. Operational risk is seen as a general competency and is therefore discussed during all on-site examinations. The frequency for on-site examinations is approximately three years where the robustness of the operational risk framework is verified and tested.</p> <p>On at least an annual basis, the supervisor receives the external audit report which is a key input into the annual risk assessment profile which the Bundesbank produces for all LSIs and submits to the BaFin. The annual risk profile includes an assessment of all material risks including operational risk. The compilation of the risk profile will include quantitative and qualitative information.</p>
EC2	<p>The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.</p>
Description and findings re EC2	<p>See also EC1. EBA SREP guidelines constitute the basis for JST work regarding operational risk. The JSTs must take into account:</p> <ul style="list-style-type: none"> (a) the management body clearly expresses the operational risk management strategy and tolerance level, as well as the process for the review thereof (e.g., in the event of an overall risk strategy review, a loss trend and/or capital adequacy concerns, etc.); (b) senior management properly implements and monitors the operational risk management strategy approved by the management body, ensuring that the institution's operational risk mitigation measures are consistent with the strategy established; (c) these strategies are appropriate and efficient with respect to the nature and materiality of the operational risk profile and whether the institution monitors their effectiveness over time and their consistency with the operational risk tolerance level; (d) the institution's operational risk management strategy covers all the activities, processes and systems of the institution – including on a forward looking basis through the strategic plan – where operational risk is or may be significant; and e. the institution has an appropriate framework in place to ensure that the operational risk management strategy is effectively communicated to relevant staff. <p>In relation to LSIs, the obligations of the board to approve and regularly update the operational risk management framework is set out in MaRisk, specifically:</p> <ul style="list-style-type: none"> - AT 4.2 item 1 MaRisk requires the senior management to define a sustainable business strategy and a consistent risk strategy. The risk strategy has to take into account the objectives and plans of the institution's risk control of material business activities as set forth in the business strategy, as well as the risks of material outsourcings.

	<ul style="list-style-type: none"> - AT 4.2 item 3 MaRisk requires that the responsibility for the determination of these strategies cannot be delegated. Senior management is required to ensure the implementation of the strategies. The level of detail contained in the strategies depends on the scope and complexity as well as the risk content of the planned business activities. Furthermore, the senior management is required to review the strategies and adjust them as appropriate. - According to AT 4.2 item 5 MaRisk, the supervisory board of the institution has to be notified of all strategies and given an opportunity to discuss them. <p>The requirements within MaRisk clearly establish the Management Body's role in relation to establishing the operational risk strategy and approving policies. Equally MaRisk makes clear the role of the management Body to oversee the implementation of operational risk. Compliance with this requirement is confirmed through the external audit report as well as internal audit reports.</p>
EC3	<p>The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.</p>
Description and findings re EC3	<p>See also EC1. According to Art. 320 paragraph (b) CRR, one condition to qualify for the use of Standardized Approach for measuring the capital requirements for operational risk is that: "an institution's operational risk assessment system shall be closely integrated into the risk management processes of the institution. Its output shall be an integral part of the process of monitoring and controlling the institution's operational risk profile;" For AMA banks, according to Art. 321 paragraph (a), one condition in order to qualify for the use of AMA is that: "an institution's internal operational risk measurement system shall be closely integrated into its day-to-day risk management processes."</p> <p>In addition to the general activities and practices as mentioned under EC1, within the SREP, while assessing the risk control framework related to operational risk, in the annual RAS, SSM supervisors have to verify several aspects related to the criteria:</p> <ul style="list-style-type: none"> • that the management body of the supervised institution approves and periodically reviews the strategies and policies for taking up, managing, monitoring and mitigating the operational risks the institution is or might be exposed to; • the frequency with which operational risk management strategies and policies are updated; • evidence that updates of the strategies have been conducted promptly after the changes in operating environment (corporate events) or in legal environment; • the impact of the strategy changes regarding actively managing operational risk in the organization; • the adequate coverage of the legal and compliance risks, reputational risks and ICT risks. <p>The effective implementation of strategies, policies and processes for operational risk management are further monitored through off-site and on-site activities like assessing risk appetite / tolerance level set, management information, internal audit/ external audit reports, organizing meetings, thematic audits.</p> <p>In particular, discussions about risk strategies and their implementation are often on the agenda of the meetings with the operational risk function of SIs. The effective implementation of operational risk strategies is also included in the scope of on-site</p>

	<p>inspections, for example regarding effectiveness of operational risk strategies with respect to outsourcing processes and vendor management. Integration within the bank's overall risk management processes are monitored for example also during analysis of the overall risk appetite (as was in particular the case within the thematic review on internal governance and risk appetite).</p> <p>There are a number of areas where the supervisory activities to determine that the operational risk management framework is effectively implemented needs further attention by supervisors in applying the framework. Within the SREP assessment, more detail regarding the quality of risk management and controls is needed to confirm whether the operational risk framework is implemented effectively. This is especially relevant for AMA banks to verify and test through on-site examinations that the AMA framework is used by management as a way to measure, monitor and manage operational risk and that the constituent elements of the AMA framework are working as per the AMA framework e.g., risk and control self-assessments are being applied by business units as a way to assess the effectiveness of the control framework, an analysis of the business environment and control factors, use of internal and external loss data and lastly scenario analysis. Furthermore, the use of loss data as an ongoing tool to assess the operational risk framework needs further attention. Benchmarking loss data of peer group SIs will help strengthen the assessment of operational risk.</p> <p>Moreover, the frequency of on-site examinations to confirm the use of the AMA framework could be strengthened entailing verification and testing by the supervisor and/or specialist divisions, including assurance that the board/management body approves and effectively oversees management in ensuring that these policies and processes are implemented effectively. Assessors saw evidence where ongoing monitoring reports for operational risk had been conducted that looked at loss data by Basel event type, loss events and other factors exposing the entity to risk e.g., legal and compliance risks. In these reports there was no detail regard risk and control self-assessment, BEICFs, analysis of ELD or results of scenario analysis.</p> <p>In addition, assessors saw evidence of management information which included operational risk information (quarterly CRO report) as well as IA reports.</p> <p>In relation to LSIs, operational risk the adequacy of capital held for reputational risk is assessed within the business model analysis and business risk analysis. The supervisor conducts a variety of activities in relation to assessing the implementation of operational risk frameworks. The frequency and intensity of those tasks could be enhanced. In a typical supervisory cycle, the Bundesbank receives the annual external auditor report, but would not typically receive a LSIs operational risk policy and process documents. While an assessment of the implementation of the framework is undertaken on-site in line with the LSIs risk profile and systemic importance, the frequency, depth and scope of on-site examinations for operational risk could be enhanced.</p>
EC4	<p>The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.</p>
Description and findings re EC4	<p>See also EC1. Specifically in relation to this EC, the legal framework for outsourcing is based on the requirements for contingency and business continuity plans are set out in Article 85 paragraph 2 of CRD IV. For the assessment of SIs, the JST will use the guidelines issued by</p>

	<p>EBA on Internal Governance (GL44), which also encompasses sound IT systems, outsourcing arrangements and business continuity management. Banks should have in place contingency and business continuity plans; recovery plans, and appropriate training should be provided. According to the EBA guidelines, plans should be regularly tested and updated. In its SREP process regarding operational risk, the SSM follows EBA guidelines (see CP 8). The risks related to business continuity are part of regular meetings with SIs by the JST. In addition, the JST will request related documentation, for example scenarios, contingency and recovery tests results. Business continuity management and continuity plans are often part of OSI related to operational risk assessed as part of on-site examinations. Among the objectives of operational risk management related on-site inspections, it is relevant whether the institution has an adequate and effective Business Continuity Management process, including adequate procedures, regular testing and crisis management framework.</p> <p>In relation to DR and BCP, the relevant regulation is MaRisk contains high level guidance and does not prescribe minimum standards for the frequency, scope or nature of DR and BCP testing. Instead, banks are obliged to follow industry standards. In addition, there is scope for the JST to pay greater attention to the assessment of DR and BCP planning and the results of DR tests.</p> <p>AT 7.3 item 1 MaRisk established the basis for expectations of LSIs to develop and implement BCP and DR plans in the event of an event. Specifically, LSIs are required ensure provisions are made for emergencies relating to time-critical activities and processes (contingency plan). The measures set forth in the contingency plan have to aim at reducing the scale of any possible impact. The effectiveness and suitability of the plan have to be reviewed on a regular basis by means of contingency testing. The results of the contingency tests have to be communicated to the responsible staff members. If time-critical activities and processes are outsourced, the outsourcing institution and the external service provider must have contingency plans that are coordinated with each other.</p> <p>Additionally, AT 7.3 item 2 MaRisk requires that the contingency plan has to include business continuity and recovery plans. The business continuity plans shall ensure that back-up solutions are swiftly available in the event of contingencies. The recovery plans have to ensure the restoration of normal operations within an appropriate period of time. The contingency plans have to provide the communication channels to be used in the event of an emergency and they have to be provided to the involved employees.</p> <p>For LSIs, the establishment of a dedicated IT risk team at BaFin has conducted a number of on-site examinations targeted at IT risk which includes analysis of BCP and DR and assessors saw examples of findings communicated to banks on this issue.</p> <p>There are however no provisions within the regulations to establish minimum expectations in regards to testing, review and approval by board of DR and BCP plans. As a result, plans typically differ with regard to key aspects. Enhancing DR and BCP standards is currently an industry issue and meetings with banks confirmed this assessment.</p>
EC5	<p>The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.</p>
Description and findings re EC5	<p>See also EC1 in relation to the requirement for SIs to establish appropriate IT policies and processes. SSM JSTs use EBA's guidelines as basis for their IT assessments. These are based</p>

	<p>on two elements of the RAS: a) Risk Level: Operational Risk (identification of material operational risk sub-categories, ICT-risk, and b) Risk Control: as part of risk management and controls.</p> <p>The risks related to information technology are part of regular meetings with the institution (such as with risk management, internal audit or representatives of the bank with specific IT systems and infrastructure responsibilities). IT/Cybercrime is a supervisory priority (thematic review) for the SSM in 2015.</p> <p>Separate from the on-going supervision within the JSTs, the SSM conduct on-site inspections (OSI). IT is part of OSI related to operational risk. Among the objectives of operational risk management related on-site inspections, the following are relevant: assess whether the institution has an appropriate IT risk management; an appropriate governance framework concerning the IT infrastructure and staff, and whether the institution has an appropriate IT security management.</p> <p>In relation to LSIs, AT 7.2 item 1 MaRisk requires that the scope and quality of the institution's technical facilities and related processes have to be based, in particular, on the institution's operational needs, business activities and risk situation.</p> <p>AT 7.2 item 2 MaRisk requires that the IT systems (hardware and software components) and the related IT processes have to ensure the integrity, availability, authenticity and confidentiality of data. In order to ensure this, as a general principle, the design of the IT systems and the related IT processes has to be based on established standards. In particular, processes have to be set up for an appropriate allocation of IT access rights which ensure that staff have only those rights that they need to perform their particular tasks; IT access rights may be summarized in a role model. The suitability of the IT systems and related processes has to be reviewed on a regular basis by the staff responsible for the technical and professional aspects of the relevant processes and IT systems.</p>
EC6	<p>The supervisor determines that banks have appropriate and effective information systems to:</p> <ul style="list-style-type: none"> (a) monitor operational risk; (b) compile and analyze operational risk data; and (c) facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	<p>The CRR includes requirements on effective information systems applicable to banks under the standardized (Art 320 paragraph c) and AMA approaches (Art 321 paragraphs c and g) in the CRR (see EC1). There are no requirements for BIA banks.</p> <p>SSM supervision bases its action on the CRR and on the EBA SREP guidelines. Within the SREP (Block 1), the JST will make an assessment whether the internal audit of the supervised institution reviews the reliability of reporting systems and the accuracy of the MIS. In case of material weaknesses, the JST will assess how shortcomings in the IT framework have affected the management's perception of operational risk. Such analysis is included as part of the assessment of management information, as part of regular meetings with the operational risk function, as well as part of on-site examinations, especially those related to model changes/approvals.</p> <p>The collection, classification and analysis of loss data by SIs which are predominantly AMA users should be enhanced especially in relation to on-site examinations to verify that banks have in place appropriate systems and controls to collect and classify operational risk loss data. More effort is needed to ensure that the data is used as a way to identify where</p>

	<p>controls are needed to be enhanced, and analyzed by senior management and the board to then adjust risk settings and management.</p> <p>For those SIs subject to an on-site operational risk examination, among the objectives of on-site inspections, the following topics are covered: whether the institution has an effective reporting system; whether the institution has implemented adequate means for the identification and assessment of the operational risk inherent in all material products, activities, processes and systems to make sure the inherent risks and incentives are well understood; assess that the internal operational risk framework enables the institution to adequately monitor its operational risk exposure; and assess that an adequate operational risk data collection process is implemented, including adequate IT components.</p> <p>In relation to the supervision of LSIs, MaRisk makes general requirements for risk management systems which are intended to include operational risk of which IT systems and infrastructures are a subset. MaRisk does not contain a level of specificity for the collection and classification of operational risk data. On-site examinations have also typically not adequately focused on the assessment of loss data collection capabilities. The development of system-wide reports to compare and contrast operational risk losses across the banking sector is needed.</p>
EC7	<p>The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.</p>
Description and findings re EC7	<p>The legal basis for the SSM to require banks to have appropriate reporting mechanisms for operational risk is set out in RTS on supervisory reporting (EU Regulation 680/2014) requiring regular reporting to the supervisor regarding own funds requirements for operational risk (quarterly) and regarding operational risk losses by business lines and event types (semi-annually). This requirement does not, however, capture the expectation in this EC for a SIs to inform the JST in a timely manner of developments affecting operational risk at their bank. Examples include a breakdown in the reliability of control functions, weaknesses identified in risk management that could potentially lead to op risks, or near misses.</p> <p>In relation to breaches, EBA guidelines for SREP include recommendations that banks should have “appropriate internal controls and practices to ensure that breaches of and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action, and to competent authorities as required”. This however is a narrow interpretation of the EC which is intended to be broader than just ex-post breaches - it is intended to be forward looking to allow the supervisor the ability to ensure banks are acting to remediate to strengthen risk man and controls so that braches do not occur.</p> <p>In addition to the general practices mentioned under EC1, the supervisory practices include:</p> <ul style="list-style-type: none"> • regular assessments of the CoRep data; CoRep data is used to determine the starting scoring for the supervisory risk assessment; • regular analysis of internal reporting of the credit institution with regard to operational risk, as well as information disclosed in public reporting • regular monitoring of the litigations and corresponding charges • discussion on the developments of the risk profile within regular meetings with bank representatives, • the banks are also required to notify the supervisors in case of model changes or ask for approval in case of material ones.

	<p>Additionally, among the objectives of operational risk management related on-site inspections the following are relevant: legal requirements for external disclosure are adequately fulfilled; information provided to the JST about the internal operational risk management is in line with internal data and reporting, regulatory reporting production process ensures quality and accuracy; and information internally or externally reported or disclosed are in line with the internal operational risk management framework as it is effectively implemented.</p> <p>In relation to supervision of LSIs, AT 4.3.2 item 6 MaRisk demands that the senior management has to submit an appropriate written report regarding the institution's risk situation to the supervisory board of the credit institution on a quarterly basis. The report has to be written in a form that is comprehensible and meaningful and has to contain both a presentation and an evaluation of the risk situation. The report has to deal separately with special risks for business performance and the measures planned by the senior management. Important information for the supervisory board of the credit institution from the risk point of view has to be passed on immediately by the senior management.</p> <p>The senior management, jointly with the supervisory board, has to establish a suitable procedure for this. Section 44 (1) KWG requires institutions, groups, members of their bodies and employees to disclose information and documents concerning any business issues to BaFin and Bundesbank on demand. Moreover, section 26 (1) KWG requires institutions to annually provide a status report (Lagebericht) to BaFin and Bundesbank.</p> <p>The content of the status report is governed by section 289 HGB. The status report has to draw a realistic picture of the course of business including the company result. It has to contain an adequate and complete analysis of the course of business and the status of the company. Besides key financial performance indicators and an explanation of the annual balance sheet, the analysis has to include predictions on chances and risks. Furthermore, it has to contain special events which occurred after the end of the accounting year, the risk management goals and methods of the company.</p>
EC8	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers:</p> <ul style="list-style-type: none"> (a) conducting appropriate due diligence for selecting potential service providers; (b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment; and (e) establishing viable contingency planning. <p>Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and findings re EC8	<p>The legal framework for outsourcing is set out in Article 85 paragraph 1 of CRD IV. Banks are also required to comply with the requirements in MaRisk where there is a dedicated section on outsourcing. As part of the SSM Risk Assessment System (RAS), the topic is covered under operational risk and outsourcing. SSM supervisors base their action on EBA's guidelines on outsourcing and internal governance.</p>

The risks related to outsourcing are part of regular meetings with the institution and, if applicable, separate with the program management that deals with outsourcing projects. In addition, outsourcing is part of OSI related to operational risk. These verify that:

- outsourcing of activities follow a controlled process and outsourcing risks are adequately managed,
- continuity and quality of outsourced activities and integrity of data is not unduly influenced,
- management and governance bodies perform an adequate level of oversight over outsourced activities.
- the credit institution has robust processes for selecting outsourcing service providers,
- the contracts used for outsourcing agreement are proportionate to the risks involved and the size and complexity of the outsourced activity.
- the transition from the service performed in-house to the service performed by the outsourcing service provider or from one outsourcing service provider to another outsourcing service provider follows a controlled process and business continuity is warranted at any time,
- the outsourcing institution keeps enough internal skills to be able to adequately manage and challenge the service providers.

AT 9 item 2 MaRisk demands that, on the basis of a risk analysis, the institution shall determine on its own responsibility which outsourcings of activities and processes it regards as material in terms of risk (material outsourcings). The relevant operational units shall be involved in conducting the risk analysis. The internal auditing function shall also be involved within the scope of its duties. The risk analysis has to be revised when any material changes occur in the risk situation.

AT 9 item 5 MaRisk states that, if an institution intends to terminate a material outsourcing contract, it shall take measures to ensure continuity and quality of the outsourced activities and processes after termination of the respective contracts.

AT 9 item 6 MaRisk requires that the following terms shall be agreed upon in the outsourcing contract for material outsourcings:

- specification and, if necessary, description of service to be performed by the external service provider;
- stipulation of information and audit rights of the internal auditing function and external auditors;
- ensuring BaFin's information and examining rights and control possibility;
- power to give instructions where necessary; rules that ensure compliance with data protection provisions; specify termination rights and appropriate notice periods;
- rules on the possibility and the modalities of subcontracting which guarantee that the institutions continue to comply with the banking supervisory requirements;
- the commitment of the external service provider to inform the institution of any developments that may impair the proper performance of the outsourced activities and processes.

	AT 9 item 7 MaRisk states that the institution shall manage the risks associated with material outsourcings in an appropriate manner and properly monitor the execution of the outsourced activities and processes. This also includes a regular evaluation of the service of the external service provider on the basis of defined criteria. The institution must assign clear responsibilities for management and monitoring.
Additional criteria	
AC1	The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g., outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).
Description and findings re AC1	<p>The JST and/or ECB horizontal functions may decide to carry out a specific scenario analysis, with common assumptions and methodologies (e.g., description of the scenario, assessment time horizon, business units affected, parameters, acceptance criteria) for all the institutions under the scope. These exercises can provide common benchmark for further analysis and are typically to be conducted on annual basis. If available, JST should use the outcomes of these exercises to determine the level of operational risk in a specific institution.</p> <p>Horizontal analyses on operational risk are started in response to the Key Risk Assessment – a process involving all the SSM. Reviews employ a number of tools such as: bilateral discussions with banks perceived as most affected by the issue as well as national supervisors and third parties with knowledge of the matter, SSM-wide questionnaires, and follow-up discussions with banks. Results input the development of supervisory practices and contribute to supervisory planning/activities - including targeted on-site inspections.</p> <p>Since its inception the SSM has initiated two reviews on operational risk matters, IT risk and conduct risk. Other reviews related to Operational risks might be initiated in the course of 2016.</p> <p>At the time of the assessment, this was a work in progress and had not developed to form a system-wide view of all banks' vulnerabilities to points of failure as a forward looking tool.</p> <p>In relation to LSIs, AT 8.2 item 1 MaRisk request that before material modifications are made to the organizational and operational structure or the IT systems, the institution shall analyze the impact of the planned modifications on the control mechanisms and control intensity. When conducting inspections in order to assess banks' risk management systems supervisors evaluate and assess for material risks the risk management systems of common service providers which serve for multiple banks for material risks. Thematic or other types of analysis to identify common points of vulnerability across the population of LSIs had not been a supervisory priority.</p>
Assessment of Principle 25	Materially Non-Compliant
Comments	The area of operational risk has undergone several enhancements since the time of the last FSAP, most notably in the strengthening of dedicated IT risk specialists to conduct on-site examinations and develop supervision approaches for IT risk more generally. This team has been successful at deepening the institutional knowledge of IT risks and vulnerabilities and identify where standards need to be raised. The most recent example is in the area of data centers where IT risk specialists have attended DR testing for several of the larger LSIs.

Nonetheless, there are a number of areas where the regulations and supervisory activities need to be strengthened: data reporting, collection and use of loss data, verification that risk management is effectively implemented and DR/business continuity.

Supervisory practices to assess that operational risk management is effectively implemented needs to be given greater attention. An assessment of the effective implementation of bank's operational risk management framework is conducted at least on an annual basis. The inputs to this assessment come from a range of sources and require the supervisor to consider the effectiveness of risk management and controls as well as the risk level.

Within the SREP assessment, however, more detail regarding the quality of risk management and controls is needed to confirm whether the operational risk framework is implemented effectively. This is especially relevant for AMA banks to verify and test throughout the supervisory cycle that the AMA framework is used by management as a way to measure, monitor and manage operational risk and that the constituent elements of the AMA framework are working as they should (e.g., risk and control self-assessments (RCSAs) are being applied by business units as a way to assess the effectiveness of the control framework, an analysis of the business environment and control factors, use of internal and external loss data and lastly scenario analysis) (EC3).

Currently, the analysis and assessment of the effectiveness of operational risk management frameworks does not include a systematic assessment of loss data (both internal and external) and information regarding RCSAs is not routinely assessed in this process. Currently the frequency and depth of activities to test and verify the implementation of the AMA framework needs to be increased. The on-site examination process for AMA model accreditation appeared to be robust and assessors saw evidence of this process. However, the ongoing assessment of the implementation and use of the framework is absent.

In the context of the German banking system, a large number of credit institutions (predominantly LSIs) use the BIA approach. While banks using the BIA approach are expected to collect loss data, there are no directly applicable rules to guide the collection, classification and use of operational risk data. MaRisk contains both general and specific requirements for the identification, measurement and management of operational risk; however, there is no reference to how loss data is meant to be integrated into the overall management of operational risk.

The use of SI peer group benchmarks for operational risk needs further development. DGIV is currently in the process of enhancing further operational risk benchmarks which will help improve the ability for the JSTs to compare and contrast operational risk indicators against peer groups as a way to identify outliers in a more systematic way. Currently the process is manual and was not fully developed at the time of the mission. As a result, there is scope to strengthen the analysis of internal loss data against peer groups and other sources of external loss data (EC1). On-site examinations have also typically not performed in-depth analysis of the collection and classification of loss data.

While operational risk is considered as part of the annual risk assessments of banks, a system-wide analysis of common points of exposure to operational risk or potential vulnerabilities had not been conducted. Meetings with staff confirmed that there was an awareness of potential system-wide vulnerabilities, especially in the area of IT-related operational risk, however systematic analysis of the sector's exposure across the range of operational risk categories as a forward looking tool of emerging risks had not been conducted at the time of the assessment (AC1). There is an opportunity for greater emphasis on the collection and analysis of material outsource providers.

	<p>MaRisk is principles-based and lays out BaFin's expectations for risk management. In relation to Business Continuity Planning and Disaster Recovery Plans, MaRisk sets out general expectations rather than prescribing minimum requirements. Instead credit institutions are expected to follow industry standards.</p> <p>Risk profiles submitted by BBk will contain an assessment of BCP and DR issues, but only when these have been identified by the EA report or if there has been an IT risk on-site examination or an event. Otherwise, BCP and DR receive only limited consideration by the LSIs supervisors.</p>
Principle 26	Internal control and audit. The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent ⁷² internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	<p>Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address:</p> <ul style="list-style-type: none"> (a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g., business origination, payments, reconciliation, risk management, accounting, audit and compliance); (b) accounting policies and processes: reconciliation of accounts, control lists, information for management; (c) checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures; and (d) safeguarding assets and investments: including physical control and computer access.
Description and findings re EC1	<p>The general framework for EU jurisdictions is established by the CRD, the CRR and further developed by the EBA guidelines.</p> <p>CRD Art. 74.1, on internal governance and recovery and resolution plans, expects institutions to have "robust governance arrangements, which include a clear organizational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks they are or might be exposed to, adequate internal control mechanisms, including sound administration and accounting procedures, and remuneration policies and practices that are consistent with and promote sound and</p>

⁷² In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

effective risk management.” The article also indicates that the arrangements, processes and mechanisms “shall be comprehensive and proportionate to the nature, scale and complexity of the risks inherent in the business model and the institution's activities.”

CRD Art. 76 .5 introduces further specific requirements from institutions regarding the risk management function:

- in accordance with the proportionality requirement institutions must “have a risk management function independent from the operational functions and which shall have sufficient authority, stature, resources and access to the management body”;
- “risk management function ensures that all material risks are identified, measured and properly reported”; and that “the risk management function is actively involved in elaborating the institution's risk strategy and in all material risk management decisions and that it can deliver a complete view of the whole range of risks of the institution”;
- “risk management function can report directly to the management body” independent from senior management, and can raise concerns, where specific risk developments may affect the institution;
- the “head of the risk management function shall be an independent senior manager with distinct responsibility for the risk management function”.

CRR requires adequate internal control mechanisms including internal control processes and tools put in place regarding risk identification, measurement, monitoring control, and capital requirement calculation, as well as for prudential consolidation and identifying and managing large exposures.

With regard to practices and procedures, supervisors regularly assess internal control and audit function of financial institutions. These assessments cover the key dimensions of a credit institution's risk profile, namely its business model and profitability, internal governance and risk management, capital related risk categories, liquidity risk and adequacy of own funds. In general, it relies on a risk-level rating and a risk-control rating using a “constrained judgment”, i.e. a rating proposed by the automated scoring system can be adjusted up to a certain extent, if deemed it appropriate and justified. Both rating changes and their rationale need to be documented and saved to the supervisory IT system together with relevant supporting documentation. All the changes to the rating or analysis are approved in line with the approval rights in the respective Directorate General.

The on-going risk profile assessment carried out by supervisors also covers the assessment of methodologies used for measuring and managing risk and the Internal Capital Adequacy Assessment Process (ICAAP) of the credit institution.

Supervisors also evaluate “Internal governance”, as part of the overall corporate governance—that includes the definition of the roles and responsibilities of the relevant persons, functions, bodies and committees within an institution and how they cooperate, both in terms of a governance framework and in terms of actual behavior. This includes such functions as internal audit, risk management and compliance. In addition, the internal governance framework in this sense encompasses all of the institution's rules and behavioral standards, including its corporate culture and values, which aim to ensure that the institution or group is properly managed. Among other things, adequate internal governance means setting the bank's targets, introducing an effective administration and internal control system, identifying and taking on board the interests of all the institution's stakeholders and going about its business in line with the principles of sound, prudent management, at the

	<p>same time abiding by any legal and administrative provisions which may be applicable. If the financial institution is part of a group, the group dimension also needs to be assessed.</p> <p>To increase efficiency and allow deeper focus in specific areas supervisors evaluate, if a board establishes certain specialized board committees. The committees should be created and mandated by the full board. According to the CRD 4 requirements, the number and nature of committees depends on many factors: including the size of the bank and its board, its internal organization and the nature, the scope and the complexity of its business areas as well as its risk profile.</p> <p>Supervisors evaluate also if the structure of the organization ensures that the internal audit department is not involved in operational organization (design, introduction or implementation of organizational and internal control measures) and that the auditors do not audit activities or functions that they themselves have recently carried out.</p> <p>Furthermore, supervisors hold regular meetings both with the group's management and with the management of significant subsidiaries following the minimum engagement approach and applying the proportionality principle. There is at least one annual meeting with the CEO, CRO and CFO, along with the Chair of the Supervisory Board, the Head of Internal Audit and the external auditor at the group level and for relevant subsidiaries. In addition, meetings with the heads of main business lines and compliance and support functions can be arranged, supplemented with thematic meetings at a technical level.</p> <p>The dialogue between JSTs and institutions directly supervised by the ECB is a key part of the supervisory work, embracing discussion on its risk profile, business model and strategy, risk management systems, internal control systems, and internal governance (including risk culture). Therefore, supervisory meetings with the institutions at various levels are to be organized by the members of the JSTs. Meetings between the NCAs and credit institutions' local management on non-SSM supervisory tasks can be held without the JSTs involvement, but JSTs should be kept informed.</p> <p>With regard to the local implementation of CRD IV rules, the starting-point for the organization of institutions is section 25a (1) KWG, which stipulates that there must be an appropriate and effective risk management function, which takes account of the institution's risk-bearing capacity. Risk management includes, in particular, the definition of strategies as well as the establishment of internal monitoring procedures. The internal monitoring procedures comprise the internal control system and the internal audit function. In particular, the internal control system comprises rules regarding the structural and operational arrangements and processes for identifying, assessing, controlling, monitoring and reporting risks as well as the risk control function and the compliance function.</p> <p>To provide a more detailed framework of provisions on the basis of section 25a KWG, BaFin published the MaRisk. According to section 25a (1) sentence 2 KWG and AT 3 MaRisk, all members of the management board are responsible, irrespective of the internal responsibilities, for ensuring that the company has a proper business organization and that this organization is developed further. This responsibility encompasses all material aspects of risk management and has to take into account outsourced activities and processes. The management board is only capable of meeting this responsibility if its board members are able to assess the risks and take the necessary measures to limit them. The management board of a parent enterprise of a group of institutions, a financial holding group or a parent financial conglomerate enterprise is also responsible for the proper business organization within the group and, thus, also for appropriate and effective risk management at group level.</p>
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	BBk and BaFin monitor compliance. BaFin monitors off-site by requesting reports from the bank and by requiring external auditors to evaluate compliance with MaRisk. BBk monitors compliance through its on-site inspections.
EC2	The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's Board) to be an effective check and balance to the business origination units.
Description and findings re EC2	<p>Supervisors expect control functions to have assigned adequate resources. The audit function must be provided with the necessary human and technical resources to carry out audits effectively and according to the planned schedule. The risk management function also should have the independence, proficiency and appropriate human (competence and staffing) and technical resources needed in order to fulfill its duties properly.</p> <p>The head of the risk management function shall be an independent senior manager with distinct responsibility for the risk management function. Where the nature, scale and complexity of the activities of the institution do not justify a specially appointed person, another senior person within the institution may fulfill that function, provided there is no conflict of interest.</p> <p>According to AT 7.1 items 1 and 2 MaRisk, the staffing of the institution has to be based, in both quantitative and qualitative terms, on the institution's internal operational needs, business activities and risk situation. The head of the risk control function and the head of the internal audit function as well as the compliance officer shall possess special professional and personal qualifications corresponding to their particular duties. The employees have to have the knowledge and experience required by their duties, competencies and responsibilities. Suitable measures have to be taken to ensure that the employees have the appropriate qualifications (e.g., on-the-job-training). This is especially valid for the back office and control functions.</p> <p>Due to the requirement of segregation of duties, i.e. front office and trading units have to be segregated from back office and control functions, especially risk control function and functions which serve to settle and control trading transactions (BTO item 3 MaRisk), there has to be an appropriate balance in the skills and resources of the back office and control functions to the front office.</p> <p>On-site BBk inspections review internal controls and audit. Additionally, external auditors must certify on the adequacy of internal controls.</p>
EC3	The supervisor determines that banks have an adequately staffed, permanent and independent compliance function ⁷³ that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function are suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.

⁷³ The term "compliance function" does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

Description and findings re EC3	<p>CRD and EBA provide a general framework to be considered by the NCAs as discussed in EC1 above. This general framework also covers the topics in EC3.</p> <p>With regard to the implementation of the CRD stipulations, the compliance function has to support and advise the management board with regard to complying with these legal rules and regulations (AT 4.4.2 item 1 MaRisk).</p> <p>The employees have to have the knowledge and experience required by their duties, competencies and responsibilities. Suitable measures have to be taken to ensure that the employees have the appropriate qualifications. According to AT 4.4.2 item 6 MaRisk, the compliance function shall report to the management board on its activities at least once a year and on an ad hoc basis. Such reports shall address the appropriateness and effectiveness of the rules that are intended to ensure compliance with the material legal rules and regulations. The reports shall also cover information on potential deficits and on remedial measures. These reports shall be additionally passed on to the supervisory board and the internal audit function.</p> <p>The internal audit function has to examine and assess the effectiveness and appropriateness of risk management and the internal control system, the orderliness of all activities and processes of the credit institution; this encompasses the adherence to regulatory provisions. Accordingly, the internal audit function as a tool of the management board (AT 4.4.3 item 2 MaRisk) also assesses the effectiveness and adequacy of the work of the compliance function itself.</p> <p>These areas are reviewed by external auditors and Bundesbank staff.</p>
EC4	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function⁷⁴ charged with:</p> <ul style="list-style-type: none"> (a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and (b) ensuring that policies and processes are complied with.
Description and findings re EC4	<p>Section 25a KWG and the MaRisk (AT 4.4.3) stipulate that all institutions must have an independent and a functioning internal audit function (exceptions are allowed only in the case of very small institutions). The internal auditors are responsible for examining and assessing the effectiveness and appropriateness of risk management including the strategies and the internal control system, the orderliness of all activities and processes of the credit institution regardless of whether outsourced or not, which also includes adherence to regulatory provisions.</p> <p>According to section 25c KWG the internal audit function reports to the management board and the supervisory board at appropriate intervals and at least once a quarter.</p>
EC5	<p>The supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing;

⁷⁴ The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g., conducted by external experts, of key internal controls as an alternative.

	<p>(b) has appropriate independence with reporting lines to the bank's Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations;</p> <p>(c) is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies or processes;</p> <p>(d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties;</p> <p>(e) employs a methodology that identifies the material risks run by the bank;</p> <p>(f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and</p> <p>(g) has the authority to assess any outsourced functions.</p>
Description and findings re EC5	<p>According to AT 7.1 items 1 and 2 MaRisk the staffing of the institution has to be based, in both quantitative and qualitative terms, on the institution's internal operational needs, business activities and risk situation. The employees and their deputies have to have the knowledge and experience required by their duties, competencies and responsibilities. Suitable measures have to be taken to ensure that the employees have the appropriate qualifications (e.g., on-the-job-training). This is also valid for the internal audit function.</p> <p>The internal audit function, as an instrument of the management board, is under its direct control and has to report to management board members (AT 4.4.3 items 2 MaRisk). It can also be subject to the direct control of one management board member, who should, if possible, be the chairperson. This notwithstanding, it has to be ensured that the chairperson of the supervisory body in consultation with the management board may obtain information directly from the head of the internal audit function. According to BT 2.2 items 1 MaRisk, the internal audit function has to perform its duties in an autonomous and independent fashion. In particular, it has to ensure that it is not subject to any instructions with regard to its reporting and evaluation activities.</p> <p>In order to enable it to perform its duties, the internal audit function has to be granted a full and unlimited right to information (AT 4.4.3 item 4 MaRisk). This right has to be ensured at all times. In this respect, the internal audit function has to be immediately provided with the necessary information, the required documents and an opportunity to review the institution's activities, processes and IT systems. The internal audit function has to be informed of any management board instructions and resolutions that could be relevant to its activities. It has to be informed of any material changes to the risk management in a timely manner.</p> <p>The activities of the internal audit function have to be based on a comprehensive audit plan, which has to be updated on a yearly basis (BT 2.3 MaRisk). Audit planning has to be risk-oriented. The activities and processes of the institution, even if these are outsourced, have to be audited at appropriate intervals, as a general rule within three years. Auditing has to be performed annually if particular risks exist. Activities and processes, which are deemed to be immaterial from a risk point of view, may be exempted from the three-year audit cycle. Audit planning, audit methods and quality are to be reviewed and further developed on a regular and event-driven basis. It has to be ensured that any special audits required at short notice, e.g., due to deficiencies which have arisen or certain informational requirements, can be performed at any time. Audit planning, as well as any major adjustments to it, has to be approved by the management board.</p>

Assessment of Principle 26	Materially Noncompliant
Comments	<p>Internal controls and audit are reviewed during on-site inspections by BBk and are also reviewed annually for compliance with regulatory requirements by the external audit.</p> <p>The independence of the internal audit and compliance officer are compromised as they direct-report to the management board and do not have an independent alternate reporting line to the supervisory board to discuss audit results without management board present. Additionally, the supervisory board is only informed of a replacement of the internal auditor, compliance officer and risk officer ex-post.</p> <p>The issue is aggravated when viewed in conjunction with the passive role played by most supervisory boards. Although activism of supervisory boards may vary by banks, its role of management oversight is not robust (CP14). Internal audit interaction with the supervisory board is through management board reports. Also management board members may join the audit committee meetings. The SSM approach, as followed within the SREP, and the thematic review on Risk Governance and Risk Appetite, highlight the need to ensure a direct and independent reporting to the Supervisory Board.</p>
Principle 27	Financial reporting and external audit. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
Essential criteria	
EC1	The supervisor ⁷⁵ holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	The management board is responsible for drawing up the annual accounts as set out in section 242 HGB. The annual accounts drawn up must be signed by all managers. According to section 340k HGB, the annual accounts and the management report as well as the group annual accounts and the group management report (where appropriate) must be audited and certified (section 322 HGB) by an external auditor or accounting firm. This applies to all credit institutions regardless of their size. The audit must include the preparation of a comprehensive auditor's report (section 321 HGB) in compliance with the Audit Report Regulation. Once the audit has been performed, the annual accounts must be approved without delay either by the supervisory board or by the general meeting (section 340k (1) HGB). The annual accounts and management reports as well as the consolidated annual accounts and group management reports (where appropriate) and the other documents set out under sections 325 and 340l HGB must be disclosed in accordance with section 340l HGB in conjunction with section 325 HGB. In other words, these must be filed with the operator of the electronic federal gazette (Elektronischer Bundesanzeiger) and published in the electronic federal gazette. Section 325 (1) HGB stipulates that these documents must include the

⁷⁵ In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

	<p>certificate of audit (or a note accounting for the withholding of such a certificate). The operator of the electronic federal gazette has to verify the filed documents for timeliness and completeness. In case of deficiencies it will inform the Federal Office of Justice (Bundesamt für Justiz), which will consider administrative fines in accordance with section 335 HGB.</p> <p>Pursuant to section 28 (1) KWG, an institution shall notify BaFin and Bundesbank of the auditor it has appointed without delay after making the appointment. Within one month of the receipt of such a notification, BaFin may request the appointment of a different auditor if this seems necessary to achieve the objective of the audit. If the notification pursuant to section 28 (1) KWG is not effected without delay after the end of the financial year, BaFin may request the court of registration having the jurisdiction at the domicile of the institution to appoint an auditor (section 28 (2) no. 1 KWG).</p> <p>Furthermore, if the annual account documents which must be filed with BaFin and Bundesbank in accordance with section 26 KWG and which shall also bear an audit certificate (or a note accounting for the withholding of such a certificate), are not submitted or are intently or recklessly not submitted correctly, in full or on time, this constitutes a breach of administrative regulations which BaFin can punish with a fine according to section 56 (2) no. 11 KWG or to section 340n (1) HGB.</p> <p>The financial statements are subject to audit (section 340k (1) HGB), which, irrespective of the size of the bank, has to be performed by a German public auditor (Wirtschaftsprüfer). In performing their audits, public auditors apply the IDW Auditing Standards. The content of the International Standards on Auditing (ISA) is consistent with the IDW Auditing Standards to the extent that there is no conflict with German legal requirements. The auditor is required to prepare a “long form audit report” (in accordance with the PrüfbV), which has to be filed with the supervisors.</p>
EC2	<p>The supervisor holds the bank’s Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor’s opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.</p>
Description and findings re EC2	<p>According to section 25a (1) sentence 1 KWG in conjunction with section 25a (1) sentence 6 no. 1 KWG, an institution must have a proper business organization which, inter alia, has to encompass appropriate arrangements by means of which the financial situation of the institution can be gauged with sufficient accuracy at all times. Furthermore, according to 25a (1) sentence 6 no. 2 KWG, a proper business organization has to provide a complete documentation of its business operations which permits a seamless monitoring by BaFin for its area of responsibility.</p> <p>The regulations regarding the setup and audit of the balance sheet, the profit and loss account, the notes and the management report are not laid down by the banking supervisors. Rather, the HGB (national GAAP) contains comprehensive regulations, including recognition criteria and valuation principles, for use in the preparation of annual accounts for corporations, as well as supplementary regulations for credit institutions and financial services institutions (sections 340 et seq. HGB). Furthermore, the HGB contains precise details of how the balance sheet and profit and loss account should be presented. The RechKredV which was drafted by BaFin and approved by the Federal Ministry of Justice and Consumer Protection contains further regulations. These regulations comply with the EU Bank Accounts Directive as well as with the fourth and seventh EC Accounts Directives; an update of HGB according to the new EU Accounting Directive (RL 2013/34/EU) followed on 18 July 2015 (see LINK). Pursuant to regulation (EC) No 1606/2002 or section 315a (2) HGB, a parent institution may be required to draw up its consolidated annual accounts in accordance with the IFRS.</p>

	<p>Where a parent institution is not required to apply the IFRS to the consolidated accounts, it has the option to do so (section 315a (3) HGB). If the consolidated accounts are set up in accordance with the IFRS, the regulations of the HGB concerning the annual accounts of corporations are only applied within the scope of section 315a (1) HGB.</p> <p>Articles 32 to 35 CRR contain prudential filters for calculation of own funds by using single or consolidated financial statements that reflect the recommendations of BCBS.</p> <p>If an institution does not comply with those requirements, BaFin may issue orders to the institution that are appropriate and necessary for putting into place safeguards within the meaning of this regulation (section 25a (2) sentence 2 KWG). If the institution violates such an enforceable order or fails to submit a set of annual accounts, a management report, an audit report, a set of group accounts or a group management report, or does not do so correctly, in full or in time, this constitutes a breach of administrative regulations which can be punished by BaFin with a fine according to section 56 (2) no. 3 or 11 (b) KWG. Furthermore BaFin can also impose an administrative fine according to section 340n (1) HGB against the responsible manager if the annual accounts, the group accounts, the interim (consolidated) financial statement or the management (consolidated) report violates specific regulations of HGB. BaFin also has the right to adopt measures against the responsible managers (formal warning or in severe cases dismissal in accordance with section 36 (2) KWG).</p>
EC3	<p>The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.</p>
Description and findings re EC3	<p>Regulation 2002/1606 (Articles 4 and 5) requires the application of IFRS to the consolidated financial statements of EU companies whose securities are traded on a regulated EU market. EU countries may extend the application to annual financial statements and to non-listed companies.</p> <p>Art. 24 of the CRR requires that the valuation of assets and off-balance sheet items shall be effected in accordance with the applicable accounting framework. For prudential purposes, Art 105 of the CRR requires that credit institutions establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates. In addition, Art 105 of the CRR requires institutions to perform an independent verification and validation and to establish and maintain procedures for considering valuation adjustments to the position required for financial reporting and regulatory purposes.</p> <p>Art. 34 of the CRR requires institutions to apply the requirements of Article 105 to all their assets measured at fair value when calculating the amount of their own funds and shall deduct from Common Equity Tier 1 capital the amount of any additional value adjustments necessary.</p> <p>Notwithstanding the applicable accounting rules, according to Article 34 in conjunction with Article 105 CRR an institution shall apply the standard for prudent valuation to all its assets measured at fair value when calculating the amount of its own funds and shall deduct from Common Equity Tier 1 capital the amount of any additional value adjustments necessary in comparison to accounting rules. The standard for prudent valuation provides requirements for establishing and maintaining systems and controls sufficient to provide prudent and reliable valuation estimates and documentation. This includes for example documented policies and procedures for the process of valuation and reporting lines for the department accountable for the valuation process that are clear and independent of the front office and</p>

	<p>shall ultimately be to the management body. Furthermore, the standard contains valuation rules for conservatively marking to model where marking to market is not possible with numerous specific requirements, e.g., for the use of valuation methodologies which are accepted market practice if available, models developed by the institution itself, formal change control procedures, periodic review to determine the accuracy of their performance, risk management and documentation. Models developed by the institution itself shall be developed or approved independently of the trading desk and shall be independently tested, including validation of the mathematics, assumptions and software implementation. Institutions shall document appropriately also their prudent valuation methodology, so that significant differences between the valuations used for financial reporting and for regulatory purposes can be recognized. EBA published on 23 January 2015 draft RTSs to specify the conditions of Article 105 CRR.</p>
EC4	<p>Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality based approach in planning and performing the external audit.</p>
Description and findings re EC4	<p>Not a requirement as such in EU law, but under Art 26 of the Audit Directive (2006/43/EU), Member states shall require auditors and audit firms to carry out statutory audits in compliance with international auditing standards and may apply a national auditing standards as long as the Commission has not adopted an international auditing standard covering the same subject-matter.</p> <p>Section 317 HGB and Section 29 KWG (special duties of the auditor for supervisory purposes) contain provisions about the scope of the audit as well as the auditor's reporting and explanation duties in the course of the audit.</p> <p>More detailed provisions on the supervisory object of the audit, the time it should be carried out and the contents of the long-form auditor's report are contained in the PrüfbV, which was issued in accordance with section 29 (4) KWG. The PrüfbV ensures that all items regularly deemed to be relevant by the German banking supervisors are audited as part of the audit of the annual accounts. Section 2 PrüfbV stipulates that the external audit should take into account the principle of the risk-oriented audit and the materiality with regard to the size of the institution, the scope of business, the complexity of the business conducted and the level of risk.</p> <p>In addition, pursuant to section 30 KWG, BaFin can instruct the auditor of the annual accounts of an institution to focus on certain aspects during the audit.</p>
EC5	<p>Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.</p>
Description and findings re EC5	<p>Generally, it would be expected that the international auditing standards (referred to in the Audit Directive) would cover all the items mentioned in this EC.</p> <p>All the areas mentioned above are covered by the PrüfbV, especially by the provisions</p> <ol style="list-style-type: none"> a. on risk management and organization (section 10 PrüfbV); b. on risk structure and risk provisioning (section 31 PrüfbV);

	<p>c. on the lending business (section 23 et seq. PrüfbV), including derivatives and securitized assets (exposures as defined by section 19 (1) KWG);</p> <p>d. on the discussion of financial situation (section 29 PrüfbV);</p> <p>e. on the discussion of profit and loss (section 30 PrüfbV);</p> <p>f. on the discussion of consolidated companies (section 35 PrüfbV) and</p> <p>g. on the data synopsis required by section 60 PrüfbV.</p> <p>Section 290 (2) No. 4 HGB contains provisions on the consolidation of special purpose vehicles. According to section 35 PrüfbV the auditor has to examine if the consolidated statement is compliant with these provisions and has to discuss the regulatory basis of consolidation including differences to the accounting basis of consolidation.</p> <p>Risks from off-balance sheet vehicles have to be incorporated appropriately according to annotation to AT 2.2 No. 2 MaRisk and will be encompassed by audit according to section 29 PrüfbV.</p>
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	In accordance with section 28 (1) KWG, the institutions shall notify BaFin and Bundesbank of the auditor they have appointed without delay after making the appointment. This duty of notification is intended to provide BaFin with a period of one month during which it may reject the auditor and request the appointment of a different auditor. This is only permitted where it is necessary to achieve the object of the audit. The object of the audit is not only to confirm that bookkeeping procedures and the annual accounts conform to the appropriate regulations, but also to assess in detail the economic situation of the institution and its compliance with its reporting duties as set out in the KWG. BaFin must have concrete, transparent findings at its disposal supporting its request. To this extent, such decisions are always made on an individual basis and take into account, in particular, experiences with previous audits.
EC7	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re EC7	The Audit Directive (2006/43/EU) sets out the rotation requirements for the key audit partner or partners on public interest entity engagements within a maximum of seven years from the date of appointment and is/are allowed to participate in the audit of the audited entity again after a period of at least two years.
EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	A standardized meeting is held once a year with the Banking Committee of the German Institute of Certified Public Accountants (IDW) which represents German individual auditors and audit firms. Furthermore, the supervision of savings banks and cooperative banks involves annual meetings with the representatives of the regional associations, which also act as the statutory auditors of their affiliated institutions. In addition, in case of significant institutions, supervisors meet regularly with auditors on the level of the individual institution. Further meetings with auditors on a collective or individual basis are arranged if and when required on a case-by-case basis.

EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	<p>The requirement of the "duty to report" is established in the CRD IV (Art 63(1)). It is, related to material breaches of laws, regulations or administrative provisions; issues which affect the ongoing functioning of the institution; and issues which may lead the auditor to refuse to certify the accounts or to the expression of reservations.</p> <p>Section 29 (3) KWG stipulates that if, in the course of his audit, the auditor learns of facts, which might warrant the qualification or withholding of the certificate of audit, jeopardize the existence of the institution or fundamentally impair its development, which constitute a material infringement of the provisions on the institution's approval requirements or the pursuit of business under this Act, or which indicate that the senior managers have severely infringed the law (including the banking supervision law), the articles of association or the partnership agreement, he shall report this without delay to BaFin and Bundesbank.</p>
Additional criteria	
AC1	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	<p>No EU-wide requirement as such. CRD IV (article 56) allows for the exchange of information, subject to professional secrecy between the supervisor and the auditor in the discharge of their supervisory functions.</p> <p>The German banking supervisors have no direct access to the external auditors' working papers. However, pursuant to section 29 (3) KWG, BaFin and Bundesbank have the right to request that the auditor explains his report to them. If this explanation requires great detail, the auditor will have to make use of his internal working papers, thus effectively granting the supervisors access to the information contained therein.</p>
Assessment of Principle 27	Largely Compliant
Comments	<p>German HGB section 322 requires all credit institutions to produce annual accounts audited by an external auditor. CRD also requires audited statements of all credit institutions. BaFin can hold management responsible and impose fines for noncompliance with accounting standards.</p> <p>Overall, all essential criteria are met. The German authorities, however, chose to be assessed and graded not only against the Essential criteria but also against the additional criterion, which represents best international practice rather than a requirement. Given the heavy reliance on the work of external auditors to determine banks' compliance with supervisory requirements and determining asset quality and provisioning, the lack of power to review the external auditors' work papers should be addressed in order to meet best international practices.</p>
Principle 28	Disclosure and transparency. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is

	easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations or the supervisor require periodic public disclosures ⁷⁶ of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	<p>Various requirements regarding disclosures and transparency are imposed on German SIs (banks and investment firms). According to Part Eight of the CRR institutions must disclose various quantitative and qualitative information pertaining to capital and capital requirements, risk management, credit risk, market risk, counterparty credit risk, securitization risk, equities risk, interest rate risk, asset encumbrance, leverage, operational risk, remuneration) or of financial nature (IFRS disclosure focus on financial performance and on the risks posed to this performance by financial instruments). In addition, CEBS the predecessor of EBA issued in April 2010 the Principles for disclosures in times of stress that institutions are recommended to apply in their public disclosures (Pillar 3, financial statements and others disclosures made on the basis of requirements or in an ad hoc manner).</p> <p>Article 6 and 13 of the CRR require the disclosure of information in Part Eight CRR by all banks and investment firms on an individual, and where relevant consolidated basis for institutions (banks and investment firms). Article 13 also governs the provisions of disclosure on a solo basis for consolidated entities within a group. IFRS disclosures however should be provided depending on the scope of application of IFRS standards.</p> <p>Regulation 1606/2002, on the application of international accounting standards, Article 4 mandatorily applies IFRS to the consolidated accounts of publicly traded companies, including in case only debt securities of that company are listed on the market. Article 5 allows Member States to permit listed entities to prepare their solo financial statements based on IFRS, and to permit other (non-listed) entities to prepare their solo or consolidated accounts under IFRS. Entities that do not apply IFRS for their consolidated or solo financial statements apply national GAAP.</p> <p>For financial disclosures, they are expected to take place in the financial statements, especially in their notes. IAS 1.10 makes notes a component of a complete set of financial statements, with the purpose of disclosing information required by IFRS or relevant to the understanding of the financial statements (IAS 1.112). IFRS 7.1, .7 and .31 requires the disclosure in their financial statements by all entities applying IFRS of information that enable users to evaluate the significance of financial instruments for the entity's financial position and performance; and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.</p> <p>Specific formats (templates and definitions) have been introduced by the EBA to improve comparability between institutions in some Pillar 3 disclosure areas:</p> <ul style="list-style-type: none"> - technical standards on own funds (Article 437 CRR with Regulation (EU) 1423/2013 - technical standards on leverage ratio (Article 451 CRR)

⁷⁶ For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

- technical standards on expositions used to compute the countercyclical buffer (Article 440 CRR)
- technical standards on disclosures of G-SIBs indicators (Article 441 CRR and Regulation 1030/2014) and Guidelines
- guidelines on disclosure of encumbered and unencumbered assets (Article 443 CRR)

In financial statements, IFRS does not require the use of specific format for disclosures, with a few exceptions: tabular formats are required for disclosures on offsetting of financial instruments (IFRS 7.13C), fair value of financial instruments (IFRS 7.27), and transfer of financial instruments (IFRS 7.42). Examples of tables are provided in IFRS 7 IG40B and C for transferred assets and in IFRS 7 IG40D for offsetting of financial assets. These examples are however not incorporated into EU law.

As regards the comparability over time, there is no requirement in Pillar 3 disclosures to disclose comparative information except for disclosures related to the value adjustments on IRB exposures (Article 452g) and the back-testing of IRB model (Article 453i). As for financial statements disclosures, IAS 1.38 requires the disclosure of comparative information in respect of the previous period for all amounts reported in the current period's financial statements. IAS 1.36 requires comparative information to be disclosed at least on an annual basis.

For Pillar 3 information, Article 431 CRR requires Pillar 3 disclosures be appropriate and timely, in the event the disclosure requirements laid out in the CRR would not be enough to convey their risk profile comprehensively to market participants, institutions shall disclose any supplementary information necessary, to the extent that information is material, not proprietary and not confidential. Guidelines recently issued by the EBA frame the possibilities to avoid disclosing information due to materiality reasons or concerns about their proprietary or confidential nature.

Article 104 of CRD IV empowers supervisors to require additional disclosures for the purpose of the application of the regulatory requirements in the CRR.

As for information in the financial statements, IAS 1.17 requires the presentation of information in a manner that provides relevant, reliable, comparable and understandable information, and to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance. IAS 1.112 requires the presentation in the notes of any information that is relevant to the understanding of the financial statements. IFRS7.32 follows the same approach, and the disclosures on risks that arise from financial instruments and on how these risks have been managed should cover, but not be limited to credit risk, liquidity risk and market risk.

Pillar 3 information is not required to be audited by the EU legislation. However, the practice for German SIs is to require assurance by the external auditor at least annually that the Pillar 3 data is prepared in accordance with the national audit framework. Furthermore, during off-site inspections, supervisors checked the accuracy of data. In addition, Pillar 3 information disclosed in the notes to the financial statements is required to be audited (see below) and Article 431 CRR requires institutions to have policies to assess the appropriateness of their disclosures, including their verification. Disclosures in accordance with IFRS are to be audited in application of Directive 2006/43 and the relevant applicable auditing standards in each Member State (for the audit requirements in the EU as stated above).

Article 433 CRR requires disclosure of Pillar 3 information at least on an annual basis, in conjunction with the date of publication of the financial statements, and requires institutions

	<p>to assess their need to publish some or all disclosures (especially disclosures on own funds, capital requirements, information on risk exposures and other items prone to rapid changes) more frequently than annually based on their relevant characteristics.</p> <p>EBA Guidelines on Disclosure frame the assessment process of institutions in accordance with Article 433, and stress the need for G-SIB institutions and all institutions with a balance sheet higher than € 30 billion to especially conduct this assessment. The Guidelines list also information the provision of which should especially be considered when disclosing more often than annually.</p> <p>Article 106 CRDIV empowers supervisors to require information to be published more frequently than annually and with specific deadlines. As for financial information, IAS1.36 requires at least annual disclosures of information specified in IFRS. IAS 34 specifies the requirements for interim disclosures but does not set the frequency of interim disclosures.</p> <p>No German SIs were subject to additional Pillar 3 reporting.</p> <p>In the case of banking groups, disclosure requirements are generally applicable on the top consolidated level. Disclosure is governed by the principle of materiality and is not applicable to legally protected or confidential information. However, in the two latter cases, institutions are required to publish more general information about the facts that they are not at liberty to disclose for the aforementioned reasons. The required information is to be published at least and is published as part of the annual report and not the Pillar 3 reports.</p> <p>There are several layers of disclosure requirements for LSIs. The first is established by commercial law where LSIs must disclose to the public at least the annual accounts (consisting of balance sheet, profit and loss account and notes) and management reports as well as the consolidated annual accounts and group management reports (where appropriate) in accordance with commercial law (See Section 325 HGBt) or stock exchange listing rules (transparency directive implemented in Germany).</p> <p>Disclosure requirements designed specifically for LSIs are established in KWG and reflect the Basel II Pillar 3 requirements. According to section 26a of the KWG, the group's legal and organizational structure as well as its principles of proper management shall be disclosed. CRR institutions shall additionally include in an annex to the annual accounts, specifying, by member state of the European Union and by third countries in which they have establishments, information regarding country-by-country reporting on a consolidated basis and shall have it audited by an external auditor (transposition of Article 89 of the CRD). CRR institutions shall also disclose in their annual report their return on assets, calculated as net profit divided by their total balance sheet (transposition of Article 90 of the CRD).</p> <p>The EBA "Guidelines on materiality, proprietary and confidentiality and on disclosure frequency under Articles 432 (1), 432 (2) and 433 CRR (EBA/GL/2014/14)" have been implemented into national law by BaFin circular 05/2015.</p> <p>Pursuant to section 26a (2) KWG, BaFin can issue specific orders to remedy deficiencies in disclosure practice (transposition of Article 67 (1) (m) of the CRD). According to the CRD, the responsibility for setting administrative penalties and other administrative measures in relation to a breach in disclosure practice is for the Member State. If the German law requires sanctions to remedy deficiencies in disclosure practice, the ECB may impose sanctions on the basis of section 26(a) (2) KWG.</p>
EC2	<p>The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties,</p>

	<p>transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.</p>
<p>Description and findings re EC2</p>	<p>See EC 1. Some of the disclosures required by Part Eight CRR duplicate with accounting disclosure requirements. Disclosures on exposures and transactions with related parties (IAS 24) and accounting policies (IAS 1.117 to .124, IFRS 7.21) are only required in the financial statements, with the exception of accounting policies for past-due and impaired (Article 442a) CRR) and securitization transactions (Article 449j) CRR). Therefore, German SIs are not required to disclose related party exposures or transactions with related parties as part of the Pillar 3 disclosures.</p> <p>The issue of the scope and content of disclosures as well as their level of aggregation of disclosures is connected with the issue of materiality, where immaterial elements of the accounts can be aggregated while more disclosure is required for material elements of the accounts and a greater amount of disaggregation required (including disclosures that are not explicitly required by specific provisions included in Part Eight of the CRR, consistently with Article 431(3) of the CRR). Guidelines specify how institutions have to implement, in relation to disclosures, materiality as defined in Article 432(1) CRR, and specify a process and the criteria institutions should take into consideration when assessing materiality.</p> <p>As regards disclosures in the financial statements, IAS 1.29 requires the separate presentation of each material class of similar items, and of items of a dissimilar nature or function unless they are immaterial. IAS 1.30 clarifies that a line item is not individually material, it is aggregated with other items either in those statements or in the notes to the accounts, but that an item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes to the accounts.</p> <p>According to Title II and III of Part 8 of the CRR institutions have to disclose their risk management objectives and policies, their governance arrangements, their risk exposures under different aspects and their remuneration policy. Since the CRR is directly binding for EU countries, SIs and LSIs have to fulfill the disclosure requirements of the CRR. In addition, the financial performance, financial position, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business of supervised entities are publicly disclosed into the annual report, either into the financial statement or the management commentary.</p> <p>The content of information provided and the level of disaggregation and detail was shown to be commensurate with the risk profile and systemic importance of SIs and LSIs. The supervisor paid attention to the content of Pillar 3 disclosures and for LSIs a sample of Pillar 3 disclosers was selected to verify compliance with the disclosure requirements.</p> <p>In relation to LSIs specifically, the disclosure requirements listed in this EC are partly covered either by the commercial law regulations regarding the contents and disclosure of balance sheet, profit and loss account, notes and management report or section 26a KWG (please also refer to the answers to EC1 (of principle 28, see above and principle 27, EC 2, 3 and 1).</p> <p>Concerning remuneration, for non-CRR institutions, Section 16 of German Remuneration Ordinance for Institutions of 16 December 2013 (hereinafter referred to as "ROI") contains provisions on disclosure for institutions as far as they are not covered by Art. 450 CRR. This information concerns the adherence of the ROI requirements for remuneration systems, the decision-making process pertaining to remuneration systems and their design as well as the total amount of all remuneration broken down into fixed and variable remuneration and the</p>

	number of beneficiaries of variable remuneration. All disclosure requirements listed above are spot checked by the competent supervisors. In particular, the German authorities double-check the disclosed information in limited cases by comparing it with the data given within an annual query on quantitative remuneration figures (remuneration benchmarking exercise).
EC3	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	<p>For supervisory purposes, the scope of consolidation is the CRD regulatory scope of consolidation rather than IAS/IFRS consolidation. Accordingly, the group structure in Pillar 3 disclosures relates to the scope under CRD consolidation. (Articles 18 and 19).</p> <p>Article 436b) CRR requires the disclosure of an outline of the differences in the basis of consolidation for accounting and prudential purposes, with a brief description of the entities therein, explaining whether they are: (i) fully consolidated; (ii) proportionally consolidated; (iii) deducted from own funds; or (iv) neither consolidated nor deducted. For SIs, material entities in the group structure will be disclosed and enables the users of the consolidated financial statements to understand the group and the interest in non-controlling interests.</p> <p>Disclosures to be provided in the financial statements (and which therefore follow an accounting scope of consolidation) relate to the name and registered office of subsidiaries, associates, proportionally consolidated entities, indirect subsidiaries, immaterial entities excluded from consolidation and entities for which consolidation would be too onerous, the proportion of capital held in the above-mentioned entities, the proportion of voting rights held in the above-mentioned entities, and the rationale for consolidation of subsidiaries (Article 43(2)h Directive 86/635). Similar requirements – although with a possible narrower scope – also exist in IFRS 12 (IFRS 12.2 and B4, IFRS 12.12 and B10):</p> <p>According to Article 436 (b) of the CRR institutions have to disclose an outline of the differences in the basis of consolidation for accounting and prudential purposes with a short description of the entities, explaining their prudential treatment: full consolidation, proportional consolidation, deduction from own funds, neither consolidation nor deduction. Institutions should also disclose the circumstances for applying the derogation from the application of prudential requirements on an individual basis (Article 7 of the CRR) and the application of the individual consolidation method (Article 9 of the CRR).</p> <p>The accounting scope of consolidation is defined in the local GAAP and in the IFRS for banks applying IFRS (IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IAS 28 Investments in Associates and Joint Ventures).</p> <p>For local GAAP, these requirements are covered by commercial law regulation. According to Section 313 (II) HGB the Notes must contain contents with respect to all companies that have been consolidated in the annual accounts regardless of whether they are subsidiaries (fully owned), partially owned or associated companies.</p> <p>Furthermore for those banks obliged to report according to IFRS, IFRS 12 defines additional disclosure requirements with respect to material associates, material joint ventures, material joint operations, subsidiaries and NCI as well as unconsolidated structured entities.</p>
EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	For German SIs, the JST verifies that disclosure statements comply with the disclosure standards as part of the annual supervisory cycle. As a second line of defense, the EBA has been reviewing disclosures by institutions on their crisis-related exposures (from 2008 to

	<p>2010), and has been assessing the compliance of the Pillar 3 disclosures of banks with the CRR disclosures requirements (from 2010 onwards). These assessments have led to the identification of good practices for enhancing disclosures, that institutions are encouraged to implement. Reports are made available in the Reports section of the following webpage: http://www.eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/-/topic-documents/m5cbuvPOTdmW/more</p> <p>The assessment of the Pillar 3 disclosures was part of a 2015 MEL activity mandatory for all German SIs under ECB's direct supervision. The exercise resulted in a number of recommendations for banks to enhance reporting and P3 disclosures aligned with the nature and scope of this EC.</p> <p>Compliance with the disclosure requirements to meet IFRS standards is ensured by BaFin and the Financial Reporting Enforcement Panel (FREP). According to the CRD, the responsibility for setting administrative penalties and other administrative measures in relation to a breach in disclosure practice is for the Member State. If the German law requires sanctions to remedy deficiencies in disclosure practice, the ECB may impose sanctions on this basis. There have been no examples of sanctions by the ECB of failure to meet IFRS standards.</p> <p>According to section 7 (1) sentence 2 KWG, the cooperation between BaFin and Bundesbank relates to the ongoing monitoring of institutions. Against this background, Bundesbank also monitors the compliance with the disclosure requirements, in particular those resulting from Part 8 of the CRR. If an institution does not fully comply with these requirements, Bundesbank informs BaFin and in agreement with BaFin demands of the institution to make the appropriate disclosures. In the event of sustained deficiencies to satisfy disclosures, BaFin will consider a specific order in accordance with section 26a (2) KWG to remedy the deficiencies. If the institution violates such an enforceable order, this constitutes a breach of administrative regulations which BaFin may punish with a fine pursuant to section 56 (6) no. 3 KWG. Furthermore, pursuant to section 24 PrüfbV, the auditor of the annual accounts of an institution also has to verify the processes for the assessment and disclosure of the information as laid down in Part 8 of the CRR and section 26a KWG and has to discuss in his report whether the appropriate disclosures according to Part 8 of the CRR and section 26a KWG have been made.</p> <p>During 2015, BaFin conducted compliance reviews of a sample of LSIs to ensure Pillar 3 disclosures met with the disclosure standards. The review considered all quantitative and qualitative requirements and was seen to be comprehensive. No exercise of administrative sanctions was conducted in 2015 or 2014.</p>
EC5	<p>The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).</p>
Description and findings re EC5	<p>Commission Implementing Regulation No 650/2014 lays down the format, structure, contents list and annual publication date of the information to be disclosed. The aggregate statistical information comprises:</p> <ul style="list-style-type: none"> • information on texts of laws, regulations, administrative rules and general guidance adopted in their respective Member State in the field of prudential regulation; • information on how they exercise options and discretions available in EU law; • information on the general criteria and methodologies used for SREP;

- aggregate statistical data on key aspects of the implementation of the prudential framework by countries:
 - number of banks and investment firms
 - total banking assets and share of GDP
 - total Tier I, total Tier 2 capital
 - total capital requirements
 - total capital adequacy ratio
 - own funds requirements by type of risks (in percent of own funds requirements)
 - credit exposure by exposure class (in percent of own funds requirements)
 - own fund requirements for operational risk by type of approach (in percent of total own fund requirements)
 - own fund requirements for market risk by type of approach (in percent of total own fund requirements)

As a reference, EBA makes public aggregate statistical data on key aspects of the implementation of prudential framework in each Member State. The disclosure provided includes national statistical data on the banking sector, credit risk, operational risk, market risk, and supervisory actions and measures. <http://www.eba.europa.eu/supervisory-convergence/supervisory-disclosure/aggregate-statistical-data>

Additional reference is contained within ECB “Consolidated banking data” on the EU banking sector. It is done on a country by country basis (aggregated balance sheet, P&L and supervisory ratios) (<https://www.ecb.europa.eu/stats/money/consolidated/html/index.en.html>)

From SIs, a banking statistics series has been developed by the ECB (see proposal 16 of the “Revised communication framework for supervision” (SB/X/14/06.rev-2)). This series provides consolidated data on the European banks including profit and loss, balance sheet items, non-performing loans and provisions and its aim is to serve as a benchmark for the health of the banking system in the medium term. The final set of indicators are based on data reported under the Implementing Technical Standard (ITS) on Supervisory Reporting and provide information on the banking system at an aggregate level, including (i) balance sheet and P&L items and (ii) capital adequacy (RWA as well as capital levels and ratios). Further indicators for liquidity and leverage will be added once available.

The definitions of indicators are consistent with those featured on the ID-Cards for the Supervisory Board developed for the ECB’s supervision. The first publication took place at 30 June 2015 where 2014 year-end data was published and covered all German SIs. Currently, the statistics will be updated yearly (see also ECB Regulation on reporting of supervisory financial information). SIs which report only on an individual basis and/or under national GAAP will be included after they start reporting FINREP as of the fourth quarter of 2015. LSIs will be required to report FINREP as of the second quarter of 2017 and will be included in the subsequent update of the statistics. The Banking Statistics is now online for data as of 2014: <https://www.bankingsupervision.europa.eu/banking/supervisory-statistics/html/index.en.html>

Another example of is the Consolidated Banking Data (CBD) which also applies ITS data as of 2015. The updated CBD using ITS data has not yet been published, but it is likely to go live in the next weeks. <http://www.ecb.europa.eu/stats/money/consolidated/html/index.en.html>

BaFin’s annual report includes information on the economic environment of the banking industry, the economic development of the banking sector and gives a general overview of the situation at the various institutions, including aggregated risk profile information.

	<p>Analyses of the latest developments in the banking sector and the economic situation of the banking industry can be found in the monthly reports published by Bundesbank.</p> <p>Furthermore, these reports contain comprehensive statistical material with regard to banks (e.g., development of balance sheet totals and of relevant items on the asset and liability side). In addition to these publications, BaFin and Bundesbank have set up a joint website with statistical data on national banking sectors including data related to credit risk, operational risk, and market risk. This website also contains information on actions and measures taken by the BaFin on an aggregated basis. This statistical data section is part of the broad EU supervisory disclosure requirements according to Article 143 of CRD IV. It shows key aspects of the implementation of the prudential framework in Germany.</p>
Additional criteria	
AC1	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	<p>Disclosures are more often provided using end-of-period values. While the CRR makes reference to some average values or over-the- period values, there was no evidence to show that these inputs are used in the risk assessment to date.</p> <p>Article 442 c) CRR requires the disclosure of the total amount of exposures after accounting offsets and without taking into account the effects of credit risk mitigation, and the average amount of the exposures over the period broken down by different types of exposure classes. Article 449 n) iv) CRR requires the disclosure of a summary of the securitization activity of the current period, including the amount of exposures securitized and recognized gain or loss on sale. Disclosures on asset encumbrance are made using median vales (Article 443 CRR).</p> <p>As regards disclosures in the financial statements, IFRS 7.42 G c), in case the transfer activity qualifying for de-recognition was not evenly distributed throughout the reporting period, requires the disclosure of when the greatest transfer activity took place within that reporting period, the amount (e.g., related gains or losses) recognized from transfer activity in that part of the reporting period the total amount of proceeds from transfer activity in that part of the reporting period.</p> <p>IFRS 12.27 requires, for sponsored entities that are sponsored without the sponsor having an interest in them, the disclosure of the income from those structured entities during the reporting period, and of the carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period.</p> <p>In relation to LSIs, the supervisor has adjusted the frequency of disclosures in some cases, however to date no attempt to been made to require disclosure of data which is not end of period data.</p>
Assessment of Principle 28	Largely compliant
Comments	<p>Disclosure standards are generally sound and promote transparency reflecting the substance of the Basel II Pillar 3 standards. As part of their routine activities, supervisors confirmed compliance with the standards through both sample testing and thematic reviews.</p> <p>German banks do not disclose related party exposures or transactions with related parties as part of the Pillar 3 disclosures. Instead, related party disclosures are covered by the HGB and will be presented as part of a credit institution's annual report (see CP 20). In relation to</p>

	disclosure of data which is not end of period data, supervisors have made attempts to adjust the frequency of disclosures in some cases, however data which is not end of period has not been made use of in the supervisory process with any impact on outcomes of analysis (AC1).
Principle 29	Abuse of financial services. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. ⁷⁷
Essential criteria	
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	<p>In Germany, the legal framework for Anti-Money Laundering / Combating the Financing of Terrorism (AML/CFT) for banks is comprised of several laws and regulations. The AML-Act (Geldwäschegesetz – GwG) is applicable to all addressees in financial markets and includes general provisions in particular regarding Customer Due Diligence (CDD) and internal safeguard measures. In addition, KWG adds certain specific rules for the banking sector only and the Regulation (EC) No. 1781/2006 on information on the payer accompanying transfers of funds defines the requirements that have to be met when effecting national and cross-border payments. Finally, the PrüfBV defines the obligations for auditors when carrying out the annual AML/CFT audits or targeted audits on behalf of BaFin.</p> <p>These laws and regulations include not only provisions to prevent money laundering and terrorist financing but (for credit and financial services institutions) also for the prevention of other criminal activities, which may cause financial damage to a bank or a financial services institution or a financial services institution. In particular, the provisions comprise both the requirements for banks regarding the implementation of preventive measures as well as the legal tools for BaFin to conduct proper supervision.</p> <p>Directive 2005/60/EC (the Third Anti-Money Laundering Directive, or 3AMLD) is a minimum harmonization Directive. This means that Member States (MS) can choose to adopt or retain stricter provisions than those the 3AMLD require (Art 5, 3AMLD). Art 37, 3MLD requires that MS shall require the competent authorities at least to effectively monitor and to take the necessary measures with a view to ensuring compliance with the requirements of this Directive by all the institutions and persons covered by this directive. The GWG and KWG framework require the BaFin to effectively monitor and to take necessary action and therefore satisfy the requirements of the 3AMLD and this EC.</p>
EC2	The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.

⁷⁷ The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

Description and findings re EC2	<p>Section 25a para 1 KWG constitutes the general requirement for banks regarding the implementation of a proper business organization. According to KWG which applies to all banks (see EC1) a bank should have an appropriate strategy and appropriate internal control procedures, which consist of an internal control system (including an IA function) for the monitoring and controlling of risks.</p> <p>Additionally, according to section 9 (2) no. 2 GwG and section 25h para 1 KWG, banks are obliged to develop and update internal principles, appropriate business and customer-related safeguards and controls targeted to prevent ML and TF. Section 25h para 1 KWG also requires such procedures with regard to other criminal activities; section 25h para 9 KWG requires that generally a single unit or person within the bank ("central unit") should be responsible for the tasks of AML/CFT compliance and prevention of other criminal activities – commonly referred to as the MLRO function). Further guidance for banks on the central unit can be found in the "DK-Hinweise"⁷⁸, nr. 89.</p> <p>According to section 11 para 1 GwG banks are required to report suspicious transactions to the FIU and to the competent law enforcement authorities. As regards STR, amendments were made to section 11 GwG to clarify that the threshold of suspicion is low and does not have to reach the level required for criminal complaints or indictments. Furthermore, specific guidance on section 11 GwG was issued by the MoF and adopted by BaFin (Circular Letter 1/2014 (GW).</p> <p>BaFin has a dedicated department (GW) responsible for AML/CFT for all entities within the mandate of BaFin which includes: credit institutions (1800), securities investment firms (98), payment services organizations (32), e-money agents (100,000), financial services firms (750), and insurance entities (130) – all numbers are estimates. GW consists of six divisions with approximately 110 staff. Within GW, Department GW2 is responsible for the AML/CFT supervision of credit institutions with a total staff of 18, of which 12 are supervising credit institutions. Each supervisor has approximately 200 credit institutions in their portfolio ranging from large complex credit institutions with extensive cross-border operations to small monoline credit institutions that service clients in a region.</p> <p>The main input to determine that banks have adequate policies and processes to identify and report criminal activities is the annual EA report. All credit institutions are required to have this audit conducted annually. The report on this audit is provided and testified by an external auditor and submitted to BBk and BaFin. The scope of the audit regarding the compliance by banks and financial services institutions with AML/CFT provisions is prescribed in PrüfBV (section 6) and requires the auditor to provide an opinion as to whether the bank has complied with the relevant sections of KWG and GWG. The EA report is submitted to the BBk which will perform an assessment of the risk profile of the bank which includes risks from ML/TF.</p> <p>The ML/TF part of the EA report together with other information obtained by BaFin lays the foundation for BaFin to make an assessment of a bank's compliance with the AML/CFT provisions and any potential shortcomings. This assessment leads to the risk classification of the bank regarding ML/TF, which is part of the general risk classification of the bank.</p>
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⁷⁸DK stands for „Deutsche Kreditwirtschaft“; it is the name of the union of the main German Banking Associations that represents the majority of the German banking sector. DK is the official issuer of the so-called "DK-Auslegungs- und Anwendungshinweise" (DK interpretation and implementation guidelines), which is the centerpiece of the German AML/CFT Guidelines; these Guidelines are drafted by DK, i.e. the private sector, but discussed with and officially endorsed by BaFin and the Federal Ministry of Finance. They therefore comply with the existing administrative practice of BaFin, which is bound to the guidelines in this regard.

BaFin is empowered to carry out on-site inspections on its own or by commissioned auditors. There are typically two types of on-site inspections: targeted on-site examinations (partially accompanied by BaFin staff) and inspections where BaFin will accompany the EA when conducting the annual audit (called auditor accompanied examinations. In relation to the targeted on-site examinations, BaFin conducted in 2015 26 of such examinations in banks and 6 in branches of foreign banks. These figures were quite similar compared with 2013 (26/6) and 2014 (28/8) (2012 was special due to an extraordinary examination campaign). In addition, BaFin conducted the following targeted on-site examinations in banks focused on the account data retrieval system (section 24c KWG): 2011: 8; 2012: 10; 2013: 10; 2014: 1; 2015: 10). Furthermore, the number of auditor accompanied examinations has increased during 2015.

Where BaFin detects AML/CFT shortcomings in a bank, it has a broad range of tools to counter these shortcomings (e.g., issuing orders and instructions to take certain measures) and to sanction the responsible person or the institution as such (including dismissal of responsible managers, withdrawal of the banking license, administrative fines) based both on the GwG (sec.17) and the KWG (e.g., sec. 35 para. 2 No. 6 Banking Act).

The dedicated division within responsibility for AML/CFT has developed a risk-based matrix that classifies banks into a single risk profile combining an assessment of inherent risk and quality of safeguards (a 12 cell matrix). The matrix recognizes the size, complexity and inherent risk profile together with risk mitigants and the matrix is calibrated such that larger more complex banks will typically receive a greater level of supervisory intensity and frequency of attention given their higher inherent exposure to AML/CFT risks. For low risk credit institutions, the EA report will be reviewed on at least a four-year cycle whilst for the highest rated credit institutions the results of the EA report will be reviewed and assessed approximately every year. As a way to streamline the assessment process and help identify deficiencies in the EA report, external auditors are requested to prepare a checklist of findings in the context of AML/CFT and the prevention of other criminal activities called Annex 6 to the PrüfBV, which was implemented in 2010.

Annex 6 obliges the EA to rate the outcome from the audit regarding ML/TF and other criminal activities by using a rating system of F0 – no deficiencies to F4 – severe deficiencies (resp. F5 – non applicable). A copy of Annex 6 is submitted and checked for each bank annually (for banks with a balance sheet of not more than 400 Mio. Euro every two years) by BaFin staff to determine whether there are evidences of higher risk issues (e.g., F4 and F3) and if so will single out the credit institutions for follow up.

Additional sources of information for off-site supervision include results from previous on-site examinations; interviews with institutions, meetings with association bodies, meetings with law enforcements officials and STR reports from FIU). An on-site examination of AML/CFT will be conducted on a cycle of approximately every ten years for lower risk credit institutions whereas for the largest credit institutions it is typically conducted more frequently.

ECB in its direct prudential supervision role is responsible to supervise the general risk management and controls at an enterprise wide level which is linked to AML/CFT compliance issues. In this way, AML/CFT will be captured as part of the overall ECB's supervision. There is a two-way communication flow via BaFin staff that are participating in the SI JSTs. In this way, BaFin staff will help to identify AML/CFT priorities. Equally, BaFin will make the ECB aware of AML/CFT issues as an input into the ECB's supervision of risk management.

	<p>BaFin will accompany the external auditor when conducting its annual audit of a credit institution which typically lasts for between 2-3 days. The BaFin will also assess the work of the EA. Targeted AML/CFT examinations which typically last for between 2-3 weeks and consist of meetings with compliance officers, management, sample testing and an in-depth review of risk management and controls.</p> <p>The reduction in targeted on-site examinations is largely a result of adjusting the emphasis of how the on-site process is applied preferring to increase the number of EA accompanied on-site examinations. The number of on-site examinations and EA accompany exams equates to approximately 5 percent of the population of credit institutions supervised by the BaFin.</p> <p>The low number of on-site examinations combined with a reliance on the external audit report is a problem. The BaFin's risk-based framework is mainly based on information received from the EA (additional information from other sources about the quality of risk management and controls and whether banks have implemented the requirements of the AML/CFT regime is also taken into account). Insofar BaFin's assessment of the AML/CFT situation in a bank depends on the quality of the work of the EA. In order to enhance the quality of the EA reports BaFin together with the Banking industry has worked out detailed interpretation and implementation guidelines ("Auslegungs- und Anwendungshinweise") with regard to the AML/CFT provisions in the GwG and the Banking Act. In addition, BaFin meets annually with the auditors association ("IDW") to discuss issues which came up during the last assessments. However, its capacity to make an own first-hand verification of the accuracy of the work of the EA as well as its own verification of the implementation of controls by banks to prevent AML/CFT abuse is limited due to the existing personal resources.</p>
EC3	<p>In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank.⁷⁹</p>
Description and findings re EC3	<p>According to the German regulations, STRs are not required to be reported to BaFin; instead banks are required to report STRs to the FIU and law enforcement agencies (LEAs). In the event the FIU or LEAs identifies an STR that is relevant for the BaFin's mandate, it is required to notify the BaFin of material STRs. In 2015, BaFin received between 5-10 notifications by LEAs in relation to individual institutions. Action taken by BaFin from these notifications included:</p> <p>BaFin hold meetings with law enforcement agencies to obtain an insight into the type, volume and nature of STRs across the German banking system. Periodic meetings are also held with a range of institutions throughout the year including: law enforcement, AML compliance officers and industry associations.</p> <p>Obligations in relation to identification of suspicious activities and preventative controls are found in the following regulations:</p> <ul style="list-style-type: none"> - According to section 25h para 1 KWG, banks and financial services institutions in the framework of their orderly business organization and appropriate risk management have to develop and update internal principles, appropriate business and customer-related safeguards and controls and perform inspections to prevent fraudulent activity to their detriment. This is an explicit obligation with regard to fraudulent activity being independent from and going beyond the general prudential supervisory requirements

⁷⁹ Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

	<p>for banks to ensure safe and sound business (please refer to section 25a para 1 KWG and the MaRisk).</p> <ul style="list-style-type: none"> - Banks are required to implement policies and procedures for the prevention of AML and CFT (see also EC1). This includes implementing and regularly updating appropriate data management systems, i.e. IT solutions that enable banks to electronically monitor their business relations and transactions on an ongoing basis. The expertise of the bank's staff, the results of the bank's risk analysis, and other available sources such as the findings of national and international typology papers will feed into the monitoring systems and procedures, i.e. influence the parameters of the monitoring systems, which are aimed at the detection of suspicious or unusual transactions and business relations. <p>In order to enable staff to recognize suspicious cases, banks are required to provide their staff with sufficient AML/CFT training as part of their AML/CFT policies and procedures. According to the regulations and transposed into bank policies and processes, suspicious cases must be internally recorded so they can be audited by IA, EA and BaFin. Furthermore, banks must ensure that all suspicious cases are presented internally to the AML compliance officer directly (without other involved persons or units that could filter out cases) for assessment and decision. Where the bank decides that a suspicious case shall not result in a suspicious transaction report, the reasons for abstaining from the report shall be documented and recorded. Compliance with these provisions is assessed by IA, EA and BaFin when it conducts its on-site examinations. Lastly, banks must have in place organizational measures that ensure immediate forwarding of the suspicious transaction report to the competent authorities; banks are to use safe electronic means of communication where these are provided by the recipients of the STRs. All reports (including internal reports that have not resulted in an STR) need to be recorded and retained for at least five years.</p> <p>Banks are not required to report to the banking supervisor suspicious activities including STRs and other incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank. Nonetheless, there are circumstances where banks will make the supervisor aware if there is a material incident/ STR. BaFin becomes aware of STRs and other incidents regarding ML and TF through regular interaction with the FIU and law enforcement officials. The results of this routine coordination will inform the risk rating of a particular bank and be reflected in the risk profile and supervisory stance. Given the size of the German bank sector, its connectedness within Europe (rated as high risk by the FATF MER in 2010) the number of STRs reported by banks as well as the low volume of STRs reported to BaFin does not provide a sound basis for BaFin to be fully aware of whether banks implementation of STR reporting requirements is effective. A more systematic mechanism is needed for BaFin to be kept aware of the type, volume and trends in STR reporting by banks as an input to its ongoing surveillance of the banking system and of individual banks.</p>
EC4	<p>If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.</p>
Description and findings re EC4	<p>Cases covered by criminal law are one of the exceptions to the professional secrecy of supervisors as provided for in Art 53 CRD IV. Art 25, of 2005/60/EC3AMLD also establishes the obligation of supervisors to inform the FIU promptly if they discover facts that could be related to money laundering or terrorist financing in the course of their supervisory work.</p> <p>Where factual circumstances exist to indicate that the assets or property connected with a transaction or business relationship are the product of an offence under section 261 of the Criminal Code or are related to terrorist financing, the competent supervisory authorities</p>

	<p>according to section 16 para 2 GwG shall promptly report such circumstances to the FIU of the Federal Criminal Police Office and the competent LEAs, section 14 para 1 GwG.</p> <p>Periodic meetings are held with a range of bodies throughout the year including: law enforcement, AML compliance officers and industry associations. BaFin, in the course of fulfilling its duties has detected and reported according to section 14 para 1 GwG the following figures of STRs to the FIU and the LEAs: 2013: 65, 2014: 157, and 2015: 118 (cf. Annual Reports of the FIU). Reports regarding agents account for most of these STRs.</p>
EC5	<p>The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements:</p> <ul style="list-style-type: none"> (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) a customer identification, verification and due diligence program on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) policies and processes to monitor and recognize unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk); (e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and (f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five year retention period.
Description and findings re EC5	<p>Chapter II of the 3AMLD sets out the different requirements on customer due diligence, including simplified due diligence and enhanced due diligence. The bundle of CDD and internal safeguard requirements forms the basis of the banks' framework of a customer acceptance policy, being also subject to the assessments of BaFin's supervisory work. When establishing a business relationship, banks are required to fulfill certain obligations with regard to the customer and the business relationship itself. According to section 3 (1) no. 1 GwG, banks have to identify the contracting party. In addition, banks shall take appropriate risk-based measures to determine whether the contracting party is a natural person based outside the country, who is or has been entrusted with prominent public functions (PEPs) according to section 6 (2) no. 1 GwG. Also, with regard to the person of the customer, section 3 (1) no. 3 GwG obliges banks to clarify whether the contracting party is acting on behalf of a beneficial owner and, if so, to identify the beneficial owner.</p>

	<p>According to section 3 (1) no. 2 GwG, institutions are furthermore required to seek and obtain information on the purpose and the intended nature of the business relationship. These provisions are complemented with the obligation that if a bank is unable to fulfill the CDD requirements, it may not establish or continue a business relationship or carry out any transactions, regardless of any legal or contractual provisions (section 3 (6) GwG).</p> <p>According to section 3 (1) no. 4 GwG, institutions are required to continuously monitor the business relationship, including the transactions carried out in the course of the business relationship, in order to ensure that they are consistent with the information obtained by the obliged entities about the contracting party and, if applicable, the beneficial owner, their business and client profile and, where necessary, with the information obtained about the origin of their assets or property; in the course of their continuous monitoring activities, obliged entities shall ensure that the relevant documents, data or information are updated at appropriate intervals. Institutions must also update CDD information where there is doubt as to the veracity of the information collected pursuant to this Act in relation to the identity of the contracting party or the beneficial owner, section 3 (2) no. 4 GwG. Based on the information required during CDD, institutions are required to apply a risk based approach in their overall risk management as well as in the assessment of individual customer relationships and transactions, taking into account relevant risk factors such as country risk, customer risk and product risk (cf. Nr. 80 of "DK-Hinweise"). Section 4 (3) GwG clearly prescribes which type of ID information must be obtained from natural persons (para 3 no. 1) or legal persons (para 3 no. 2) during CDD. All information obtained during CDD must be retained for a period of at least five years, section 8 para 3 GwG.</p> <p>The regulatory framework sets out the following:</p> <p>(a) Chapter II sets out rules for customer due diligence on new and existing customer relationships (Art 9(6)). Art 9(5) requires that where an obliged entity cannot comply with its customer due diligence obligations it must not carry out the transaction, establish a business relationship and terminate an existing business relationship. This includes situations where the obliged entity applied customer due diligence measures in line with Art 7 (because it suspects money laundering or terrorist financing, or has doubts about the veracity or adequacy of previously obtained customer identification data).</p> <p>(b) Art 8 sets out rules for customer due diligence, including the identification and verification of customers and, where applicable, their beneficial owners. It also requires obliged entities to obtain information on the purpose and intended nature of the business relationship, monitor transactions and ensure that all documentation, data and information held is up to date. Obligated entities can determine the extent of these measures on a risk-sensitive basis.</p> <p>(c) In addition to the general monitoring requirement in Art 8, Art 20 requires obliged entities to pay special attention to any activity which they regard as particularly likely, by its nature, to be related to money laundering or terrorist financing and in particular complex or unusually large transactions and all unusual patterns of transactions which have no apparent economic or visible lawful purpose.</p> <p>(d) Art 13 requires obliged entities to apply enhanced customer due diligence measures, in addition to normal customer due diligence measures, in situations which by their nature can present a higher risk of money laundering or terrorist financing. The Directive does not specify what these measures must be in all cases but where the customer is a 'politically exposed person', enhanced due diligence will include escalation to senior management level.</p>
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	<p>(e) Art 13.4 sets out detailed rules for obliged entities where they have a business relationship with, or carry out a transaction for, PEPs. This includes risk-based procedures for establishing whether the customer is a PEP, senior management approval for entering into a business relationship with a PEP, establishing the source of wealth and the source of funds and enhanced monitoring on an ongoing basis (Commission Directive 2006/70/EC defines who Politically Exposed Persons are).</p> <p>(f) The record keeping obligations are in Chapter IV. Chapter IV mandates record-keeping of the evidence obtained when applying customer due diligence measures as well as supporting evidence of all transactions and business relationships for a period of at least five years after the termination of the business relationship or the carrying out of the transaction.</p> <p>The main input to determine whether banks have effectively implemented adequate CDD policies and processes is the EA report which is conducted for all credit institutions and submitted to the BBk and BaFin. According to the individual risk classification of each bank and using a supervisory risk-based framework, BaFin will select a sample of banks to conduct on-site examinations during the supervisory cycle. A key input not only into the risk classification but also into the aforementioned selection of banks includes a review of the Annex 6 report which is a high level summary of banks' compliance with the AML/CFT regulations containing a rating from F0-F5. In the event issues have been identified (designated as F4 or F5), the BaFin will typically select the bank to make a more in-depth assessment of the EA report. While the regulatory framework is established and satisfies the requirements for adequate CDD approaches to be in place, the supervisory practices to gain assurance that CDD policies and processes are integrated into a bank's risk management are incomplete and place undue reliance on the EA report.</p>
EC6	<p>The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include:</p> <ul style="list-style-type: none"> (a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and (b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC6	<p>Art 13(3), 3AMLD applies to correspondent banking, and sets out certain measures that must be applied where the respondent is from a third (non-EEA) country. It requires, inter alia, that a bank must gather sufficient information about the respondent institution in order to fully understand the nature of its business, to determine the quality of its supervision and the reputation of the correspondent bank. Art 13(5) prohibits credit institutions from entering into or continuing a correspondent banking relationship with a shell bank and requires that credit institutions take appropriate measures to ensure that they do not engage in or continue previous correspondent relationships with a shell bank.</p> <p>A review of a sample of EA reports during the field mission demonstrated that correspondent banking relationships were duly considered as part of the EA report to varying degrees depending upon the materiality of these relationships for the business model. The information included in the EA report was not sufficiently detailed to contain information which would detect a change in the business model, number of new correspondent relationships, a shift in emphasis towards higher risk locations etc. For this reason, a more in-depth knowledge of the bank's business model is required to fully assess the inherent risk of</p>

	correspondent relationships of AML/CFT. Correspondent banking is considered a high risk activity and is referenced as such in the German banking law. Risk monitoring is complex and requires a transaction-level monitoring.
EC7	The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.
Description and findings re EC7	Art 37, 3AMLD requires supervisors to monitor banks' compliance with all of the Directive's requirements, which include measures to prevent and detect money laundering and terrorist financing and to report suspicious transactions. (See EC 1-4).
EC8	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.
Description and findings re EC8	Art 39, 3AMLD provides that MS shall ensure that natural and legal persons can be held liable for infringements of the provisions adopted pursuant to this directive. The penalties must be effective, proportionate and dissuasive. MS shall also ensure, in conformity with their national law, that the appropriate administrative measures can be taken or administrative sanctions can be imposed against credit and financial institutions. In June 2013, section 30 OWiG ("Regulatory fine imposed on legal persons and on associations of persons") was amended, increasing the maximum amount of the fine in the case of a criminal offence by the factor ten (ten million Euros in cases of intent, five million Euros in cases of negligence).
EC9	The supervisor determines that banks have: <ul style="list-style-type: none"> (a) requirements for internal audit and/or external experts⁸⁰ to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports; (b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported; (c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and (d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.

Description and findings re EC9	Se CP 25. 3AMLD sets out high-level provisions in relation to obliged entities' internal controls, including in relation to internal governance and management information: Art 34 requires in general terms that obliged entities establish 'adequate and appropriate policies and procedures', including in relation to internal control, risk and compliance management and communication;
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⁸⁰ These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	<p>Art 22 (2) requires that obliged entities designate a person in accordance with Art 34 (this will include the person who will normally report suspicious transactions to the FIU);</p> <p>Art 35(2) requires that obliged entities ensure that their staff are aware of these and specifies that relevant staff must have training to not only recognize money laundering and terrorist financing, but also to know how to proceed in such cases.</p>
EC10	<p>The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Boards, management and the dedicated officers with timely and appropriate information on such activities.</p>
Description and findings re EC10	<p>See also CP 26 and above, EC9: 3AMLD sets out high-level provisions in relation to obliged entities' internal controls, including in relation to internal governance and management information. Art 34 requires in general terms that obliged entities establish 'adequate and appropriate policies and procedures', including in relation to internal control, risk and compliance management and communication. Art 22 (2) requires that obliged entities designate a person in accordance with Art 34 (this will include the person who will normally report suspicious transactions to the FIU). Art 35(2) requires that obliged entities ensure that their staff are aware of these and specifies that relevant staff must have training to not only recognize money laundering and terrorist financing, but also to know how to proceed in such cases. Art 27 3AMLD on protection of staff when reporting internationally or to the FIU suspicions of money laundering or terrorist financing: MS shall take all appropriate measures in order to protect employees of the institutions or persons covered by this Directive who report suspicions of money laundering or terrorist financing either internally or to the FIU from being exposed to threats or hostile action.</p> <p>Credit institutions must draw up service and organizational instructions to ensure that written reports on all internal cases of suspicion (including financial transactions which were requested but refused and all transactions which are unusual on money laundering and terrorist financing criteria) are submitted to the compliance officer (AML) in writing for further examination and decision-making and are also documented there. Furthermore, the internal auditing department of each bank must examine the institution's compliance with all applicable duties under the GwG.</p> <p>Examination reports must be drawn up and submitted at least once a year to the management board of the bank. The reports must contain, inter alia, a description of the internal reporting system for suspicious transactions as well as detailed information on the type, number and local occurrence of suspicious transactions reports filed with the competent law enforcement authorities in accordance with section 11 GwG and on the termination of business relationships. In addition, ad-hoc information of the management board is necessary with regard to single cases that could have a deep impact on the reputation of the institution. In particular, the reports must contain an assessment of whether the measures adopted by the bank to prevent money laundering, terrorist financing and other criminal activity which may endanger the assets of the bank are adequate and sufficient and whether the compliance officers (AML) has fulfilled the tasks assigned.</p> <p>In addition, the compliance officer (AML) is obliged to annual reporting to the board of management.</p>
EC11	<p>Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.</p>

Description and findings re EC11	Article 26, 3AMLD provides that a disclosure in good faith by an institution or person covered by this Directive or by an employee or director of such an institution or person shall not constitute a breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, and shall not involve the institution or person or its directors or employees in liability of any kind. Article 27 further provides that Member States shall take all appropriate measures in order to protect employees of the institutions or persons covered by this Directive who report suspicions of money laundering or terrorist financing either internally or to the FIU from being exposed to threats or hostile action.
EC12	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	See also ECs 1-4). Though not specific to anti-money laundering and counter-terrorist financing, the provisions of CRDIV will apply (see, for example, explanations provided in the context of Principles 3 and 13). The Audit regulation requires the EA to provide assurance regarding the offshore activities of banks. Instead the EA when preparing the EA report will place reliance on internal and external sources of information to confirm compliance. BaFin has extended its on-site program to include offshore operations of German banks. In 2013, it conducted an off-site program to several jurisdictions to assess compliance with AML/CFT obligations.
EC13	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.
Description and findings re EC13	Art 37 (2), 3AMLD states that there must be adequate resources at the disposal of competent authorities to perform their functions, including to ensure banks' compliance with the requirements of this Directive. Art 35 (2) and (3) requires MS to ensure that obliged entities have access to up to date information on money laundering and terrorist financing practices, risk indicators and feedback on suspicious transaction reports where practicable, but it does not specify which national authority shall be responsible for providing that information. BaFin as a supervisory authority has no legal responsibility and no specific expertise for addressing criminal activities. However, BaFin cooperates closely with the Federal Criminal Police Office – Financial Intelligence Unit and LEAs, which have such expertise and shares it with BaFin in order to strengthen the supervisory quality.
Assessment of Principle 29	Largely Compliant
Comments	Germany has introduced reforms to enhance its AML/CFT regime e.g., criminalized self-laundering and immobilized bearer shares, enhanced domestic cooperation, improved the supervisory framework for designated non-financial business and professions (DNFBPs) and the risk analysis model applied by BaFin for AML/CFT supervision. On-site visits to financial institutions and DNFBPs have increased. In light of the revised AML/CFT standard, Germany is currently conducting a national assessment of its money laundering (ML) and terrorist financing (TF) risks. While legislation on AML/CFT is generally comprehensive, however, supervisory practices need to be strengthened to ensure compliance with regulations is maintained at a high standard.

	<p>BaFin has established a risk-based framework to discriminate banks' risk profiles and exposure to risks from AML/CFT. The framework is designed to help identify those institutions where enhanced monitoring and attention is required. The framework is based on a matrix of inherent risk and quality of safeguards. The matrix recognizes the size, complexity and inherent risk profile together with risk mitigants and the matrix is calibrated such that larger more complex banks will typically receive a greater level of supervisory intensity and frequency of attention given their higher inherent exposure to AML/CFT risks. Low risk credit institutions will typically receive attention on a less frequent basis. While the framework should help focus supervisory attention on the highest risk institutions, inputs into the process need to be refined to be fully risk-based. The framework is mainly reliant on the EA report to identify deficiencies or weaknesses in risk management, notwithstanding BaFin has taken several steps to enhance the quality of EA reports. Ongoing monitoring of banks' compliance with the regulations needs to be more systematic through the ongoing receipt of a range of inputs into off-site surveillance especially those sources that it gathers from first-hand analysis and verification of bank's risk management and controls for AML/CFT. Lastly, the coverage of the banking sector through on-site examinations (targeted examinations and auditor accompanied examinations) should be expanded by increasing the number of such examinations (and the personal resources which are necessary given the size of the German bank sector and its connectedness within Europe (rated as high risk by the FATF MER in 2010). A more systematic mechanism with regard to information by the FIU and the LEAs to BaFin in case of identified non-compliance with AML/CFT obligations (including STRs not being reported immediately) would be desirable for BaFin to be kept more aware of the type, volume and trends in STR reporting as an input to its ongoing surveillance of the banking system and of individual banks (EC3).</p> <p>While the regulatory framework is established and satisfies the requirements for adequate CDD approaches to be in place, the supervisory practices to gain assurance that CDD policies and processes are integrated into a bank's risk management rely mainly on the EA report to confirm CDD policies are properly implemented (EC5).</p>
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SUMMARY COMPLIANCE WITH THE BASEL CORE PRINCIPLES

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	C	While the division of responsibilities between BaFin and Bundesbank regarding LSIs supervision seems to be clear, the framework for the SSM supervision is evolving and there are still uncertainties regarding the operational roles of each. These uncertainties reflect the complex legal and operational framework of the SSM, in particular on imposition of sanctions and enforcement actions, but do not seem to affect the overall understanding of responsibilities by market or authorities.
2. Independence, accountability, resourcing and legal protection for supervisors	LC	The three supervisory agencies responsible for German banks enjoy operational independence, in the sense that there is no government or industry interference in individual supervisory decisions. However, the fact the MoF is responsible for approving minutely all of BaFin's organizational matters may indirectly affect the execution of supervisory priorities. In addition, while BaFin does not depend on government funding, its budget is approved by a committee composed of government and industry representatives, chosen by the MoF in consultation with the associations of supervised entities. Decision making process in the newly established SSM does not foster effectiveness and timeliness of supervisory decisions.
3. Cooperation and collaboration	C	Cooperation channels are highly developed and effective.
4. Permissible activities	C	Permissible activities are well defined in German legislation and the use of the word "bank"
5. Licensing criteria	LC	The ECB, which is the licensing institution for new banks and for subsidiaries of foreign banks establishing in Germany, and BaFin, which is the licensing institution for branches of non-EEA banks, have available a clear set of criteria and are able to reject applications that not meet it. In general, financial suitability of shareholders is limited to the availability of the initial capital. The assessment of the supervisory board does not play a relevant role in the licensing process; in particular, ensuring the professional qualification and collective knowledge of the supervisory board was not customarily assessed. The assessors have reviewed samples of more recent

Core Principle	Grade	Comments
		licensing files and observed there is a growing concern with these elements.
6. Transfer of significant ownership	C	Process identifies ultimate beneficial owners but fit-and-proper requirements should be strengthened
7. Major acquisitions	MNC	Investments not exceeding 15 percent of capital do not require ex-ante consultation or approval. The acquisition of holdings in an EU regulated financial entity is assessed from the perspective of the target undertaking (CP6). The acquisition by a bank of a non-EU bank is not covered by the CRR or CRDIV. This may create situations where acquisitions occur that increase the risk to the banking group due to financial products that exceed the bank's risk appetite or managing ability.
8. Supervisory approach	LC	<p>The introduction of the SSM has had positive externalities for supervision of German SIs and LSIs. For example, more focus on quantitative analysis and the SREP process. There are several aspects of the framework which are still a work in progress at the time of the assessment: application of a consistent methodology to make meaningful comparisons between banks will need time to develop as the SREP and RAS process matures. To date, the SREP process has been mainly focused at the consolidated level and has not penetrated deep into the organizational structure. While there is a sound understanding of group structures generally, application of the SREP process across the group structure will help identify potential pockets of risk that deserve greater supervisory attention and incorporated into SEPs. For larger and more complex banks this is an important part of the assessment that will help drive a thorough analysis of risk and help identify where further documentation is needed to better inform of the risk assessment process.</p> <p>Greater emphasis is needed to verify the reliability, accuracy, and integrity of the information used for risk assessments and prudential outcomes.</p>
9. Supervisory techniques and tools	LC	Overall supervisors of German banks take an active approach to using supervisory tools. The supervisory manual and associated frameworks provide a sound basis for supervisors to perform comprehensive risk assessments using a mix of on-site and off-site supervision activities. Annual

Core Principle	Grade	Comments
		<p>risk assessments and the SREP process allow for the results of off-site and on-site supervision to be integrated and combined for form a single overall view of all material risks and the necessary measures. Supervision manuals are detailed and help guide the risk assessment process in a systematic way. On-site examinations were demonstrated to be an effective tool to focus on deficiencies in risk management. There are, however, gaps in the approach for on-site and off-site that need to be attended to. For LSI off-site supervision there is an undue reliance on the work of the external auditor and while the annual EA report contains a significant amount of detail, a greater use of other inputs to off-site supervision is needed in the risk assessment process.</p> <p>The results of on-site examinations for SIs are not ranked in degree of severity. While there is a clear process for the communication of findings at the conclusion of the examination process, the ultimate communication to the bank does not prioritize findings from high priority to low. As a result, it is not always clear for banks the prioritization of actions to address on-site findings. A ladder of severity will help ensure management and supervisory boards are able to prioritize remedial action according to severity of on-site findings.</p>
10. Supervisory reporting	MNC	<p>The requirements associated with supervisory reporting are now predominantly governed by a harmonized EU regime. However, the application of regulatory data requirements (FINREP/CoRep) is not uniform, resulting in circumstances where some banks do not report a comprehensive suite of data for offsite analysis based on common definitions. While the data contributes to the risk assessment process, analysis of regulatory data is hampered by a lack of granular data. Supervisors need to perform manual calculations to map exposure values from nGAAP to IFRS which inhibits systematic and consistent comparisons between different account treatments. Processes to map supervisory data reported using different accounting treatments are in the process of being completed and at the time of the mission this process was not consistently applied.</p>

Core Principle	Grade	Comments
11. Corrective and sanctioning powers of supervisors	LC	German law and SSMR provide a broad range of actions that can be taken by supervisors in their respective responsibilities. Direct enforcement powers and sanctions of ECB are limited; however, the ECB can make use of the enforcement and sanction powers available to BaFin. Assessors had access to evidence of such indirect actions. At the time of this mission, ECB had not directly applied any sanction or enforcement action. While BaFin seems to have adequate set of supervisory tools at its disposal, actual use of these formal powers in practice is not intensive. There are no laws or regulations that guard against BaFin or ECB unduly delaying appropriate corrective actions.
12. Consolidated supervision	C	A consolidated supervisory approach is in place at both the SI and LSI level. A detailed planning approach is in place through supervisory colleges and MOUs that results in a comprehensive review for the consolidated group. Additionally, ring-fencing powers are available to ensure that the group can be insulated from related companies that may adversely impact the group. Banking groups may be required to close reorganize to correct a non-transparent structure.
13. Home-host relationships	C	Collaboration and coordination framework with domestic and cross-border supervisors is highly developed. The EU has adopted a supervisory coordination process that is based on joint supervision through the SSM; colleges of supervisors led by the home country coordinator and signed MOUs with third country supervisors and nonbanking sector regulators.
14. Corporate governance	LC	While Germany has well-developed corporate governance requirements, the oversight role of the supervisory board is passive and its operational oversight role is limited. The fit-and-proper process is streamlined for supervisory board members as are technical knowledge requirements
15. Risk management process	LC	The risk management standards for German banks are anchored in MaRisk which require banks to have regard to all material risks calibrated against a bank's risk bearing capacity. MaRisk has been revised on several occasions and most recently in January 2016 to incorporate areas such as risk culture and risk aggregation. The standards encourage a generally sound approach to risk management. For the largest and more complex banks, an enterprise-wide

Core Principle	Grade	Comments
		<p>approach to risk management is often employed using more sophisticated measurement systems and tools to assess required capital, capital allocation etc. (e.g., economic capital models) consistent with their risk profile and systemic risk. Supervisory practice is also generally well developed and a number of techniques are used by the supervisor to confirm and assess the quality and effectiveness of risk management systems. Furthermore, the ICAAP is an integrated part of the risk assessment framework for German banks. ICAAP and ILAAP guidelines have recently been released by the ECB which will be the standard banks will be expected to adhere to going forward. To date, there have been no published minimum standards.</p> <p>The reporting of risk management is through the Management Board and the CEO which is responsible for setting the business plan and risk taking. The risk function does not report directly to the Supervisory Board but to the Management Board and therefore the CEO. This approach may weaken the independence of the risk management function and the CRO to raise issues. While banks had in place formal “whistle-blowing” processes, the structure may inhibit the independence of the CRO and the risk function to report weaknesses in the RMF.</p>
16. Capital adequacy	LC	<p>The deviations from Basel standards regarding the definition of capital do not seem to be material for German banks in general, although some may be for specific banks (deduction of participation in insurance, for instance).</p> <p>For Germany, a few elements for which the RCAP found deviations regarding the calculation of capital requirements may be significant, such as sovereign exposures under the permanent and temporary partial, lower risk weights for covered bonds, and counterparty credit risk framework. Assessors observed some cases where these deficiencies were being addressed by banks’ internal capital adequacy assessments and supervisory action. Nevertheless, assessors do not feel comfortable that existing framework is not in general resulting in overstated CET1 ratios.</p> <p>Both ECB and BaFin can require banks to hold capital in excess of the minima under Pillar 2; however, the practice is not commonly used by German authorities, which in general prefer to address these through direct discussion with the</p>

Core Principle	Grade	Comments
		banks on the adequacy of ICAAP. ECB as a supervisor has only concluded one SREP cycle, in which some banks were required to implement Pillar 2 add-ons. The leverage is specifically taken into account in the SSM SREP methodology, not yet systematically so by BaFin.
17. Credit risk	C	General guidance on credit risk exists and is monitored. Granularity of data on credit portfolios is limited (see CP 18)
18. Problem assets, provisions, and reserves	LC	Loan valuation is performed by external auditors with limited supervisory involvement. Loan classification guidelines have not been issued and neither MaRisk nor the KWG define nonperforming, cured, restructured and renewed loans. Loan classification and provisioning are viewed as an accounting issue. The supervisors do not re-classify loans or request increased provisions and rely on capital add-on. Supervisor expectations on loan valuation and guidelines should be communicated and discussed with bankers and auditors. Provisioning and impairment views of the supervisor should also be discussed with the objective of issuing conservative parameters for bank management's broad judgment granted by IFRS.
19. Concentration risk and large exposure limits	LC	Both ECB and BaFin focus on concentration as part of credit risk, and occasionally discuss concentration of other types when some material risk is detected. MaRisk provides a general framework for the supervision of concentration risk, and while the ECB internal procedures for credit concentration are aligned with the CP, the expectations of the supervisor with respect to concentration risk management are not clearly communicated to the banks. In addition, there is no requirement that all material concentrations to be regularly reviewed and reported to the bank's supervisory board.
20. Transactions with related parties	MNC	The definition of related parties is wide and detailed. The framework covers loans in a broad definition that includes off-balance sheet exposures and leasing operations, albeit not exposures such as dealings such as service contracts, asset purchases and sales, construction contracts. Related party loans must be granted on market terms, but there is no requirement that individuals with conflict of interest are excluded from the whole process of granting and managing such exposures. There is no requirement that related party exposures are

Core Principle	Grade	Comments
		monitored and controlled separately and in aggregate. There is no regular reporting of exposures to related parties. Supervision of related party risk is mostly carried out by external auditors, whose analysis of related party risk is limited. No limits on related party are imposed by laws, regulation, or the supervisor.
21. Country and transfer risks	LC	Banks have little guidance from supervisors on their expectations regarding country risk. Standard reporting on the basis of LrV excludes several countries. There is no specific requirement that banks MIS are able to identify, aggregate, monitor and mitigate country risk. There is no specific requirement to include country risk in bank's stress testing. Assessors saw no evidence that country risk is indeed a regular part of stress testing. While an increase in Pillar 2 or imposition of provisions would be possible if country risk concentrations are detected, there is no specific guidance for banks on measures to provision and mitigate country risk.
22. Market risk	C	The obligations in MaRisk are generally sound and establish the requirements for banks to implement effective risk management frameworks to measure and manage market risk. Market risk has been a focus of the supervisors during 2014 and 2015. Supervisors periodically reviews banks to assess that their market risk management processes are consistent with the risk bearing capacity and the market risk management framework.
23. Interest rate risk in the banking book	C	IRRBB has received a significant amount of the supervisor's attention during the last several years and features as a key supervisory priority. Banks are required to measure, calculate and report their exposure to IRRBB on a quarterly basis. Banks are also required to conduct regular stress testing using both standardized and bespoke scenarios, especially for those banks with more complex business models and optionality in the portfolio. Supervisors make an assessment of IRRBB through the SREP process and assessors saw evidence that showed this risk featured in the SREP assessment as well as a key topic in discussions with bank senior management.
24. Liquidity risk	LC	Since 2007/08 German supervisors have stepped up the frequency and intensity of interaction with credit institutions regarding their management of liquidity risk, contingency plans and funding

Core Principle	Grade	Comments
		<p>requirements. Over time the level of frequency of contact has moderated given considerably more stable market conditions where calls were daily at the height of the crisis to weekly and now less frequent but periodic. Supervisors have built-up in-depth understanding for liquidity funding risks at individual institutions through over this period.</p> <p>The LCR and LiqV requirements apply to all credit institutions as a Pillar 1 minimum standard. Banks are also required to run regular stress tests where the results are incorporated into the assumptions for contingency funding plans. While coverage is comprehensive across all banks, the LCR adopted in EU has a number of elements which are less stringent than the Basel agreed rule, most notably wider definition of HQLA. Given EC 1 clearly states that for internationally active banks the prescribed liquidity requirement should not be lower than the applicable Basel Standard, and the analysis by the EBA shows relatively large impact from these changes, the EU regulatory framework's compliance with the EC is problematic, even if the impact of these modifications concentrates on non-internationally active banks. Discussions with the authorities at the time of the mission suggested that banks make use of the benefits from the modifications although the impact has been reduced since the EBA study.</p> <p>Aspects of the assessment of liquidity risk management as part of the SREP was under development at the time of the mission. For example, benchmarks for liquidity risk indicators were developed during 2016. Also, guidance for assessing ILAAPs will be implemented for 2016. As a result, the analysis of the ILAAP was not fully implemented at the time of the mission and many aspects of the qualitative assessment of ILAAP had not featured in the SREP for SIs. Supervisors are aware however of bank's liquidity risk management processes and have established relationships with key areas within the bank managing liquidity funding risk. To this regard, SSM issued a letter in the beginning of the year on Supervisory expectations on ILAAP and harmonized information collection on ILAAP to enhance the analysis of ILAAP and its integration in the SREP.</p>
25. Operational risk	MNC	The area of operational risk has undergone several enhancements since the time of the last

Core Principle	Grade	Comments
		FSAP, most notably in the strengthening of dedicated IT risk specialists. Nonetheless, there are a number of areas where the regulations and supervisory activities need to be strengthened: data reporting, collection and use of loss data, verification that risk management is effectively implemented and DR/business continuity.
26. Internal control and audit	MNC	The independence of the internal audit and compliance is compromised as they report to the management board.
27. Financial reporting and external audit	LC	Banking supervisors do not have legal power to access external auditors' work papers. Although this is not an essential requirement, Germany chose to be assessed against the best international practices, and given the heavy reliance on external auditors for reviewing not only the reliability of financial statements but also reporting on whether the banks comply with all risk management guidelines, this gap should be addressed.
28. Disclosure and transparency	LC	<p>Disclosure standards are generally sound and promote transparency reflecting the substance of the Basel II Pillar 3 standards. As part of their routine activities, supervisors confirmed compliance with the standards through both sample testing and thematic reviews.</p> <p>German banks do not disclose related party exposures or transactions with related parties as part of the Pillar 3 disclosures (EC2). Instead, related party disclosures are covered by the Commercial Code (HGB) and will be presented as part of a credit institution's annual report.</p> <p>In relation to disclosure of data which is not end of period data, supervisors have made attempts to adjust the frequency of disclosures in some cases, however data which is not end of period has not been made use of in the supervisory process with any impact on outcomes of analysis (AC1).</p>
29. Abuse of financial services	LC	As the competent supervisor, BaFin has established a risk-based framework to discriminate banks' risk profiles and exposure to risks from AML/CFT. The framework is designed to help identify those institutions where enhanced monitoring and attention is required. The framework is based on a matrix of inherent risk and quality of safeguards. While the framework should help focus supervisory attention on the highest risk institutions, inputs into the process

Core Principle	Grade	Comments
		<p>need to be refined to be fully risk-based. The framework is heavily reliant on the EA report to identify deficiencies or weaknesses in risk management. Ongoing monitoring of banks' compliance with the regulations needs to be more systematic through the ongoing receipt of a range of inputs into off-site surveillance especially those sources that it gathers from first-hand analysis and verification of bank's risk management and controls for AML/CFT. Lastly, coverage of the banking sector through on-site examinations needs to be expanded.</p>

RECOMMENDED ACTIONS AND AUTHORITIES

COMMENTS

A. Recommended Actions

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 1	Ensure new consumer protection responsibilities do not affect BaFin's ultimate responsibility for safety and soundness
Principle 2	Reduce scope for potential influence of industry and government in the execution of supervisory priorities and allocation of resources at BaFin through budget and organizational structure Streamline SSM decision making processes for supervisory measures
Principle 5	Include systematic analysis of availability of additional resources in the licensing process Include systematic analysis of the collective knowledge of the management and of the supervisory board Enhance qualification criteria for Supervisory Board members
Principle 7	Review significant bank investments ex-ante
Principle 8	Greater focus on first hand verification of compliance with regulations.
Principle 9	Complete implementation of the supervisory framework.
Principle 10	Collect more granular data as part of routine supervisory reporting as a way to strengthen off-site analysis using peer group benchmarks. Implement a data mapping solution to compare IFRS and nGAAP supervisory data.
Principle 14	Strengthen supervisory board qualifications and responsibilities
Principle 15	Strengthen reporting lines of the CRO and risk control function to the Supervisory Board. Implement a prior notification requirement to the Supervisory Board in the event a CRO is removed.
Principle 18	Issue guidance on loan classification and provisioning

Principle 19	<p>Issue guidance on management of concentration risk in a broader sense (beyond credit exposures).</p> <p>Introduce requirement that all material concentrations to be regularly reviewed and reported to the bank's supervisory board</p> <p>Monitor large exposures beyond the compliance with LE limits</p>
Principle 20	<p>Introduce a regime for the management, monitoring, and actual supervision of related party risk.</p>
Principle 21	<p>Issue guidance on the management of country and transfer risk, including requirements for banks' MIS, and specific requirements for country and transfer risk to be included in bank's stress testing if applicable.</p> <p>Enhance reporting of country and transfer risk.</p> <p>Issue guidance on provisioning and mitigation for country risk.</p>
Principle 24	<p>Develop a greater suite of industry benchmarks for liquidity risk analysis.</p>
Principle 25	<p>Collect more granular data for operational risk. Place more emphasis on confirming that operational risk management systems are effectively implemented.</p>
Principle 26	<p>Provide opportunity for independent reporting to supervisory board without management board participation</p>
Principle 27	<p>Find workaround to gain access to external audit work papers</p>
Principle 29	<p>Place more emphasis on ongoing surveillance to confirm bank's risk management and controls for AML/CFT, especially those sources that it gathers from first-hand analysis and verification.</p>

B. Authorities' Response to the Assessment

a) German Authorities' Response

The German authorities wish to express their appreciation to the IMF and its assessment teams for this assessment since they strongly support the Financial Sector Assessment Program, which promotes the soundness of financial systems in IMF-member countries and contributes to improving supervisory practices around the world.

The German authorities appreciate the assessment in general. Some clearly unsatisfactory ratings are considered as an encouragement to critically reflect current supervisory practices and to make changes and adjustments where appropriate.

However, there are a number of recommendations where the German authorities believe that the current regime effectively fulfils the IMF's requirements. These are set out below:

[The following comments are ordered in the sequence of the DAR text (*factual corrections*):]

Licensing, qualifying holdings and major acquisitions (CPs 5-7)

Regarding **Principle 5** the German authorities want to point out, that although the assessment of the members of the supervisory board is not explicitly a part of the licensing procedure the appointment of any member of the supervisory board undergoes an assessment process by the competent supervisor. According to section 25d (1) of the German Banking Act [Kreditwesengesetz – KWG], the members of the supervisory board of an institution, a financial holding company or a mixed financial holding company must be trustworthy, have the necessary expertise to fulfil their control function as well as to assess and monitor the business of the undertaking, and devote sufficient time to performing their duties. Pursuant to section 36 (3) sentence 1 KWG BaFin is entitled to force a bank to withdraw a member of the supervisory board which does not fulfil these standards. According to section 25d (2) KWG the supervisory board as a whole shall have the necessary knowledge, skills and experience to fulfil its control function as well as to assess and monitor the management board of the institution, group of institutions or financial holding group, financial holding company or mixed financial holding company.

Regarding **Principle 5 and 6** the authorities want to point out that BaFin has published Guidelines regarding the licensing procedures, qualifying holding procedures and the assessment of managing directors and members of the supervisory board. The Guidelines regarding the licensing procedures that were published in 2007 and especially the Guidelines regarding the assessment of the managing directors and the members of the supervisory board which were published for the first time in 2012 and 2013 contain passages regarding the term "trustworthiness" and provide an overview of the standards applied by BaFin in so far. The Guidelines regarding the assessment of managing directors and members of the supervisory board which were revised in 2016 will be published in English shortly as well.

Regarding **Principle 7** the authorities are convinced that although German legislation does not provide for the authority to ex ante review and (dis)approve such participations the qualification as materially non-compliant is not justified. Firstly, Article 89 Capital Requirements Regulation [CRR] is directly applicable in Germany and in so far Germany does not see the possibility to apply a stricter approach than the one set out in directly applicable Union law. Secondly, in our view the acquisition of participating interests outside the financial sector is a business decision in which the supervisor should not intervene. The potential risks stemming from an institutions' acquisition and investment policies are sufficiently limited by quantitative limits and by the fact that the institutions' managers are responsible and accountable for the handling and monitoring of the institutions' risks which includes acquisitions and investments. The managers' performance in turn is subject to review by auditors and supervisory interventions in case the requirements are breached. Thirdly, the qualifying holding procedures also apply for significant participations in insurance companies according to section 17 of the German Act on the Supervision of Insurance companies [Versicherungsaufsichtsgesetz - VAG] and other financial services institutions (i.e. investment firms) according to section 1 (1a), (2) KWG. The requirement of a pre-approval by the competent supervisor for any significant participation in one of these regulated entities also applies if the proposed acquirer is a bank.

Supervisory reporting (CP 10)

The authorities cannot agree with the overall assessment. Taking into account their entire supervisory environment, their experience with the information available and their capacity to react if necessary promptly on banks' situations which are not satisfactory the isolated assessment of **Principle 10** is too harsh and should be upgraded. Moreover, we would like to emphasize that the assessment does not take future developments into account. According to the ECB regulation 534/2015 which further elaborates Regulation (EU) 680/2014 the required information will be available next year.

Corporate Governance (CP 14)

On **Principle 14, Corporate Governance**, on basis of its findings the IMF concludes that the following actions are needed to strengthen the role of the supervisory board:

- Supervisory guidance should clearly state that ultimate responsibility for establishing the risk culture, developing business plans and risk appetite statement rests with the supervisory board.
- *Supervisory enforcement and sanctioning programs should explicitly address supervisory board member liability.*
- *The knowledge/experience requirements for supervisory board members should be commensurate with the complexity of the bank.*
- *Reporting to the board should be frequent and with sufficient detail to enable the board members to challenge management.*

- *Banking supervisors should continue to increase dialogue and discussions with the supervisory board on results of supervisory activities and concerns.*

Reference has been made to BCP standards, requiring increased emphasis on the role of the supervisory board's oversight of management and the institution. According to paragraph 6, page 2, of the Basel Principles for enhancing corporate governance of October 2010, insufficient board oversight of senior management, inadequate risk management and unduly complex or opaque bank organizational structures and activities failures and lapses were one of the reasons for the financial crisis that began in mid-2007. For this reason, Principle 1 of the Basel Principles for enhancing corporate governance of October 2010 states, that "The board has overall responsibility for the bank, including approving and overseeing the implementation of the bank's strategic objectives, risk strategy, corporate governance and corporate values. The board is also responsible for providing oversight of senior management".

Also Principle 1 of the Basel Corporate Governance Principles for banks, published July 2015, requires that "the board has overall responsibility for the bank, including approving and overseeing management's implementation of the bank's strategic objectives, governance framework and corporate culture".

However, neither the above cited guidelines nor the BCP address the "supervisory board" in specific but the "board" in general, which is defined, according to Basel Corporate Governance Principles for banks of July 2015 as

"The body that supervises management. The structure of the board differs among countries. The use of "board" throughout this paper encompasses the different national models that exist and should be interpreted in accordance with applicable law within each jurisdiction."

Footnote 27, page 25 of BCP states that the BCP "[...] refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms "board" and "senior management" are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction".

Also, paragraph 7 of the Basel Principles for enhancing Corporate Governance of October 2010 points out that "the application of corporate governance standards in any jurisdiction is naturally expected to be pursued in a manner consistent with applicable national laws, regulations and codes". Paragraph 15 of the Basel Corporate Governance Principles for banks of July 2015 states that the Principles are "intended to guide the actions of board members, senior managers, control

function heads and supervisors of a diverse range of banks in a number of countries with varying legal and regulatory systems, including both Committee member and non-member jurisdictions. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries which may restrict the application of certain principles or provisions therein. Each jurisdiction should apply the provisions as the national authorities see fit. In some cases, this may involve legal change. In other cases, a principle may require slight modification in order to be implemented.”

Against this background we would like to point out that the German two tier structure differs from the one tier structure. However, the abovementioned Basel principles in general and especially the BCP 14 requirements have been fulfilled.

As regards the responsibilities of both boards, it seems that the interaction between the management board and the supervisory boards and the full range of the supervisory board’s tasks and powers in German banks have not been made sufficiently clear yet.

The German two-tier system allocates the board’s responsibilities in two institutionally independent bodies, the management board, which has the direct responsibility for the management of the company, including the exercise of management control over the lower hierarchical levels, and the supervisory board, which in turn supervises the management activities of the management board. The basic idea is to separate the supervision in an own body, which is staffed and functionally separate from the management board, namely the supervisory board. The aim of this separation of responsibilities is not only to prevent that management responsibilities become so extensive that there is not enough room for the monitoring responsibilities, but also to avoid an involvement of the supervisory board members in management decision-making and accordingly as a final consequence the need to monitor themselves with all resulting potential conflicts of interest. The clear separation of management and supervisory responsibilities as well as the independence of the supervisory board members are major advantages of this system. Requiring an ultimate responsibility for establishing the risk culture, developing business plans and risk appetite statement rests with the supervisory board would contravene this separation.

The role of both, the management board and the supervisory board, is not only governed by supervisory law, i.e. the KWG, but to a large extent subject to the respective company law. In order to facilitate a better understanding of the German two-tier structure and especially the role of the supervisory board, the main responsibilities and powers are outlined below (where governed by company law, using the public limited company (Aktiengesellschaft) as an example).

With respect to the management board, we firstly refer to our explanations in the Preliminary remarks of the German specific part of the Detailed Self-Assessment on BCP 14. Furthermore, we would like to emphasize the fact that due to corporate law it is the management board which has to manage the company on its own responsibility (sec. 76 German Stock Corporation Act [Aktiengesetz – AktG]). This means on the one hand performing the management tasks - or in other words the leadership tasks - and on the other hand bearing the ultimate management responsibility. In its

leadership function, the management board is not limited to performing day-to-day management, but also responsible for developing the corporate strategy as well as determining the corporate policy and ensuring their implementation (cf. sec. 4.1 of the German Corporate Governance Code (GCGC); cf. also sec. 25c KWG). The tasks of the management board also encompass the exercise of management control in the sense of ongoing and subsequent monitoring of the performance and success of delegated management tasks. Concerning the latter, the main responsibility of the supervisory board is normally to assess whether such delegation is appropriately organized, e.g., whether the responsible individuals are properly selected and sufficiently monitored by the management board.

With regard to the qualifications of the supervisory board members, we would like to refer to BCP 14, EC 4, German specific part, and to highlight the fact that, when assessing whether a member of the supervisory board has the necessary expertise, the scope and complexity of the business conducted by the institution, group of institutions or financial holding group, financial holding company or mixed financial holding company has to be taken into account (sec. 25d para. 1 sentence 2 KWG). We also refer once more to BCP 14, EC 9, German specific part, with special regard to corrective measures against supervisory board members.

As already said in the preliminary remarks of the German specific part of the Detailed Self-Assessment on BCP 14, the main responsibility of the supervisory board is the supervision of the management board. For credit institutions, sec. 25d para. 6 KWG specifies that the supervisory board shall oversee the management board, also with regard to its adherence to the applicable prudential supervisory requirements, and shall devote sufficient time to the discussion of strategies, risks and remuneration systems for management board members and employees. Credit institution specific responsibilities also follow from sec. 25d para. 7-12 KWG, where the tasks of the supervisory board's committees are laid down.

For the purpose of supervising the management board, the supervisory board has quite significant powers:

- The supervisory board is responsible for the appointment and dismissal of members of the management board (sec. 84 AktG), including the service agreement and its termination, the compensation of each management board member (cf. sec. 25d (12) KWG in accordance with sec. 3 (2) Remuneration Ordinance for Institutions [Institutsvergütungsverordnung – InstitutsvergVO]) as well as the representation of the company vis-à-vis the members of the management board (sec. 112 AktG). Where necessary, the supervisory board has to consider and to pursue claims for damages against members of the management board (cf. sec. 116, 93 AktG). Corresponding to the liability of the members of the management board, supervisory board members can also be held liable personally for damages in case of infringements of their duty of care (sec. 116 AktG).
- The management board is subject to comprehensive regular and case-specific reporting obligations vis-à-vis the supervisory board (sec. 90 AktG). In addition, the supervisory board may require at any time further reports from the management board on the affairs of the

company (sec. 90 para. 3 AktG). It may also inspect and examine the books and records of the company as well as the assets of the company, in particular cash, securities and merchandise (sec. 111 para. 2 AktG). A specificity for all credit institutions is the right of the chairs of the risk committee and the audit committee, or, if such committees have not been established, the chair of the supervisory board, to make direct enquiries to both the head of the internal audit function and the head of the risk control unit (sec. 25d para. 8 and 9 KWG).

Correspondingly, the chair of the remuneration committee (or the chair of the supervisory board) may make direct enquiries to both the head of the internal audit function and the heads of the organisational units responsible for the structure of the remuneration systems (sec. 25d para. 12 KWG).

- Within the scope of its supervising function, the task of the supervisory board is also to advise the management board in the management of the enterprise regularly. The supervisory board must be involved in decisions of fundamental importance to the enterprise. (cf. sec. 5.1.1 GCGC)
- The supervisory board shall instruct the auditor as to the annual financial statements and consolidated financial statements according to sec. 290 of the Commercial Code (sec. 111 para. 2 sentence 3 AktG). It shall itself examine the annual financial statements, the annual report and the proposal for appropriation of distributable profit and shall report on the results of its examination in writing to the shareholders' meeting (sec. 171 AktG). The annual financial statements shall be deemed to have been approved, upon approval thereof by the supervisory board, unless the management board and the supervisory board resolve that the annual financial statements are to be approved by the shareholders' meeting (sec. 172 AktG).
- While it is explicitly stipulated that management responsibilities may not be conferred on the supervisory board, the articles of association or the supervisory board have to determine that specific types of transactions may be entered into only with the consent of the supervisory board (sec. 111 para. 4 AktG).
- The supervisory board shall call a shareholders' meeting whenever the interests of the company so require (sec. 111 para. 3 AktG), e.g. to achieve a vote of no confidence by the shareholders' meeting in order to revoke the appointment of a member of the management board.
- The strategies and, where applicable, adjustments to the strategies shall be brought to the attention of and discussed with the institution's supervisory board (guidance provided by AT 4.2 para. 5 Minimum Requirement for Risk Management [MaRisk], an administrative regulation issued by BaFin).
- Risk management creates a basis for the proper performance of the supervisory board's monitoring functions and thus shall also include the adequate involvement of the supervisory board (guidance provided by AT 1 para. 1 MaRisk).

Against this background, we would like to emphasize that the management board is the right body regarding the reporting lines of the control functions. All control functions are instruments of the management board due to its responsibility to manage the company on its own responsibility. Therefore, the control functions report directly to the management board. The management board, then again, is obliged to report to supervisory board. This reporting line does not mean that risk reporting to the supervisory board is influenced in an undue manner. Firstly, the control functions are clearly (up to and including management board level) segregated from the operational functions (front office) to enable the control functions to monitor and report on risk issues independently from divisions where risks may arise. Secondly, it is not up to the management board members to decide about form and extent of the information provided by the control functions. German supervisors have the clear expectation that reports to the supervisory function are identical or at least coextensive to those that are provided to the management board in order to ensure the same level of information for the supervisory board and the management board (please see also responses to BCP 15).

However, to a certain extent reporting lines of the control functions to the supervisory board are also in place. As already mentioned above, the supervisory board has direct access to the heads of control functions, namely the CRO and the head of internal audit. According to sec. 25d (8) KWG, the chair of the risk committee, and if no risk committee has been established, the chair of the supervisory board, may make direct inquiries to the head of internal audit function and the head of risk control unit. The management board shall be informed thereof. The same applies to the chair of the audit committee and the head of supervisory board if an audit committee has not been established, according to sec. 25d (9) KWG.

Specific guidance regarding reporting requirements to the supervisory board are also laid down in the MaRisk. According to the guidance provided by AT 4.4.2 para. 6 MaRisk, the reports of the compliance function shall (next to the primary reporting line to the management board) additionally be passed to the supervisory board. Additionally, according to the guidance provided by BT 2.4 para. 4 of MaRisk's amended version, the Internal Audit function has to write an overall report on its performed audits on a quarterly basis and provide them to both, the management board and the supervisory board. Regarding the reporting obligation of the risk management function, please see the comments regarding the preliminary assessment of BCP 15.

Regarding remuneration topics, the chair of remuneration committee or, if a remuneration committee has not been established, the chair of the supervisory board may make direct inquiries to the head of the internal audit function and the heads of the organizational units responsible for the structure of the remuneration systems. The management board shall be informed thereof according to sec. 25d (12) KWG.

In this regard, it is important to point out, that all members of the respective committees are only supervisory board members; no management board member is included.

Regarding the assessment that *“Banking supervisors should continue to increase dialogue and discussions with the supervisory board on results of supervisory activities and concerns”* we do not understand on which basis this assessment has been made. We believe that the dialogue between the German banking supervisors and the respective institution’s bodies is commensurate with the role of each board.

Consequently, we do not think that the findings made by the IMF are sufficiently justified. Considering the content of the Basel Core Principles, we are convinced that the requirements relating to the “board” are addressed correctly against the background of the German two-tier system.

Therefore, we are convinced that the German system is compliant with the requirements of Principle 14.

Prudential Requirements, Regulatory Framework, Accounting and Disclosure (CPs 15-29)

Comment on the Assessment of **BCP 15 Risk management process**: We do not share the view of the IMF that the existing dual system of the legal structure in German companies and banks (strict separation of the management board and the supervisory board) and the resulting implications for their tasks in Germany leads to a weakening of independence of the control functions (risk management function, compliance function, internal audit function) within the institutions in general and with regard to the risk management function in particular. The responsibility of the supervisory board according to German company law is clear: it is in the responsibility of the supervisory board to observe and monitor the business management of the management board. Furthermore, the supervisory board must not perform business management tasks. This fact implies some modifications concerning the reporting requirements (reporting lines) and the organisational and operational structure in which the risk management function is embedded. For more details concerning the specific role of the supervisory board and the resulting implications see response to BCP 14.

To begin with, it has to be emphasized that all control functions, including risk management function, are instruments of the management board (due to their responsibility for the business management) and therefore organizationally subordinated to the management board. This is why the risk management function reports initially to the management board. The fact that it is in the responsibility of the management board (not automatically the CEO but usually the CRO—when the CRO is member of the management board, as it is the case in the most largest institutions in Germany—or the management board member where the risk management function is subordinated) to report to the supervisory board (at least quarterly) does not mean (and should not lead to the conclusion) that risk reporting to the supervisory board could be influenced in an undue manner. Two facts in this context are particularly important: Firstly, the risk management function is clearly (up to and including management board level) segregated from the operational function (front office) to enable this function to monitor and report on risk issues independent from those divisions of the institution where risks arise. Secondly, it is not left to the discretion of the

management board members in what form and to what extent risk related information is reported to the supervisory board. German supervisors have the clear expectation (and review if these expectations are met by institutions, especially in the context of onsite inspections) that risk reports to the supervisory function to be identical or at least coextensive to those which are presented to the management board in order to ensure the same level of information for the supervisory board and the management board. The compliance with this requirement are reviewed during ongoing supervision and on-site inspections.

In addition, the chair of the supervisory board (or the chair of the audit committee if such a committee exists, see also section 25d (9) KWG in connection with section 25d (7) KWG) has direct access to the head of the risk management function and can call for further information. The fact that the management board shall be previously informed is a direct implication of the organisational and disciplinary subordination of those staff members and does not imply that the chair of the supervisory board cannot discuss with the head of risk management in confidence (without presence of a management board member). Please note that large institutions are required to implement the head of risk management function exclusively on management board level ("CRO"). In those cases the CRO has always the access to supervisory board (and vice versa) at all times.

For these reasons it is sufficiently ensured that the risk management can act independently and can provide both management board and supervisory board with risk information without any influence of the management board.

With regard to the required notification of the supervisory board in cases where the head of the risk management function is removed (for removals of the head of compliance and head of internal audit there are identical requirements; see guidance provided by AT 4.4.1, AT 4.4.2, AT 4.4.3 MaRisk) we would like to point out that this notification is not only required ex-post but a sufficient time before the removal in order to enable the supervisory board to discuss those issues with the management board. German supervisors have addressed this topic in the draft of a revised version of the MaRisk (consultation process was opened in February 18th 2016) and will amend the respective sections of the MaRisk to make clear that the notification has to be given due in advance and under specification of the reasons of the removal.

Comment on Assessment of Principle 18: Based on the experience and the results of AQR from 2014, BaFin is aware that there has to be a stronger focus on questions in terms of valuation. For that reason, BaFin established a new division, BA 53, Financial Accounting and Valuation Practices, with the task to get a better understanding of the institutions' valuation practices, the underlying assumptions and the calculation of provisions.

In this way, BaFin aims for a deeper insight into the institutions' processes and their valuation methods to discuss the institutions' appraisals in terms of a prudential perspective. Based on the various banking practices, a guidance for the supervisor might be a helpful tool. Nevertheless, a conflict with existing accounting legislation should be avoided. In this regard, the new division will explore a possible balanced way forward. Nevertheless, we expect that challenging the institutions results and comparisons might lead to an increase of quality of valuation methods and its results.

Additionally BaFin and BBK implemented a supervisory approach for LSI in 2015 (PAAR – Prudential Assessment of Adequate Risk-Provisioning) and set up a supervisory training program which was enrolled in 2015. Regarding that it is a completely new inspection approach for BBK there are no public issued guidelines yet, however there are comprehensive internal guidelines for inspectors available. This safeguards to keep room for adjustments in this early stage of this new inspection approach.

On SSM-level there is an on-site methodology for credit risk available and detailed information for loan valuation and provisioning are yet to be finished.

Regarding **Principle 19** we would like to point out that the CEBS Guidelines on the management of concentration risk under SREP (GL 31) still are applicable and establish a framework on the EU level which relates to Art. 81 Capital Requirements Directive [CRD]. Without explicit mentioning the definition of these Guidelines, all aspects referred to in the Core Principle as footnote are covered. At the same time, the definition is congruent with the guidance provided by the MaRisk (see AT 2.2, para Annotations).

Furthermore, the MaRisk definition of intra-risk concentrations includes market-risks aspects (market, currencies) as well as funding risk concentrations. The requirement to analyse regularly the access to relevant refinancing - even in the event of tight markets - clearly points in this direction (BTR 3.1. Tz. 4).

Regarding the regular review of all material concentrations by a bank's supervisory board we cannot agree with the statement that there is no such requirement: MaRisk do require a special reporting about risk concentrations and their potential consequences (see AT 4.3.2., para 4). Besides, according to AT 4.3.3 para 1 stress tests have to be extended on risk concentrations. The results of the stress tests have to be reported as well and shall therefore cover the assumed risk concentrations additionally.

According to the guidance provided by BTR 1 para 7a MaRisk the risk report on credit risk has to contain information regarding the development of the credit portfolio. Risk concentrations as well as large exposures (Para 7b) have to be considered. The risk reports are generally sent via the management board in identical or at least coextensive form to the supervisory board so it is ensured that the supervisory board gets the same information as the management board in a timely manner.

Regarding **Principle 20** the statement that there is no regular reporting of exposures to related parties is correct, but it doesn't mean that German supervisors never obtain information on loans to related parties. According to section 34 (2) No. 4 of the Audit Report Regulation [Prüfungsberichtsverordnung – PrüfBV], stricter (single-loan-based) reporting requirements apply where loans to related parties must be regarded as noteworthy because of their size or the way they are structured or because indications of conflicts of interests occur. Furthermore, in case of reaching or exceeding certain thresholds (large loans according to section 14 KWG and large exposures

according to Article 394 CRR), exposures to related parties have to be reported to the supervisor, too.

In addition, granting exposures to related parties is part of the institution's credit granting and surveillance process. Therefore, not only section 15 of the KWG, which, among other things, defines transactions with related parties and regulates the unanimous decision by all general managers of the institution in advance of the credit granting, but also all the other provisions as section 18 KWG or the guidance provided by the MaRisk have to be respected. Consequently, related party exposures have to be monitored and controlled and there is no need for a separate regulation in this context.

Even if there is no separate legal limit for exposures with related parties, the large exposure limit according to Article 395 of the CRR is applicable. Besides, according to section 15 (2) KWG, BaFin can impose limits on exposures to related parties on a case by case basis.

Finally, regarding the definition of related party transactions or the relevant provision, the supervisor can always decide on a case by case basis if there are some doubts.

Regarding **Principle 21** we have difficulties in understanding the basis for your assessment that banks would have little guidance on country risk. Country risk as part of credit risk is subject to the guidance provided by MaRisk standards to credit business like "normal" credit risk. Country risk includes an economical and a political aspect which of course has to be analysed. According to BTO 1.2 para 3 MaRisk all important aspects of a credit engagement have to be fleshed out (not only at the time of the granting of the loan but also during the ongoing monitoring), whereby country risks are to be considered in an appropriate way. The bulk of German banks operate regionally and are usually not engaged in foreign exposures (with the exception of some EU sovereign bonds) so that country risk is rather in exceptional cases an essential risk in the LSI-context. According to the national Guidelines on the supervisory assessment of bank-internal capital adequacy concepts (published in December 2011) unrealised losses in relation to hidden burdens which have occurred with European sovereign bonds in the near past must be considered.

In addition, reporting requirements regarding country risk follow from the guidance provided by BTR 1, para 7 MaRisk: according to lit. a information must be given on the development of the credit portfolio, inter alia broken down by countries. If significant positions with country risk exist, a special presentation of these risks is necessary (see para 7c).

Finally, regarding the verification of internal limits we would like to mention that auditors of Bundesbank also examine the limit system in the context of their audits and whether country risks are appropriately taken into account and limited, of course (the guidance provided by MaRisk emphasizes that country risks as part of the credit risk have to be regarded). However as mentioned above, this is a rather exceptional case with LSIs as most LSIs don't have significant country risks.

Regarding **Principle 25**: We disagree with the classification because it is not clear where Germany does not comply with the Basel framework.

We agree that there might be room for improvements, which is always the case. But the benchmark has to be the BCP requirement and not what seems to be desirable.

However, we do not agree that the findings justify a verdict of material non-compliance. The Basel text is fully covered by the CRR and the guidance provided by the MaRisk. OpRisk management, disaster recovery and BCP are regular topics of bank examinations, in dedicated operational risk audits as well as in examinations with a broader or different scope where it is implicitly covered. As a material risk, operational risk is covered by the guidance provided by MaRisk examinations by default. It is also touched upon in market and credit risk examinations where boundary issues are concerned. Moreover, in our opinion some of the requests of the IMF assessors went beyond what the Basel text asks for. We would therefore like to ask for clarification on the conclusion of the assessors. For any details with respect to the individual ECs, please refer to our statements below.

Concerning the findings of EC1, Bundesbank has both supervisors dedicated exclusively to operational risk as well as quantitative and qualitative experts with a lot of experience on operational risk examinations. Bundesbank furthermore offers in-house trainings for supervisors on operational risk that covers both regulation and presentations from bank practitioners.

Concerning the findings of EC3, we disagree that the use test does not receive sufficient attention during AMA examinations. AMA banks are thoroughly examined before given accreditation and the monitoring of KRIs and other risk management instruments is part of our ongoing supervision. The four elements of an AMA and their use are also an explicit part of AMA first-time inspections and a common part of follow-up inspections. In the past, AMA examinations have rendered 12 findings with respect to the integration of the AMA into day-to-day management and an additional 36 findings with respect to the four data elements.

While a benchmarking of losses is currently not performed by Bundesbank, such an exercise is in progress by ECB (DG IV). Please be mindful that the (desirable) supervisory collection of loss data for BIA-banks would exceed BCBS requirements. We agree that a cross-sector analysis of operational risks is not performed; however this is not envisaged by the Basel text either. We also see no basis for such an analysis as the Basel text does not require small banks to systematically collect loss data and we consider the BIA capital requirement to be not risk sensitive enough to allow for comparisons.

The assessors criticize that the frequency, scope and depth of operational risk examinations could be enhanced. In the past we have had dedicated operational risk exams for large banks, which have each lasted several weeks with teams of more than 6 people. While the frequency of follow-up AMA assessments varies from bank to bank, our largest bank is examined on at least a yearly basis. All other banks that do not have an approved AMA are regularly examined for compliance with BTR 4 MaRisk, which regularly results in findings with regard to the banks' operational risk management. In total, MaRisk examinations have yielded more than 90 operational risk findings since 2013. We are hoping for a statement from the assessors what is considered an adequate frequency, scope and depth for operational risk examinations.

Concerning EC4, the assessors state that there are "no provisions within the regulations to establish minimum expectations with respect to testing, review and approval by board of DR and BCP plans.". However, the German banking act clearly states in section 25a that "risk management shall comprise, in particular, (...) the definition of an adequate contingency plan, especially for IT systems". Further in section 25c, the banking act states that "As part of its overall responsibility to ensure a proper business organization of the institution pursuant to section 25a (1) sentence 2, the management board of an institution shall ensure that the institution has in place the following strategies, processes, procedures, functions and frameworks:

- adequate contingency plans pursuant to section 25a (1) sentence 3 number 5 for contingencies affecting time-critical activities and processes; as a minimum, the management board shall ensure that regular contingency tests are carried out in order to verify the suitability and effectiveness of the contingency plan and the results are communicated to the respective responsible staff;". Between 2012 and 2014, Bundesbank has conducted more than 50 audits with a focus on DR and BCP (MaRisk AT 7.3) that have resulted in 71 findings.

The assessors also criticize that in relation to DR and BCP, the MaRisk contains high level guidance and does not prescribe minimum standards for the frequency, scope or nature of DR and BCP testing and that banks are obliged to follow industry standards instead. In addition, the assessors criticize that there is scope for the JST to pay greater attention to the assessment of DR and BCP planning and the results of DR tests. In addition to the banking act and the MaRisk which are more principle based, it should be mentioned that all Bundesbank supervisors are given guidelines on how to examine DR and BCP and that we have done roadshows and in-house training to create awareness for this topic. Furthermore, industry standards are not only defined by regulators but also by independent bodies such as the federal office for information security (BSI) which sets ISO norms among others.

Regarding EC6, the assessors criticize that loss data from AMA SI banks should be collected and compared. Once again, we reference to the on-going SSM exercise. It should also be noted that large loss events are discussed with JSTs on a regular basis and that management awareness is created through the regular reporting of operational risk losses and scenarios. While a cross-sector comparison for Germany might seem desirable, we still see no legal basis to ask this from the supervisors.

It is also not correct that MaRisk does not contain a level of specificity for the collection and classification of operational risk data. MaRisk specifically states in its BTR 4 that "It shall be ensured that any material operational risk is identified and assessed at least once a year.". The upcoming revisions of the MaRisk guidance will also include the requirement to use loss databases.

In total, further clarification where exactly Basel rules are violated would be useful so we can further improve our supervisory approach.

Regarding the assessment of BCP 26, we would like to refer to the comments regarding the assessment of BCP 14 and 15.

In addition, we would like to point out, that in contrary to the statements in the assessment, the internal audit function and the compliance function have alternative reporting lines to the supervisory board.

According to sec. 25d (8) and (9) KWG, the chair of the risk committee and internal audit committee respectively or, if the respective committee has not been established, the chair of the supervisory board may make direct inquiries to the heads of the both control functions. Additionally, according to the guidance provided by BT 2.4 para. 4 of MaRisk's amended version, the Internal Audit function has to write an overall report on its performed audits on a quarterly basis and provide them to both, the management board and the supervisory board.

Since the internal audit function is an instrument of the management board, the function is obliged to report directly to this body in the first instance (BT 2.4 MaRisk). However, if management board members might be involved, the internal audit function has to report directly to the supervisory board. According to BT 2.4 para. 5 MaRisk, in case the audit reveals serious findings concerning members of the management board, the internal audit function shall inform the chair of the supervisory board if the management board fails to meet its reporting obligation or if it fails to adopt appropriate remedial measures.

As already pointed out in the comments to BCP 14, the compliance function is also an instrument of the management board regarding the specific responsibility of this body. For this reason, the compliance function has to report to the management board directly. But in addition, according to the guidance provided by AT 4.4.2 para. 6 MaRisk, the reports of the compliance function shall additionally be passed to the supervisory board (and the internal audit function).

Finally, we do not share the view that the supervisory board is informed of a replacement of the internal auditor, compliance officer and risk officer ex-post only. According to the guidance provided by MaRisk, the supervisory board shall be notified, if the head of the risk control function (AT 4.4.1 para. 5) and the compliance officer (AT 4.4.2 para. 7 MaRisk) and the head of internal audit function (AT 4.4.3 para. 6 MaRisk) respectively is replaced. It is clearly not required to provide any of this information ex-post but instead in a sufficient time before the removal so that the supervisory board is able to discuss these issues with the management board. The draft of the revised version of the MaRisk (consultation process was opened in February 18th 2016) will be clearer in this regard. In future, if the head of the risk control function (AT 4.4.1 para. 6 revised version) and the compliance officer (AT 4.4.2 para. 7 revised version) and the head of internal audit function (AT 4.4.3 para. 6 revised version) respectively is replaced, the supervisory board shall be notified in advance in a timely manner, stating the reasons for the replacement.

Therefore, we are convinced that Germany is compliant with the BCP 26 guidelines.

b) ECB's Response

The ECB welcomes the assessment prepared by the IMF based on the "Basel Core Principles (BCP) for Effective Banking Supervision" in the context of the Germany FSAP. In general, the ECB concurs

with the views expressed in the report, as they generally reflect in a very balanced and thoughtful manner the reality of the SSM and take due account of the complexity of the matter. The ECB highlights the excellent cooperation with the IMF mission team and the German authorities all throughout the process.

The ECB strongly supports the IMF in its objective to promote globally best supervisory practices via FSAPs, as this is fully in line with the SSM's objective of ensuring that banks across the euro area are supervised according to the same high standards. More specifically, SSM banking supervision does not have a national focus, but takes a European perspective, allowing the ECB to compare and benchmark banks across institutions and identify problems at an early stage. In addition, it combines the experience and expertise of 19 national supervisors, enabling the ECB to draw on the best national practices. Finally, SSM banking supervision is shielded against undue influence from different stakeholders.

The ECB also welcomes that the report acknowledges that in 2015 the European banking supervision took a great step towards harmonised and unbiased supervision by conducting a euro area-wide Supervisory Review and Evaluation Process (SREP) according to a common methodology. For the first time, all significant institutions in the euro area were assessed against a common yardstick. Quantitative and qualitative elements were combined through a constrained expert judgment approach, which ensured consistency, avoided supervisory forbearance and accounted for institutions' specificities.

Notwithstanding the general positive view on the report, the ECB considers that the assessment of BCP 25 on operational risk does not fully take into consideration the initiatives undertaken by the SSM, by means of the actions of the Joint Supervisory Teams, to measure and assess these risks in significant institutions. The ECB is of the view that, while recognizing that of course there is still room for improvement, the progress made so far and the initiatives that are still ongoing to improve the supervision of operational risk were not fully recognised in the assessment. Most notably, the SSM supervisory assessment guidance, which, while tailored to more advanced risk management practices as applicable under AMA, in practise also provides BIA banks with guidance on this matter. In addition, operational risk issues are addressed in the specific risk control assessments that are part of the regular supervisory activity of the JSTs. In this regard, for example, questions relating to adequate risk management processes, potential data weaknesses or risks resulting from technical or human errors are covered in JSTs' assessments not only for operational risk itself but also when analysing credit, liquidity or market risk, as well as in governance risk control assessments.

Regarding the remarks included in the report that there should be more supervisory focus on ensuring reported data quality, including the verification that risk management policies exist and are effectively implemented, the ECB indicates that the JSTs – following the SSM Supervisory manual – undertake quantitative and qualitative assessments to determine respectively the actual level of exposure to this risk and the internal risk controls established by the banks. These assessments are included in the RAS assessment and in the monitoring reports that are produced at least once per year, which are complemented with additional supervisory assessments for AMA banks. In addition,

JSTs perform specific assessments, the so-called ‘deep dives’, and cover these issues through on-site inspections.

Finally, it is also worth to be noted that the SSM undertook a number of reviews – notably on CyberCrime, BCBS 239 and cybercrime incident reports – and is currently in close contact with key service providers to assess preparedness to risks related to systemic threats.

The ECB will duly consider the observations and recommendations included in the report to further improve the quality of the SSM banking supervision.